

Lanka Hospital Corporation PLC - 2019

1.1 Opinion

The audit of the financial statements of The Lanka Hospital Corporation PLC, (“ the Company”), and the consolidated financial statements of the Company and its subsidiary (“ Group”), which comprise the statement of financial position as at 31 December 2019 and the income statement, statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flow for the year then ended, and notes to the financial statements, including 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 read in conjunction with provisions of the National Audit Act No. 19 of 2018. My comments and observation which I consider should be report to parliament appear in this report.

In my opinion, the accompanying financial statements of the Company and the Group give a true and fair view of the financial position of the Company and the Group as at 31 December 2019, 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 Key Audit Matters

Key audit matters are those matters that, in my professional judgement, were of most significance in my audit of the Company Financial Statements and the Consolidated Financial Statements of the current year. These matters were addressed in the context of my audit of the Company Financial Statements and the Consolidated Financial Statements as a whole, and in forming my opinion thereon, and I do not provide a separate opinion on these matters.

• **Revenue recognition** – Refer to Note 4.15 – accounting policy and Note 5 to the Financial Statements. The Revenue of the Group for the year ended 31st December 2019 was Rs. 7,549 Mn.

Risk Description

The Group's revenue generated from its healthcare services is disclosed in Note 5 together with the related accounting policy in 4.15. I considered revenue as a focus area due to the complexity of the pricing structure, its high volume, determination of appropriateness of gross or net basis of revenue recognition in certain arrangements, and reliance on IT controls.

My Response

My audit procedures included the following, among others;

- I carried out audit procedures over revenue measurement by testing on a sample basis, transactional level pricing and applicable documentary evidence.
- I discussed with management regarding the contractual arrangements where consultant medical personnel are involved, and tested on a sample basis the appropriateness of the recognition of revenue on a gross or net basis.
- I obtained an understanding about the key IT and manual controls over the occurrence of revenue and tested the same on a sample basis.
- I performed specific audit procedures over cash collection related to revenue covering a sample of locations where the Group's business is carried out.
- I assessed the adequacy of the disclosures made in Note 5 in the financial statement.

- **Carrying value of inventories** – Refer to Note 4.8– accounting policy and Note 17 to the Financial Statements

The Group carried inventories of Rs. 413 Mn as at December 31, 2019, at the lower of cost or net realisable value.

Risk Description

Valuation of inventory involves judgement and estimates due to the nature of products and stringent quality requirements. Due to allocation and sale of inventories within Group operations based on the business model, both existence and valuation of inventories are key areas of focus.

My Response

My audit procedures included;

- assessing adequacy and consistency of provisioning for inventories at the reporting date with the Group's inventory provision policy.
- On a sample basis, comparing the carrying amounts of the Group's inventories with net realisation value of those inventories.
- Testing the existence of inventories through physical verification as at year end and validating the cost allocation within Group

entities.

• **Recoverability of Trade Receivables** – Refer to Note 4.3.1 – accounting policy and Note 18 to the Financial Statements.

The Group's trade receivables as at 31 December 2019 was Rs.915 Mn

Risk Description

Assessment of recoverability of the Group's trade receivables involves based on management judgement. The historical payment patterns and other information relating to the creditworthiness of customers. Inherent subjectivity is involved in making judgements in relation to credit risk exposures to determine the recoverability of trade receivables.

My Response

My audit procedures included –

- Testing the Group's credit control procedures, including the controls around credit terms, and reviewing the payment history and financial information pertaining to the customers.
- Testing the receipt of cash after the year end relating to 31 December 2019 balances; and
- Testing the adequacy of the Group's impairment provisions against trade receivables by assessing the judgements made and the historical trading experience with the relevant customers.
- Assessing the adequacy of the Group's disclosures about the degree of estimation involved in arriving at the impairment provision.

1.4 Other Information

Management is responsible for the other information. The other information comprises the information included in the Annual Report, but does not include the Financial Statements and my auditor's report thereon. My opinion on the Financial Statements does not cover the other information and I do not express any form of assurance conclusion thereon. In connection with my audit of the financial Statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Financial Statements or my knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work I have performed, I conclude that there is material misstatement of other information; I am required to report that fact. I have nothing to report in this regard.

1.5 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 Group'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 Group or to cease operations, or has no realistic alternative but to do so.

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

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Group 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 Group.

1.6 Auditor's Responsibilities for the Audit of the Financial Statements

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 Group'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 Group'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 Group 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 been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

1.7 Financial Statements

1.7.1 Internal Control over the preparation of financial statements.

Audit Issue	Management Comment	Recommendation
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The Company had not maintained payment vouchers in serial orders.	All company financials are maintaining in "Tally" accounting system therefore all the payment vouchers are generated through "Tally" accounting system. Due to inherent limitation in "Tally" accounting system payment voucher numbers are not constant. Therefore, the company refer cheque number and the date as a serial for all references.	Payment Vouchers should be arranged in serial order.

1.8 Accounts Receivable and Payable

1.8.1 Advances

Audit Issue	Management Comment	Recommendation
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A total balance of refundable deposit amounting to Rs.1,414,401 had been brought forward over a long period without being cleared.	The management will consider clearing up above provision during this year.	Action should be taken to clear the balances.

1.9 Related Parties and Related Party Transactions not disclosed

Audit Issue	Management Comment	Recommendation
A sum of amount due to Related Party (Sri Lanka Insurance Corporation Ltd) amounting to Rs.4,769,076 had been brought forward over a long period without being cleared.	The management will consider the clearing up above balances.	Necessary actions should be taken to clear the balance.

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

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
Public Enterprise Department circular PED 1/2015	Fuel allowances had been granted by the Company to the Chief Executive Officer and Chief Operating Officer/ Chief Financial Officer exceeding the limits by 50L and 35L respectively.	The Lanka Hospitals Corporation PLC is a public listed company and fuel allowance is part of remuneration of the employees. Fuel limits have been defined as per the organization practice which has been therefrom the known history. The company fuel entitlement has been decided at the time of recruitment as a part of remuneration package. The total remuneration is negotiated with the candidates including the fuel which should par with the amounts of similar categories and those offered by other public listed companies.	Action should be taken to get approval from Public Enterprise Department.
Nation Building Tax Act No.9 of 2009 paragraph (iii) of subsection (2) of section 3 “liable turnover” relating to any article or service means, the sum receivable, whether received or not, from the supply of an article or the provision of any service subject to the exclusions referred to in subsection 3 of that section.	Nation Building Tax amounting Rs.3, 253,471 for the year 2019 should be recognized as the part of the revenue for the year of 31 December 2019. Therefore, the company revenue and NBT expense is understated by Rs. 3, 253,471.	NBT cannot be consider as part of the revenue. And NBT act does not specify who is the tax payer therefor tax payer will select according to agreement between buyer and the seller. As hospital policy, collect NBT from the customers. Further NBT act not required mention NBT component separately in the invoice.	Necessary action should be taken to maintain future compliance.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a profit of Rs. 420,196,801 and the corresponding profit in the preceding year amounted to Rs. 826,467,460. Therefore, decline amounting to Rs. 406,270,659 of the financial result was observed. The reasons for the decline is the decrease of both inpatient and outpatient inflows decreased by 3% while occupancy rates declined from 82% to 77%. Gross profit margins decreased marginally from 44% to 43% due to the sharp decline in medical tourism and increasing competition in the sector. Administrative expenses and other operating expenses increased by 11% and 10% respectively as the team grew by 7% to 2,002 as the hospital enhanced our footprint and services. The decline in finance income is attributable to a significant gain of Rs.287 Mn on foreign exchange stemming from the steep devaluation of the rupee in 2018 which was reversed to a loss of Rs.7 Mn in the current year. Additionally, the amount for 2019 includes Rs. 37 Mn as Interest Cost of Right to use assets due to the adoption of SLFRS 16 on leases this year. Accordingly, Profit before tax declined by 25% to Rs.841 Mn. Consequently, profit after tax amounted to Rs.581 Mn, decline of 33% from Rs.870 Mn.

Lanka Hospitals maintains a strong balance sheet with equity of Rs.6.6 Bn. Total assets amounted to Rs.9 Bn of which Rs.4.4 Bn is represented by property, plant and equipment.

2.2 Ratio Analysis

	2019	2018
Current Assets Ratio	3.77 times	3.19 times
Quick Assets Ratio	3.41 times	2.90 times
Gross Profit Ratio	43%	44%
Return on Capital Employed	9%	13%
Gearing Ratio	N/A	N/A

2.3 Key Performance Indicators

The Company Key Performance Indicators and its achievement are as follows.

	Actual	Budget	Variance
Average length of Stay (Days- Total beds)	2.16	2.62	(0.46)
Average Occupancy Rate	77%	86%	(9%)
Average daily admissions	76	84	8

Total Admissions	27,632	30,833	(3,201)
Foreign patient admissions	1,969	3,015	(1,046)
OP Consultations	347,849	392,097	(44,248)
No of Surgeries	10,810	12,795	(1,985)

3. Operational Review

3.1 Operational Inefficiencies

Audit Issue	Management Comment	Recommendation
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<p>Seychelles Medical Center</p> <p>It was noted that Seychelles Medical Center has reported net loss of Rs. 11,193,820 for the period ended 31 December 2019.</p>	<p>The main objective of opening Seychelles medical center is to get referral patients from Seychelles. After the Easter bomb attack it was adversely affected the getting referral patients from Seychelles and it has contributed to the loss from Seychelles medical center operations.</p> <p>Currently COVID-19 situation also affected the operations in Seychelles adversely. Especially the hospital were unable to continue the essential supplies to the center in Seychelles. Considering the adverse trends and safety of hospital staff, the hospital discontinued the operation from 31st July 2020.</p>	<p>Proper evaluation should be done before made an investment.</p>

3.2 Transactions of Contentious Nature

Audit Issue	Management Comment	Recommendation
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<p>Strategic Doctor Payment</p> <p>The company had paid Rs.116,585,312 to retain consultants hired from some specialized areas during the year under review, while the company paying separately for the jobs that they have performed.</p>	<p>Sri Lanka is a country having consultant driven market rather than hospital driven market. Majority of Sri Lankan patients are consulting their preferred consultants by their names not by the hospital's names. This industry nature will also apply to Lanka hospital as well. To be in the industry leader Lanka hospital need to have a partnership with key highly reputed consultants. Patients coming to the hospital around the clock and some patients require specialized medical assistance in urgent basis not like in other business the delaying medical assistance may cost of human life therefore hospital require to have a partnership with industry leading consultants in different specialties.</p>	<p>Proper evaluation should be made to check whether the payment is economical.</p>

3.3 Delays in Projects or Capital Work

Audit Issue	Management Comment	Recommendation																						
<p>A considerable delay was noticed when implementing following procurements.</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left;">Description</th> <th style="text-align: left;">Planned Date to be completed</th> </tr> </thead> <tbody> <tr> <td>3C – Rooms & Wards Renovation</td> <td>2019/02/20</td> </tr> <tr> <td>Pa system Re wire and replace damaged V/controllers and speakers</td> <td>2019/06/01</td> </tr> <tr> <td>TCM Machine</td> <td>2019/04/01</td> </tr> <tr> <td>Hot water distribution system replace defective pipe lines, PRV's Valves, Etc.</td> <td>2019/03/01</td> </tr> <tr> <td>CSSD Construction</td> <td>2019/07/01</td> </tr> <tr> <td>Cold Room</td> <td>2019/03/01</td> </tr> <tr> <td>Scanning & Uploading OP/IP records to HIS</td> <td>2019/10/01</td> </tr> <tr> <td>High Flow Machine</td> <td>2019/12/01</td> </tr> <tr> <td>Argan Laser Machine</td> <td>2019/05/01</td> </tr> <tr> <td>Combined machine of ultra sound and TENS/IFT</td> <td>2019/03/01</td> </tr> </tbody> </table>	Description	Planned Date to be completed	3C – Rooms & Wards Renovation	2019/02/20	Pa system Re wire and replace damaged V/controllers and speakers	2019/06/01	TCM Machine	2019/04/01	Hot water distribution system replace defective pipe lines, PRV's Valves, Etc.	2019/03/01	CSSD Construction	2019/07/01	Cold Room	2019/03/01	Scanning & Uploading OP/IP records to HIS	2019/10/01	High Flow Machine	2019/12/01	Argan Laser Machine	2019/05/01	Combined machine of ultra sound and TENS/IFT	2019/03/01	<p>Date given in the budget / procurement plan is only tentative dates. Actual purchased date depends on the actual requirement of the existing equipment / breakdown and procurement process.</p>	<p>During project execution the original should be regularly monitored and updated (Procurement Guideline 4.2.1.).</p>
Description	Planned Date to be completed																							
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3.4 Human Resources Management

<u>Audit Issue</u>	<u>Management Comment</u>	<u>Recommendation</u>
<p>The actual carder exceeded the approved carder by following numbers.</p>		
<u>Designation</u>	<u>Excess</u>	
01. Audit Assistant	01	01. 1 Internal Audit Executive position replaced with Audit Assistant position on June 2019. Then 1 Audit Assistant position has been transferred to the Finance Department with the headcount on January 2020
02. Coordinator to Gyn & Obs	01	02. Ms. Darshani Kumarihami (Emp No - 5271) has been temporary transferred to assist the Chief Ward Master from Gyn & Obs due to her poor performance. Somehow she is now on Maternity leave and should return on 27th August 2020. Then need to do a proper transfer if she willing to work
03. Gas Operator	01	03. Ms. Anujadevi (Emp No - 5819) had given resignation and last working date was 10th December 2019. She has been deleted from the payroll on January 2020 as per the current practice.
04. Senior Assistant Pharmacist / Assistant Pharmacist / Trainee Assistant Pharmacist	01	04. There was 1 vacancy available for Pharmacist in IP Pharmacy at that time. That vacant Pharmacist position replaced with Assistant Pharmacist position.
05. Pharmacy Dispenser	01	05. There was 1 vacancy available for Assistant Pharmacist in OP Pharmacy at that time. That vacant Assistant Pharmacist position replaced with Pharmacy Dispenser position.
06. Pharmacy Assistant	01	06. There were 2 vacancies available for Assistant Pharmacist in Retail at that time. That vacant 1 Assistant Pharmacist position replaced with Pharmacy Assistant position.