

Hotel Developers (Lanka) Ltd - 2022

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 2022 comprising the statement of financial position as at 31 December 2022 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 2022, 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 intends 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.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a loss of Rs. 885,123,000 and the corresponding loss in the preceding year amounted to Rs. 957,225,000. Therefore, an improvement amounting to Rs. 72,102,000 of the financial result was observed. The increase in the revenue by Rs. 1,708,886 was the main reason for this improvement.

2.2 Trend Analysis of major Income and Expenditure items

Financial Statement Line Item		2022	2021	2020	2019
Revenue	(Rs. 000)	2,887,267	1,178,381	1,081,135	2,878,752
Increase/ Decrease of Revenue	(Rs. 000)	1,708,886	97,246	(1,797,617)	(31,788)
Revenue Growth / (Reduction)	%	145.0	9.0	(62.4)	(1.1)
Gross Profit	(Rs. 000)	1,061,770	255,686	270,043	1,475,059
Increase/ Decrease of Gross Profit	(Rs. 000)	806,084	(14,357)	(1,205,016)	(8,320)
Gross Profit Growth / (Reduction)	%	315.3	(5.3)	(81.7)	(0.6)
Administration Expenses	(Rs. 000)	855,887	585,498	591,036	910,514
Increase/ Decrease of Administration Expenses	(Rs. 000)	270,389	(5,538)	(319,478)	55,975
Administration Expenses Growth / (Reduction)	%	46.2	(0.9)	(35.1)	6.6
Depreciation and Other Expenses	(Rs. 000)	673,824	554,539	550,046	797,207
Increase/ Decrease of Depreciation and Other Expenses	(Rs. 000)	119,285	4,493	(247,161)	12,917
Depreciation and Other Expenses Growth / (Reduction)	%	21.5	0.8	(31.0)	1.6
Net Finance Income	(Rs. 000)	(371,412)	(123,255)	(31,696)	(39,370)

Increase/ Decrease of Net Finance Income	(Rs. 000)	(248,157)	(91,559)	7,674	(14,003)
Net Finance Income Growth / (Reduction)	%	201.3	288.9	(19.5)	55.2
Profit after Tax	(Rs. 000)	(885,123)	(957,225)	(918,107)	(325,630)
Increase/ Decrease of Profit after Tax	(Rs. 000)	72,102	(39,118)	(592,477)	(198,123)
Profit after Tax Growth / (Reduction)	%	(7.5)	4.3	181.9	155.4

2.3 Ratio Analysis Ratios

		2022	2021	2020	2019	2018
Gross Profit ratio	(%)	37	22	25	51	51
Net Profit / (Loss) Ratio	(%)	-22	-83	-81	-11	-4
Current Ratio		0.64	0.47	0.34	0.94	0.79
Quick Ratio		0.21	0.15	0.16	0.56	0.43
Return on Capital Employed		-0.06	-0.07	-0.06	-0.02	-0.01
Earnings Per Share (EPS)		-0.43	-0.46	-0.45	0.54	-0.05

3. Operational Review

3.1 Operational Inefficiencies

Audit Issue	Management Comment	Recommendation
(a) The term loan amounting to Rs. 2 Billion from Peoples Bank had not been fully utilized for the agreed purpose where only Rs. 1,427 million had been spent as the project expense up to April 2023. Further, the loan disbursement was received to the current account of Peoples bank which had an approved overdraft limit of Rs. 900 million for working capital requirement. However, the said overdraft as at 31 December 2022 was Rs. 883 million even though the refurbishment was still in progress. Therefore, it was observed that the Company had failed to properly estimate and spend the funds for the agreed purpose.	A new facility has been arranged with Sampath Bank and the total banking facility for the project will be Rs. 3,800 Mn. As per our project cash flows and additional overdraft facility of Rs. 600 Mn, the amount utilized from the term loan will be reimbursed back to the project during 2023.	The funds should be used for the intended purpose.
(b) Although actual possession of the 30 perch land in front of the hotel using for the carpark since 2016 rest with the Company, lease agreement had not signed. Further, as per the notice sent by Urban	The signing in the lease agreement is currently in progress which was previously delayed with the outbreak of the COVID 19. An actual provision	Lease Agreement should be entered into.

Development Authority on 20 December 2022, had been already provided in the amount payable for the period of 2021 – 2023 was financial statements for the Rs. 24 million and the due date was 01 January outstanding lease premiums and the 2023. However, the company had been failed to amount outstanding for 2021 and work in accordance with the above notice. 2022 has been paid in 2023.

3.2 Procurement Management

Audit Issue

The Company implemented a comprehensive renovation plan for Hilton Colombo at the investment of Rs. 2 billion which was phased out in two phases whilst hotel is in operation in order to generate revenue sufficient to over the fixed overheads and generate profit during the renovation period. All public areas, main kitchen and the main dining restaurant was completed under the 1st Phase while the renovation of guest rooms and corridors inclusive of civil, interior works and associated mechanical, electrical and plumbing works have been planned under the 2nd phase. Following observations were made with regards.

Management Comment

Recommendation

- (a) Although, the Company had taken actions to change the scope of the procurement items time to time engineer’s estimation had not revised accordingly. Hence, awarded bid prices were deviated with first Engineer’s estimate for the following procurement items.

Item\	Deviation
Supply of area Rugs and Carpets	68%
Supply of Sanitary fittings	62%

Engineers estimate has derived from the prices obtained by the cost consultant from specified sources or from a specific product/brand. At the point of determining the lowest evaluated bidder, it was noted there were significant difference in the comparison of some products, which was mainly due to product shortlisted and selected vs the product which was considered for pricing. Generally, the specified source will be at high pricing compared to equivalent products which could be different country of origin and with minimum performance criteria. We consider the lowest bidder as the market benchmark and proceed to award. Finally estimates should not be altered after commencing the bidding process.

Revised Estimate should be prepared in accordance with the revised scope.

Supply & Installation of Decorative & architectural light fittings 38%

Supply & Installation of Drapery System 61%

Supply of Wall coverings 70%

- (b) Significant delays were observed in the process of bid evaluation and issuance of Letter of Intent for 7 procurements. Delay in the process was due to the administrative delays in convening timely meetings and several time extensions were provided on the request of the bidders to cater the difficulties during the peak COVID pandemic period followed by lockdowns, world market pricing due to global impact of the pandemic etc. The process of renovation should be speed up.
- (c) Although the bidder selected for the procurement of Supply of Area Rugs and Carpets for sum of Rs. 77,630,334 had accepted the Letter of Intent issued on 08 March 2022 and agreed to undertake the supply subject to the terms and conditions contained in the Bid documents and this Letter of intent, as per the letter issued by the selected bidder on 3rd August 2022, they informed that they are unable to supply the scope of the tender. However, the Company had not been followed paragraph 8:11:4 (Default on Implementation) of the National Procurement Guidelines with regards to this. Furthermore, in the later procurement of Supply of area rugs at the price of Rs. 34,566,500, above scenario was happened and the paragraph 8.11.4 of the National Procurement had not followed. The Guideline was not adopted taking into consideration of the prevailing market conditions at that time affecting the bid submitted and the experience of litigations faced during this period. Action should be taken in accordance with National Procurement Guidelines.

- (d) The procurement of Supply of type one cast iron bath tubs had been awarded to the substantially responsive bidder at a price of Rs. 8,596,500. According to the inspection report dated 27 April 2023 by the Interior Design Consultants, 06 numbers was passed and 05 numbers was rejected due to the non-compliances with specification and design intent. Even though the Company had informed to contractor that making arrangements to replace the rejected Bathtubs with the correct product as per intent price to 31st August 2023 to full fill the contract conditions, contractor had not response to above request.
- Considering that the bath tubs were cast iron and the bidder had complied to all technical specs and was considered compliant, the surface conditions of the cast iron was not accepted by the architect stating that the surface was not smooth. Hence, they were requested to seek market for other brands with cast iron surface if the surface was similar to other products. Having checked, the architect stated that the surface can be accepted providing they are within the tolerance observed in other brands TOTO. However, the bidder has requested that the rejection is revisited since their factory had stated that the nature of the cast iron tub after the coating would be the same for all product brands. After a meeting with the parties held on 17 August 2023, it was mutually agreed that the final review to be done by Hilton operator with their experience with cast iron tubs in other Hilton hotels and to select, if possible, to accept the same. Any decision by the operator to be final and any rejections to be accepted by the bidder, which they agreed. The process is yet to be concluded.
- The process of renovation should be speed up.