



Merchant Bank of Sri Lanka & Finance PLC

FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

ICRA 'S' (SL) BBB+ (Negative Outlook)
Co. Reg. No. PQ10

STATEMENT OF PROFIT OR LOSS	Rs. '000	
	2019	2018
Income	6,839,015	6,549,905
Interest and similar income	6,532,729	6,194,937
Interest and similar expenses	(4,331,275)	(3,752,471)
Net interest income	2,201,454	2,442,466
Fee and commission income	208,928	210,175
Fee and commission expenses	(25,847)	(2,039)
Net fee and commission income	183,081	208,142
Net trading income	9,652	(2,337)
Net gain/(loss) on financial instruments at fair value through profit or loss	18,768	(29,999)
Other operating income	68,938	177,129
Total operating income	2,481,893	2,795,401
Impairment charges for loans and other losses	(279,673)	(134,531)
Net operating income	2,202,220	2,660,870
Personnel expenses	(1,143,504)	(1,096,338)
Depreciation and amortisation	(278,100)	(119,806)
Other operating expenses	(700,713)	(789,583)
Total operating expenses	(2,122,317)	(2,005,619)
Operating profit before VAT on financial services and impairment of investment in Group Companies	79,903	655,251
Impairment reversal/(charge) of investment in subsidiary	270,692	58,160
Impairment reversal/(charge) of investment in associate	(5,058)	-
Profit from operations after impairment of investment in Group Companies	345,537	713,411
Taxes on financial services	(289,343)	(266,733)
Profit before income tax	57,194	446,678
Income tax (expense)/reversal	45,390	(265,391)
Profit for the year	102,584	181,285
Earnings per share:		
Basic/diluted earnings per share (Rs.)	0.62	1.09

STATEMENT OF COMPREHENSIVE INCOME	Rs. '000	
	2019	2018
Profit/(loss) for the year	102,584	181,285
Other comprehensive income/(expenses)		
Other comprehensive income to be reclassified to profit or loss in subsequent periods (net of tax):		
Gains/(Losses) on re-measuring financial investments at fair value through other comprehensive income	3,299	(14,038)
Net other comprehensive income/(expenses) to be reclassified to profit or loss in subsequent periods	3,299	(14,038)
Other comprehensive income/(expenses) not to be reclassified to profit or loss in subsequent periods (net of tax):		
Actuarial gains/(losses) on defined benefit plans	(30,822)	27,670
Deferred tax effect relating to components of other comprehensive income	8,630	(12,750)
Net other comprehensive income/(expenses) not to be reclassified to profit or loss in subsequent periods	(22,192)	14,920
Other comprehensive income/(expenses) for the year, net of tax	(18,893)	882
Total comprehensive income/(expenses) for the year, net of tax	83,691	182,167

STATEMENT OF FINANCIAL POSITION	Rs. '000	
	2019	2018
Assets		
Cash and cash equivalents	1,355,785	1,587,292
Placements with banks & financial institutions	1,477,103	1,070,575
Financial investments at fair value through profit or loss	945,199	267,106
Loans & receivables at amortised cost	29,228,215	30,721,147
Financial investments at fair value through other comprehensive income	1,216,478	1,180,998
Financial investments at amortised cost:		
Real estate stock	297,075	78,503
Investment in associate company	76,026	81,084
Investment in subsidiary	849,968	79,276
Investment properties	117,276	120,181
Property, equipment and right-of-use assets	895,799	320,113
Intangible assets	180,255	193,121
Other assets	334,431	299,303
Total assets	36,975,123	35,659,527
Liabilities		
Due to banks	7,740,021	5,869,317
Due to customers at amortised cost	22,755,930	20,831,021
Debt issued and borrowed funds at amortised cost	2,466,268	5,331,077
Current tax liabilities	14,851	424
Deferred tax liabilities	212,520	340,444
Other liabilities	897,039	515,432
Retirement benefits obligations	271,699	247,708
Total liabilities	34,367,328	33,135,423
Equity		
Stated capital	2,124,457	2,124,457
Statutory reserves	234,613	214,096
Retained earnings	252,487	193,012
OCI reserve	(4,162)	(7,461)
Non-controlling interests	-	-
Total equity	2,607,795	2,524,104
Total liabilities and equity	36,975,123	35,659,527
Commitments and contingent liabilities	121,337	124,250
Net assets value per share (Rs.)	15.72	15.22

SELECTED PERFORMANCE INDICATORS	Rs. '000	
	As at 31/12/2019	As at 31/12/2018
Regulatory Capital Adequacy		
Core capital (Tier 1 Capital), Rs. '000	1,881,523	1,678,967
Total Capital Base, Rs. '000	2,949,093	3,208,643
Core Capital Adequacy Ratio, as % of Risk Weighted Assets (Minimum requirement, 6.5%)	5.60%	4.70%
Total Capital Adequacy Ratio, as % of Risk Weighted Assets (Minimum requirement, 10.5%)	8.78%	8.98%
Capital Funds to Deposit Liabilities Ratio (Minimum requirement, 10%)	12.09%	12.67%
Assets Quality (Quality of Loan Portfolio)		
Gross Non-Performing Accommodations, Rs. '000	4,744,019	3,818,929
Gross Non-Performing Accommodations Ratio, %	14.77%	11.46%
Net Non Performing Accommodations Ratio, %	7.02%	5.94%
Profitability (%)		
Interest Margin	6.52%	7.83%
Return on Assets (before tax)	0.78%	0.51%
Return on Equity (after tax)	3.93%	7.18%
Regulatory Liquidity (Rs. '000)		
Required minimum amount of Liquid Assets	2,870,890	2,859,480
Available amount of Liquid Assets	3,479,769	2,872,282
Required minimum amount of Government Securities	2,040,948	2,163,857
Available amount of Government Securities	2,060,240	2,296,457
Memorandum information		
Number of employees	1,000	1,023
Number of branches	40	40
Number of other centers	9	9

The Company has been imposed with caps of LKR 35 Bn on loan and advances (net of interest in suspense) and LKR 23 Bn on deposits by the Central Bank of Sri Lanka with effect from April 2019 and May 2019 respectively pending compliance with Capital Adequacy Ratios.

Certification:
We, the undersigned, being the Head of Finance and the Chief Executive Officer (Acting) of Merchant Bank of Sri Lanka & Finance PLC certify jointly that:

- (a) the above statements have been prepared in compliance with the format and definitions prescribed by the Central Bank of Sri Lanka;
- (b) the information contained in these statements have been extracted from audited financial statements of the Licensed Finance Company unless indicated as "Unaudited".

(Sd.) P.I. Kandanaarachchi
Head of Finance
31/08/2020

(Sd.) J. Gamalath
Chief Executive Officer (Acting)
31/08/2020



The Chairman
Member of Board of Sri Lanka and Finance PLC

Report of the Auditor General on the Financial Statements and Other Legal and Regulatory Requirements of the Merchant Bank of Sri Lanka and Finance PLC for the year ended 31 December 2019 in terms of Section 12 of the National Audit Act, No. 19 of 2018.

1. Financial Statements

1.1 Opinion
The audit of the financial statements of the Merchant Bank of Sri Lanka and Finance PLC ("the Company") and the consolidated financial statements of the company and its subsidiaries ("the Group"), which comprise the statement of financial position as at 31 December 2019, and the statements of profit or loss, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, were carried out under my audit in pursuance of provisions in Article 154(d) 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 report to Parliament in pursuance of provisions in Article 154 (d) of the Constitution will be tabled in due course. To carry out this audit I was assisted by a firm of Chartered Accountants in public practice.

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 their financial performance and 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 (SLASs). 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 Emphasis of Matters
I draw attention to Note 5.1 of the financial statements, which describes the Company's level of compliance with stipulated minimum capital adequacy ratios, and the remedial action taken by the Company since the year end. My opinion is not modified in respect of these matters.

1.4 Key Audit Matters
Key audit matters are those matters that, in my professional judgment, were of most significance in my audit of the financial statements of the current period. These matters were addressed in the context of my audit of the financial statements as a whole, and in forming my opinion thereon, and I do not express a separate opinion on these matters. For each matter below, my description of how my audit addressed the matter provides that context.

I have fulfilled the responsibilities described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report, including in relation to these matters. Accordingly, my audit included the performance of procedures designed to respond to the assessment of the risks of material misstatement of the financial statements. The results of my audit procedures, including the procedures performed to address the matters below, provide the basis for my audit opinion on the accompanying financial statements.

Key audit matter How my audit addressed the key audit matter

Impairment Allowance for Loans & receivables at amortised cost: designed my audit procedures to obtain sufficient appropriate audit evidence on the reasonableness of the impairment allowance, that included the following procedures:

- My audit considered impairment for Loans & receivables at amortised cost as a key audit matter. The materiality of the reported amounts of those balances (and impairment thereon), the subjectivity associate with management's impairment estimation, complex manual calculations of impairment underpinned my basis for considering it as a key audit matter.
- I evaluated the design, implementation and operating effectiveness of key internal controls over estimation of impairment for loans & receivables, which included assessing the level of oversight, review and approval of impairment profiles by the Board Audit Committee and management.
- As at 31 December 2019, 75% of total assets of the Group consisted of loans & receivables at amortised cost amounting to LKR 28.516 Million (Note 23) net of impairment allowance of LKR 2,856 Million (Note 23).
- I evaluated the effectiveness of the Company's process around modifications to terms after initial granting, focusing on identification of restructured and restructured credit facilities.
- Significant estimates and assumptions used by the management in such calculations, their sensitivities and basis for allowance for impairment are disclosed in Note 5.5.12 & Note 5.2.
- I tested the underlying calculations and data used in such calculations.

In addition to the above, following focused procedures were performed:

- For these individually assessed for impairment:
 - I assessed the main risks noted by the management for determining whether impairment existed had occurred.
 - where impairment indicators existed, I assessed the reasonableness of management's estimated future recoveries including the expected future cash flow and discount rates. I also compared the actual recoveries against previously estimated amounts of future recoveries.
- For these collectively assessed for impairment:
 - I tested the completeness of the underlying information used in the impairment calculations by agreeing details to the source documents and information in IT systems.
 - I also considered reasonableness of macroeconomic and other factors used by management in their judgmental overlays, by comparing them with relevant publicly available data and information sources.

I assessed the adequacy of the related financial statement disclosures as set out in Note 5.5.12, 5.2 and 23.

My procedures included the following:

- Assessing the reasonableness of the estimates and judgments made by the management on the assessment of the recoverability of the Deferred Tax Asset by comparing industry data where applicable.
- Assessing the business plans used and thus the likelihood that taxable profits would be available to utilize the tax losses in the future.

Management has exercised critical judgments and estimates described in Note 5.2 and Note 23, in estimating the Deferred Tax Asset as of the reporting date.

- I independently assessed the future cash flows prepared by management and used my professional judgment, corroborated with external information, to assess the appropriateness of the impairment on the net tax loss.

Due to the significant assumptions and judgments involved, recognition and measurement of deferred tax asset relating to subsidiary is considered to be a key audit matter.

- Assessing the adequacy of disclosures stated in Note 5.2 and Note 15.4.

1.5 Other information included in the 2019 Annual Report
Other information consists of the information included in the Annual Report other than the financial statements and my auditor's report thereon. Management is responsible for other information.

My opinion on the financial statements does not cover the other information and I do not and will 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 a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

1.6 Responsibilities of the Management and Those Charged with Governance
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 determines 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 18(1) of the National Audit Act, No. 19 of 2018, the Company is required to maintain proper books and records of all its income, expenditures, and liabilities, to enable annual and periodic financial statements to be prepared for the Company.

1.7 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 misstatements, 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 internal control of the Company and the Group.
- 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 to my 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.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. I am responsible for the direction, supervision and performance of the group audit. I remain solely responsible for my audit opinion.

I communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during the audit.

From the matters communicated with those charged with governance, I determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. I describe these matters in my auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, I determine that a matter should not be communicated in my report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

2. Report on Other Legal and Regulatory Requirements
National Audit Act, No. 19 of 2018 and Companies Act No. 7 of 2007 include specific provisions for following requirements:

- I have obtained all the information and explanation that required for the audit and as far as appears from my examination, proper accounting records have been kept by the Company as per the requirement of the section 18(1)(d) of the Companies Act, No. 7 of 2007 and the section 12 (a) of National Audit Act, No. 19 of 2018.
- The financial statements of the Company comply with the requirement of the section 155 of the Companies Act, No. 07 of 2007.
- The financial statements presented are consistent with the preceding year as per the requirement of the section 61 (1) (i) of the National Audit Act, No. 19 of 2018.
- The financial statements presented include all the recommendations made by me in the previous year as per the requirement of the section 61 (i) (ii) of the National Audit Act, No. 19 of 2018.

Based on the procedures performed and audit evidence obtained, I was not aware of any matters that are material, nothing that comes to my attention, or to state that any member of the governing body of the Company has any direct or indirect interest in any interest entered into by the Company which is out of the normal course of business as per the requirement of section 12 (b) of the National Audit Act, No. 19 of 2018.

- to state that the Company has not complied with any applicable written law, general or special directions issued by the governing body of the Company as per the requirement of the section 12 (f) of the National Audit Act, No. 19 of 2018 except for non-compliances that are material are given below,

Reference to Law/ Direction Description

Direction No. 03 of 2018 issued by the Central Bank of Sri Lanka (Risk Weighted Average Capital Adequacy Requirements) Non-compliance with the Risk Weighted Average Capital Adequacy Ratios as disclosed in Note 5.2 of the financial statements.

- to state that the Company has not performed according to its powers, functions and duties as per the requirement of the section 12 (g) of the National Audit Act, No. 19 of 2018.
- to state that the resources of the Company had not been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws as per the requirement of the section 12 (h) of the National Audit Act, No. 19 of 2018.

(Sd.) M.P. Wickramaratne
Auditor General

