Lanka Rest Houses Company Limited - 2021

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1. Financial Statements

1.1 Disclaimer of Opinion

The audit of the financial statements of the Lanka Rest Houses Company Limited ("Company") for the year ended 31 December 2021 comprising the statement of financial position as at 31 December 2021 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.

I do not express an opinion on the accompanying financial statements of the Lanka Rest Houses Limited. Because of the significance of the matters discussed in the Basis for disclaimer of opinion. Section of my report I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

1.2 Basis for Disclaimer of Opinion

My opinion is disclaimed base on the matters described in paragraph 1.5 of this report.
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 qualified 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 (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 scepticism 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 Audit Observations on the preparation of Financial Statements

1.5.1 Non-Compliance with Sri Lanka Accounting Standard

	Non-Compliance with the reference to particular Standard	Management Comment	Recommendation
(a)	Even though the land and buildings belong to the 32 Rest Houses as at 31 December 2021, had been transferred to the Urban Development Authority (UDA) as per Gazette No. 105/3 dated 09 September 1980, those had not been properly identified or accounted for as 'right of use' assets in accordance with Paragraph 22 of the Sri Lanka Financial Reporting Standard No. 16 (SLFRS 16)	Any Rest House has not been assessed up to now.	Financial statements should be prepared in accordance with the respective Financial Reporting standard.
(b)	In accordance with paragraph 32 of Sri Lanka Accounting Standard No. 01 assets, liabilities and revenues and expenses should not offset each other unless permitted by an accounting standard. However, due to the offsetting of credits amounting to Rs. 8.72 million against a debtor balance	The balance for the relevant periods reflects credit balances due to the inclusion of concessions (deductions) granted to rest house keepers who had paid the correct installments.	Financial statements should be prepared in accordance with Sri Lankan accounting standards

	of Rs. 24.19 million, the debtor balance in the financial statements for the year under review had been under stated by Rs. 8.72 million.		
(c)	Although the company had filed one court case against the external party and three court cases had been initiated against the company by various external parties as at 31 December 2021, potential contingencies of these legal matters had not been disclosed in the preparation of the financial statements for the year under review in accordance with Sri Lanka Accounting Standard No. 37.	It will be disclosed while preparing the financial statements in 2022.	Financial statements should be prepared in accordance with Sri Lankan accounting standards.

1.5.2 Accounting Deficiencies

	Audit Issue	**Management Comment**	**Recommendation**
(a)	A repair had been carried out at a cost of Rs.10.42 million in the year 2020, at the Mahianganaya rest house which had been operated directly by the company without properly identifying and accounting for the asset this expenditure had been recorded in the financial statements as property, plant and equipment.	To be corrected as a prior year adjustment in the financial statement of 2022.	Asset related to the capital expenditure should be identified.
(b)	When the preparation of the financial statements for the year under review, 05 debit balances totaling Rs.444,824 and 02 credit balances totaling Rs.14.93 million which were included in the trial balance had not been included. In addition to that in comparing with trial balance a difference of Rs. 12.99 million had been observed in 10 accounting balances. Thus, balancing of the financial statements were questionable in Audit.	Corresponding corrections will be made in the financial statements of the year 2022.	Financial statements should be prepared accurately.

(c)	Interest income of Rs.6.012 million had been deducted under adjustments in cash flow statement and it should have been added back under the investment activities, but it had also been deducted under investment activities. As a result, the cash flow from investment activities had been overstated by Rs.6.012 million.	The relevant corrections will be made in the financial statements of the year 2022.	Financial statements should be prepared accurately.
(d)	The office equipment, furniture and fittings of the company with a carrying value of Rs.2.53 million had been separately entered in the asset ledger at cost and in the corresponding accumulated depreciation accounts. However, the carrying value of Rs.641,873 assets such as mobile phones, computer accessories, China, Silver Glass & Linen had been accounted by using the direct depreciation method. Thus, two different methods had been applied in accounting for the depreciation of property, plant and equipment and it had also observed that this directly affected to the consistency of financial reporting.	The corrections will be made in the financial statements of the year 2022.	Financial statements should be prepared accurately.
(e)	According to the notes of the financial statements of the company in the year under review, the under provision for bad debt was Rs. 6.47 million, but it had not taken as a loss of the year under review and adjusted as a loss of the prior year and the profit of the year under review had been overstated by that value.In addition to that, the Information regarding to Rs.5.31 million shown under previous year adjustments in the Statement of Equity Changes had not been submitted to the audit.	It had been adjusted in the previous year (2020) and management approval does not require.	The under provision of bad debt should be recognized in the year under review.

1.5.3 Unreconciled Control Accounts or Records

Item	As per the Financial Statement Rs. Million	As per corresponding Record Rs. Million	Difference Rs. Million	Management Comment	Recommendation
Annual Rent Income	24.41	40.21	15.88	The reconciliation will be prepared and corrected in the financial statements of 2022.	Reconciliation statement should be prepared.

1.5.4 Going Concern of the Organization

Audit Issue	Management Comment	Recommendation
Compare to the non-current assets, the current assets of the company had increased by 6.45 times as at 31 December the year under review. And also, the retained earnings of the company had been shown as a negative value of Rs.32.28 million and that was decreased by 74 percent compared with the previous year. Current assets of the company had increased by 4.96 percent compared with the previous year, but current liabilities had increased by 15.64 percent. Accordingly, problems may be arisen on the company's ability to generate income, short-term liquidity, and going concern in future.	The comment had not been given.	Financial position and financial performance should be improved.

1.5.5 Documentary Evidences not made available for Audit

	Item not available	Amount Rs. Million	Evidence Not Made	Management Comment	Recommendation
(a)	Line Items	37.01	Schedules, journal entries and balance confirmations	The schedules related to the line items which were worth of Rs.101.7 million mentioned in the financial statements will be submitted herewith.	The relevant evidence should be submitted to the audit along with the financial statements.

(b)	Monthly Management Fee	56.08	The decision taken that the local authority should have been paid.	Agreed. The matter will be reported to the Board of Directors and taken the necessary approval.	A certified copy of the relevant decision should be submitted to the audit.

1.6 Accounts Receivable and Payable

1.6.1 Receivables

Audit Issue	Management Comment	Recommendation
The debtor age analysis revealed that the outstanding balance of rental income amounting to Rs. 8.80 million was over one year, while the outstanding balance of Rs.5.73 million was over two years at the last day of the year under review.	The operations department had been informed to collect the outstanding.	The outstanding balances should be recovered immediately.

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

	Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
(a)	Section 150 (1) of the Companies Act No. 07 of 2007	Although the company should prepare Annual Financial Statements during the period, the financial statements for the year 2021 had been submitted to the Audit on 26 April 2024. According to the provisions mentioned in Section 150 (2) of the said Act, the Board of Directors of the Company should be liable in this regard in future.	The comment had not been given.	Action should be taken as per the section of 150(1) of the Act.
(b)	Section 133	The company should conduct an Annual General Meeting, but Lanka Rest Houses Company had not arranged an Annual General Meeting at the date of audit.	The comment had not been given.	The action should be taken as per the section of 133 of the Act.

2. Financial Review

2.1 Financial Result

The operating result of the year under review was a loss of Rs.2 million and the corresponding profit in the preceding year was Rs.3.77 million. Therefore, deterioration of Rs. 5.7 million of the financial result was observed. The reasons for the deterioration was decrease of Rest House income by Rs.7.73 million or 24.05 percent.

2.2 Trend Analysis of major Income and Expenditure items

Items	Year under review (2021) Rs. Million	Responding Year (2020) Rs. Million	Difference Rs. Million	Percentage of difference (%)
Rest House Income	24.41	32.14	(7.73)	(24.05)
Mahiyangana Rest House Income	4.91	2.68	2.23	83.20
Interest Income	6.01	4.84	1.16	24.17
Payment to Local Authority 65%	17.38	15.06	2.32	15.40

2.3 Ratio Analysis

Ratio	Year under review 2021	Corresponding year 2020	Difference
Gross Profit Ratio (%)	92.75	94.59	(1.84)
Net Profit Ratio (%)	(6.63)	10.39	(17.02)
Current Ratio	0.65	0.72	(0.07)
Quick Assets Ratio	0.65	0.72	(0.07)

(a) Although, the current ratio should be at least 02 current assets to 01 current liability for having desired liquidity level of an entity. The previous year and the year under review, it had been at very low level of 0.72 and 0.65 current assets for 01 current liability, due to the amount to be paid to the local authorities at high rate.

(b) Although, the Quick ratio should also be at least 01 current assets to 01 current liabilities, it was lower that for the previous year and the year under review. It was also observed that this had been adversely affect to the short-term liquidity of the Company.

3. Operational Review

3.1 Identified Losses

Audit Issue	Management Comment	Recommendation
The company's board of directors consisted of 08 members and 15 other staff members only worked at the end of the year under review. The company had incurred a loss of Rs.2 million due to incurring administrative expenses of Rs.36.08 million over the annual operating income of Rs.30.29 million in the year under review. Establishing of a separate company to handle only administrative affairs of 32 rest houses were not economical and effective, and further it was a problematic issue in Audit.	The comment had not been given.	The company should be dissolved and the assets transferred to the Urban Development Authority.

3.2 Management Inefficiencies

	Audit Issue	Management Comment	Recommendation
(a)	The institutional framework had not been prepared for the company's financial, administrative, human resource, operational and procurement and tender affairs and the decision had not been taken so far as to which institutional framework or policy that the company should followed in those areas.	The procedure which includes matters related to human resource management, is being implemented from the beginning of year 2024.	An institutional framework should be prepared in this regard with the agreement of the Urban Development Authority and the Ministry.
(b)	At the sample of audit, it was observed that, the contract period of 04 rest houses had been expired at the last day of the year under review. However, 03 rest houses had been operated without lease agreement and one rest house had	The approval had been granted considering the existing economic and income situation of the institution to extend the period as per the terms of the agreement without the tender	Rest Houses should not be assigned to operational activities without entering into an agreement and a new agreement should be made in respect of expired agreement.

been remained inactive at the last day of the year under review. Furthermore 03 rest houses are being run without extending the contract period.	procedure.

3.3 Operational Inefficiencies

Audit Issue	Management Comment	Recommendation
According to the information had been submitted to the audit, the company had lost an income from 25 rest houses out of the 32 had been active and 07 rest houses had been inactive during the year of 2021.	Agreed. Out of 07 inactive rest houses Weligama rest house had been leased at this moment.	The necessary actions should be taken to utilize the non-performing rest houses effectively.

3.4 Transactions of Contentious Nature

	Audit Issue	Management Comment	Recommendation
(a)	Due to the Covid-19 pandemic in the year 2021, the business activities of the rest houses had been exhausted while the annual income of the company had been fallen. Therefore, the company had requested a concession of 50 percent out of the 65 percent that paid from the rental income of the rest houses to the local authorities. Some Local Authorities had agreed for that, but some Authorities had not given an approval. Accordingly, the company had unilaterally obtained a concession of 50 percent regarding the value of 65 percent to be paid by the company to the relevant Local Authorities without concurrence with them.	The discussions are being made with the Local Authorities in this regard.	The action should be taken to obtain the relevant concurrence.

(b)	Although it had been stated in the agreements between the company and the lessee that if the lessee fails to pay the rent income to the company on the due date, a surcharge of 1.5 percent per month will be charged, It had not been clearly stated in the agreements whether the surcharge is imposed on the monthly rent or the due amount of the rent.	Agreed. The surcharge had been levied on the monthly rent.	Unclearity and unfavorable conditions in the agreements should be identified and corrected immediately.