



# Mercantile Investments and Finance PLC

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## INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF MERCANTILE INVESTMENTS & FINANCE PLC

### Report on the Audit of the Financial Statements

#### Opinion

We have audited the accompanying Financial Statements of Mercantile Investments & Finance PLC (the "Company"), which comprise the statement of financial position as at 31 March 2023, Income statement, 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.

In our opinion, the accompanying Financial Statements give a true and fair view of the financial position of the Company as at 31 March 2023, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

#### Basis for opinion

We conducted our audit in accordance with Sri Lanka Auditing Standards (SLAS). Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Company in accordance with the Code of Ethics issued by CA Sri Lanka (Code of Ethics), and we have fulfilled our other ethical responsibilities in accordance with the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements of the current period. These matters were addressed in the context of the audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

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

#### Key Audit Matter

##### Provision for credit impairment on financial assets carried at amortized cost

As at 31 March 2023, financial assets carried at amortized cost net of impairment allowances amounted to LKR 32.8 Bn as disclosed in notes 3.2 (v), 23 - 25 & 26.1 to the financial statements.

This was a key audit matter due to the materiality of the reported provision for credit impairment which involved complex calculations, degree of significant judgements and assumptions and level of estimation uncertainty associated with estimating future cashflows management expects to receive from such financial assets.

Key areas of significant judgments, estimates and assumptions used by management in the assessment of the provision for credit impairment included the following:

- Management overlays to incorporate the current economic contraction.
- The Incorporation of forward-looking information such that expected cashflows reflect current and anticipated future external factors evaluated under different economic scenarios and the probability weighting determined for each of these scenarios.

##### How our audit addressed the key audit matter

In addressing the adequacy of the provision for credit impairment on financial assets carried at amortized cost, our audit procedures included the following key procedures:

- We assessed the alignment of the Company's provision for credit impairment computations and underlying methodology including responses to market economic volatility with its accounting policies, based on the best available information up to the date of our report.
- We evaluated the Internal controls over estimation of credit impairment, which included assessing the level of oversight, review and approval of impairment allowances policies and procedures by the Board and management.
- We checked the completeness, accuracy and classification of the underlying data used in the computation of credit impairment by agreeing details to relevant source documents and accounting records of the Company.
- In addition to the above, following procedures were performed.
  - For Loan, Lease and Hire Purchase receivables assessed on an individual basis for impairment:**
    - We evaluated the reasonableness of credit quality assessment.
    - We checked the arithmetical accuracy of the underlying individual impairment calculations.
  - We evaluated the reasonableness of key inputs used in provision for credit impairment made with particular focus on current economic contraction.** Such evaluations were carried out considering the customer exposure to elevated risk industries, debt moratoriums, status of recovery actions of collateral in forecasting the value and timing of cashflows.
- For Loan, Lease and Hire Purchase receivables assessed on a collective basis for impairment:**
  - We tested key inputs as disclosed in notes 23 - 25 and the calculations used in the provision for credit impairment.
  - We assessed whether judgements used in assumptions and estimates made by the management when estimating future cashflows, in the underlying methodology and management overlays were reasonable. Our assessment included portfolio segmentation, elevated risk industries, evaluating the reasonableness of forward-looking information, different economic scenarios and probability weighting assigned to each of those scenarios.

We assessed the adequacy of the related financial statement disclosures set out in notes 3.2 (v), 23 - 25 & 26.1 of the financial statements.

##### Information Technology (IT) systems and internal controls over financial reporting

Company's financial reporting process is significantly reliant on multiple IT systems with automated processes and internal controls. Further, key financial statement disclosures are prepared using data and reports generated by IT systems, that are compiled and formulated with the use of spreadsheets.

Accordingly, IT systems and related internal controls over financial reporting were considered a key audit matter.

Our audit procedures included the following:

- We obtained an understanding of the Internal control environment of the processes and checked relevant controls relating to financial reporting and related disclosures.
- We involved our internal specialized resources to check and evaluate the design and operating effectiveness of IT systems and relevant controls, including those related to user access and change management.
- We also obtained a high-level understanding, primarily through inquiry, of the cybersecurity risks affecting the company and the actions taken to address these risks.
- We checked source data of the reports used to generate disclosures for accuracy and completeness, including review of general ledger reconciliations.

#### Other Information included in the 2023 Annual Report

Management is responsible for the other information. The other information comprises the Company's 2023 annual report, but does not include the financial statements and our auditor's report thereon. The Company's 2023 annual report is expected to be made available after the date of this auditor's report.

Our opinion on the financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

#### Responsibilities of management and those charged with governance in the financial statement

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 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.

#### Auditor's responsibilities for the audit of the Financial Statements

Our objectives are 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 our opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with SLASs 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 SLASs, we exercise professional judgment and maintain professional skepticism throughout the audit. We 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 our 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 management.
- Conclude on the appropriateness of 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 we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our 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.

We 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 we identify during our audit.

We also provide those charged with governance with a statement that we have complied with ethical requirements in accordance with the Code of Ethics regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we 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. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

#### Report on Other Legal and Regulatory Requirements

As required by section 163 (2) of the Companies Act No. 07 of 2007, we have obtained all the information and explanations that were required for the audit and, as far as appears from our examination, proper accounting records have been kept by the Company.

CA Sri Lanka membership number of the engagement partner responsible for signing this independent auditor's report is 2471.

23 June 2023  
Colombo

Partners: H. M. A. Jayasinghe FCA, FCM, R. N. de Saram ACA, FCM, M. N. A. De Silva FCA, W. R. D. Silva FCA, A. C. M. A. M., Y. A. De Silva FCA, M. K. R. M. Fernando FCA, ACA, M. V. R. L. Fernando ACA, W. K. B. S. P. Fernando FCA, FCM, M. L. K. H. I. Fonseka FCA, D. N. Gamage ACA, ACA, A. P. A. Ganesan ACA, ACA, A. Herath FCA, D. K. Hulsingrum FCA, FCM, L.L.B. (London), M. G. S. Mananunga FCA, A. J. R. Perera ACA, ACA, M. P. V. K. N. Sajewanani FCA, M. N. M. Sulaiman ACA, ACA, B. E. Wijesuriya FCA, FCM, C. A. Yalagala ACA, ACA

Principals: W. S. J. De Silva BSC (Hons) MIS, MS-IT, G. B. Gnanadurai ACA, D. L. R. Karunathilaka ACA, M. P. S. Paranjitane ACA, ACA, L.L.B. (Colombo), T. P. M. Ruberu FCM, ACA

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STATEMENT OF COMPREHENSIVE INCOME		
For the Year ended 31 March	2023 Rs. '000	2022 Rs. '000
Gross income	9,035,723	7,127,706
Interest income	8,749,868	6,759,925
Interest expenses	(6,134,824)	(2,586,220)
Net interest income	2,615,044	4,173,706
Fee and commission income	75,568	67,496
Net fee and commission income	75,568	67,496
Other operating income	210,288	300,285
Total operating income	2,900,900	4,541,486
Impairment (charge)/reversal for loans and receivables and other financial assets	276,201	147,674
Net operating income	3,177,101	4,689,160
Less: Operating expenses		
Personnel expenses	(1,302,861)	(1,425,843)
Depreciation of PPE and Right-of-use assets and amortization of intangible assets	(161,831)	(156,759)
Other operating expenses	(1,267,105)	(1,146,562)
Total operating expenses	(2,731,797)	(2,729,164)
Operating profit before taxes on financial services	445,304	1,959,996
Taxes on financial services	(331,848)	(493,579)
Operating profit after taxes on financial services	113,456	1,466,417
Add: Share of associate company's profit / (Loss) net of tax	19,365	2,504
Profit before taxation from operations	132,820	1,468,920
Less: Income tax expenses	(26,767)	(457,370)
Profit for the year	106,053	1,011,550
Other comprehensive income/(expenses)		
Other comprehensive income/(expenses) to be reclassified to profit or loss in subsequent periods		
Changes in fair value of financial investments through OCI	-	-
Other comprehensive income/(expenses) to be reclassified to profit or loss in subsequent periods		
Other comprehensive income/(expenses) not to be reclassified to profit or loss in subsequent periods		
Changes in fair value of financial investments through OCI	196,647	(363,628)
Net change in revaluation surplus on Land & Buildings	-	302,589
Deferred tax effect on revaluations surplus on Land & building	(169,086)	(78,837)
Share of other comprehensive income of associates ( net of tax)	(98,662)	97,735
Actuarial gain/(loss) on retirement benefit obligation	(13,210)	66,517
Deferred tax effect on actuarial gain	19,927	(25,470)
Net other comprehensive income/(expenses) not to be reclassified to profit or loss in subsequent periods	(64,383)	(1,094)
Other comprehensive income/(expenses) for the year (net of tax)	(64,383)	(1,094)
Total comprehensive income/(expenses) for the year (net of tax)	41,670	1,010,456
Earnings per share		
Basic earnings per share (Rs.)	35.28	336.51
Diluted earnings per share (Rs.)	35.28	336.51
Dividend per ordinary share (Rs.)	-	115.00

STATEMENT OF FINANCIAL POSITION		
As at 31 March	2023 Rs. '000	2022 Rs. '000
Assets		
Cash and cash equivalents	1,791,064	681,130
Placement with banks at Amortized cost	1,422	997,771
Financial investments - At FVOCI (quoted)	6,303,228	4,161,039
Financial investments - At FVPL	3,250	2,924
Loans and receivables at Amortized Cost	13,593,368	16,125,123
Finance leases receivables at Amortized Cost	19,026,269	18,334,913
Hire purchase receivables at Amortized Cost	127,176	242,430
Financial investments - at FVOCI (unquoted)	70,427	70,427
Other financial assets	442,950	423,726
Inventories	314,853	36,000
Other assets	230,244	166,727
Current tax refunds	117,327	-
Investment in associates	1,255,524	1,334,821
Investment property	227,219	220,718
Property, plant and equipment	3,930,649	3,952,290
Right-of-use assets	139,667	181,499
Leasehold property	39,334	39,802
Intangible assets	9,335	28,235
Total assets	47,623,304	46,999,575
Liabilities		
Bank overdraft	93,518	395,159
Deposits due to customers at Amortized Cost	31,223,715	26,349,272
Debt instruments issued and other borrowings at Amortized Cost	3,487,442	7,022,730
Other financial liabilities	378,645	658,957
Current tax liabilities	-	328,579
Deferred tax liabilities	795,864	639,064
Other liabilities	112,023	125,719
Retirement benefit obligations	337,518	272,003
Lease Liability	178,573	233,757
Total liabilities	36,607,298	36,025,239
Shareholders' funds		
Stated capital	36,000	36,000
Revaluation reserve	2,643,604	2,911,351
Statutory reserve fund	857,400	851,400
General reserves	4,086,430	4,086,430
Retained earnings	2,721,856	3,639,546
Regulatory loss allowance reserve	1,043,234	-
Fair Value through OCI reserve	(372,519)	(550,391)
Total shareholders' funds	11,016,006	10,974,336
Total liabilities and shareholders' funds	47,623,304	46,999,575
Net assets per share (Rs.)	3,665	3,651

**CERTIFICATION:**  
I certify that these financial statements have been prepared in compliance with the requirements of the Companies Act No. 07 of 2007.

**Deva Anthony**  
Chief Financial Officer / Director (Non-Board)

The Board of Directors are responsible for these Financial Statements.  
The Financial Statements were authorized for issue by the Directors on 23 June 2023. Signed for and on behalf of the Board by:

**Gerard G. Ondaatje**  
Managing Director  
23 June 2023 - Colombo

**Shermal H. Jayasuriya**  
Finance Director

SELECTED KEY PERFORMANCE INDICATORS				
Item	As at 31st March 2023		As at 31st March 2022	
	Actual	Required	Actual	Required
<b>Regulatory Capital Adequacy (%)</b>				
Tier 1 Capital Adequacy Ratio	16.45%	8.5%	15.45%	7.00%
Total Capital Adequacy Ratio	18.02%	12.5%	16.84%	11.0%
Capital Funds to Deposit Liabilities Ratio	30.27%	10.0%	36.23%	10.0%
<b>Quality of Loan Portfolio (%)</b>				
Gross Stage 3 Loan Ratio		12.02%		9.03%
Net Stage 3 Loan Ratio		8.62%		5.81%
Net Stage 3 Loans to Core Capital Ratio		39.09%		27.54%
Stage 3 Impairment Coverage Ratio		31.67%		39.09%
Total Impairment Coverage Ratio		4.67%		5.32%
<b>Profitability (%)</b>				
Net Interest Margin		5.49%		8.88%
Return on Assets		0.28%		3.13%
Return on Equity		0.96%		9.22%
Cost to Income Ratio		105.6%		70.97%
<b>Liquidity (%)</b>				
Available Liquid Assets to Required Liquid Assets (Minimum 100%)		187.65		135.07
Liquid Assets to External Funds		17.07		10.59
<b>Memorandum information</b>				
Number of Branches		43		42
External Credit Rating		Long-term Financial Institution Rating at BBB-(Ika) (Rating Watch Negative) by Fitch Ratings		Long-term Financial Institution Rating at BBB-(Ika) (Negative outlook) by Fitch Ratings

The Company does not have any regulatory penalties or regulatory restrictions on deposits, borrowings and lendings during the period ended 31st March 2023 and 2022.

**CERTIFICATION:**  
We, the undersigned, being the Chief Financial Officer, Finance Director, Managing Director and the Compliance Officer of Mercantile Investments and 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 (CBSL);  
(b) the information contained in these statements have been extracted from the unaudited financial statements of the Licensed Finance Company unless indicated as audited.

**Ramidu Costa**  
Compliance Officer

**Shermal H. Jayasuriya**  
Finance Director

**Gerard Ondaatje**  
Managing Director