

**THE MERCANTILE SERVICE PROVIDENT
SOCIETY**

REPORT OF THE COMMITTEE

AND

ACCOUNTS

FOR THE

YEAR ENDED 31ST DECEMBER, 2018

THE MERCANTILE SERVICE PROVIDENT SOCIETY

(Inaugurated 20th December, 1939)

TRUSTEE : THE CEYLON CHAMBER OF COMMERCE

(Established 25th March, 1839)

REPORT OF THE COMMITTEE FOR THE YEAR ENDED 31ST DECEMBER 2018

COMMITTEE

Rule 7 (i) (a)	-	Mr. D.T.S.H. Mudalige (Chairman)
Rule 7 (i) (b)	-	Dr. S.S.H. Wijayasuriya Mr. V. Govindasamy
Rule 7 (i) (c)	-	Mr. D.A. Cabraal Mr. E.A.P. Ekanayake
Rule 7 (i) (d)	-	Mr. C.L.T.P. Rupasinghe Ms. E. Sirimanne Mr. H.D.D. Gunasekara Mr. K.A.V. Manatunga

The Membership of the Society as at 31st December 2018 was 15,501 as compared with 15,399 members for the previous year, and was distributed among the 51 contributing firms as follows:-

Acme Printing & Packaging PLC.	-	63	Ernst & Young.	-	144
Astron Ltd.	-	475	E.B. Creasy & Co, PLC.	-	407
A Baur & Co, (Pvt) Ltd.	-	809	F.J. & G. De Saram.	-	54
AT & T Global Information Solutions (Lanka) Ltd.	-	45	Finlays Colombo Ltd.	-	104
Akzo Nobel Paints Lanka (Pvt) Ltd.	-	86	Gamma Pharmaceuticals (Pvt) Ltd.	-	96
Bartleet & Co, Ltd.	-	22	George Steuart & Co, Ltd.	-	529
Ceylon Shipping Lines Ltd.	-	107	Gestetner of Ceylon PLC.	-	186
Ceylon Trading Co, Ltd.	-	10	Glaxo SmithKline Pharmaceuticals (Pvt) Ltd.	-	108
Chemanex PLC.	-	1	Grand Oriental Hotel.	-	451
CIC Holdings PLC.	-	497	Hemas Holdings PLC.	-	194
Chas P. Hayley & Co, Ltd.	-	20	Hayleys PLC.	-	13
C.W. Mackie PLC.	-	176	IBM World Trade Corporation.	-	104
Darley Butler & Co, Ltd.	-	586	KPMG	-	1143
De Soysa & Co, Ltd.	-	40	Lankem Ceylon PLC.	-	387
DFCC Bank.	-	1733	Lee Hedges PLC.	-	14

Malship (Ceylon) Ltd.	- 3	Singer Industries (Ceylon) PLC.	- 36
Mercantile Investments and Finance PLC.	- 18	Singer (Sri Lanka) PLC.	- 2707
Morison PLC.	- 719	SmithKline Beecham (Pvt) Ltd	- 332
M.S.J. Industries (Ceylon) (Pvt) Ltd.	- 2	Thomas Cook Lanka (Pvt) Ltd.	- 39
Nestle Lanka PLC.	- 385	The Cargo Boat Despatch Co, Ltd.	- 1
Premium Exports Ceylon Ltd.	- 22	The Capital Maharaja Organisation Ltd.	- 1219
PricewaterhouseCoopers.	- 551	The Ceylon Chamber of Commerce.	- 93
Reckitt Benckiser (Lanka) Ltd.	- 83	Unilever Sri Lanka Ltd.	- 537
Rhino Roofing Products Ltd.	- 67	Van Rees Ceylon Ltd.	- 26
Shaw Wallace Ceylon Ltd.	- 39	Whittall Boustead Ltd.	- 3
Shums & Co, (Pvt) Ltd.	- 15		
			<u>15,501</u>

On behalf of the Committee of Management of the Mercantile Service Provident Society it gives me pleasure to present the Annual Report of the Society for the financial year ended 31st December 2018.

During the year there was an increase of 102 in the membership, making up a total membership of 15,501. With the restriction of admitting new contributing firms remaining in force, the number of contributing firms as at 31st December 2018 stood at 51.

The total income of the Society for the year 2018 was Rs. 2,550 million as compared to Rs. 2,345 million in 2017, thus recording an increase of Rs. 205 million which is 8.8% over the previous year.

During the year 2018 due to the fluctuation of interest rates and the imposition of higher income tax through the new Inland Revenue Act there was a negative impact to the profits of MSPS.

The following factors contributed mainly towards the downward trend in profits.

1. Interest rates in Treasury Bonds had a downward trend throughout the year.
2. Income Tax on Provident Funds were increased to 14% from 10% with effect from 01st April 2018.
3. Grossing up and Notional Tax on Treasury Bonds was also withdrawn from 01st April 2018 and as a result effective tax rate on interest income arising from Treasury Bonds increased to 24% from 10%.
4. The share portfolio recorded a loss of Rs. 50.7 Million in 2018 as compared to the loss of Rs. 6.9 Million in the previous year, due to the indices of the Colombo Stock Exchange recording a significant reduction.
5. Interest rates on Fixed Deposits and Debentures which were low had an upward trend in the second half of the year 2018.

Interest income for 2018 was Rs. 2,570 million as against Rs. 2,306 million in 2017. The Committee managed to keep the distributable rate at 10% in 2018 same as previous year. Current year the Society was able to distribute a dividend of Rs. 2,136.8 million as against dividend of Rs. 1,990.5 million in 2017 recording an increase of Rs. 146.3 million over the last year.

The total fund value increased from Rs. 23.5 billion in 2017 to Rs. 25.4 billion in 2018 thus recording a growth of 8.3% in the total fund value.

The following table shows the investments as at 31st, December 2018 and the income earned during the year.

<u>INVESTMENTS</u>		<u>INCOME</u>
Loans to Members	Rs. 4,024,030,504	Rs. 493,761,117
Treasury Bonds	Rs. 9,144,697,175	Rs. 1,187,807,416
Fixed Deposits	Rs. 9,227,039,103	Rs. 626,424,255
Commercial Papers	Rs. -	Rs. 13,835,566
Savings A/C	Rs. 150,015,243	Rs. 25,262,545
Bank Guaranteed Debentures	Rs. 2,323,118,800	Rs. 223,169,921
Fund Managers (Equity)	Rs. 106,845,795	
	1. Gain on Disposal of Shares /	
	Interest Income / Dividend Income	Rs. (7,115,407)
	2. Unrealised Loss on Shares	Rs. (33,596,025)
		Rs. (40,711,432)
	<u>Rs. 24,975,746,620</u>	<u>Rs. 2,529,549,388</u>

Given below are details of the Excess Income Over Expenditure before taxation and rates of income distribution for the past ten years.

Year	Net Income	Rate
2008	989,460,982	13.00%
2009	1,741,815,944	21.00%
2010	1,767,040,069	18.00%
2011	1,171,660,223	10.00%
2012	1,584,664,658	11.75%
2013	1,792,069,288	11.50%
2014	1,908,169,039	11.00%
2015	1,691,763,327	9.00%
2016	1,800,727,013	10.00%
2017	2,311,289,397	10.00%

As the Committee would like to be in a position to answer questions on which members would like further information as fully as possible it would be appreciated if any queries they may have can be submitted to the Secretary prior to the Meeting.

By Order of the Committee

23rd May 2019

DUMINDA HULANGAMUWA
Secretary.



KPMG
(Chartered Accountants)
32A, Sir Mohamed Macan Markar Mawatha,
P. O. Box 186,
Colombo 00300, Sri Lanka.

Tel : +94 - 11 542 6426
Fax : +94 - 11 244 5872
+94 - 11 244 6058
Internet : www.kpmg.com/lk

INDEPENDENT AUDITORS' REPORT

TO THE MEMBERS OF THE MERCANTILE SERVICE PROVIDENT FUND SOCIETY

Report on the Audit of the Financial Statements

Opinion

We have audited the accompanying financial statements of the Mercantile Service Provident Fund Society, ("the Fund"), which comprise the statement of financial position as at December 31, 2018, and the statement of income and expenditure, statement of changes in fund 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 Fund as at December 31, 2018, and of its income and expenditure 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 (SLAuSs). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Fund 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.

Other Information

Our opinion on the financial statements does not cover any other information and we will not express any form of assurance conclusion thereon. Management is responsible for the other information. These financial statements do not include any other information.

Responsibilities of Management and Committee of Members 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 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 Fund'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 Fund or to cease operations, or has no realistic alternative but to do so.

Committee of Members are responsible for overseeing the Fund'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 SL AuSs 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.

KPMG, a Sri Lankan Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International cooperative ("KPMG International"), a Swiss entity.

M.R. Mihular FCA	P.Y.S. Perera FCA	C.P. Jayatilake FCA
T.J.S. Rajakarier FCA	W.W.J.C. Perera FCA	Ms. S. Joseph FCA
Ms. S.M.B. Jayasekara ACA	W.K.D.C. Abeyrathne FCA	S.T.D.L. Perera FCA
G.A.U. Karunaratne FCA	R.M.D.B. Rajapakse FCA	Ms. B. K. D. T. N. Rodrigo FCA
R.H. Rajan FCA	M.N.M. Shameel ACA	Ms. C.T.K.N. Perera ACA

Principals - S.R.I. Perera FCMA(UK), LLB, Attorney-at-Law, H.S. Goonewardene ACA



KPMG
(Chartered Accountants)
32A, Sir Mohamed Macan Markar Mawatha,
P. O. Box 186,
Colombo 00300, Sri Lanka.

Tel : +94 - 11 542 6426
Fax : +94 - 11 244 5872
+94 - 11 244 6058
Internet : www.kpmg.com/lk

A further description of the auditor's responsibilities for the audit of the financial statements is located at Sri Lanka Accounting and Auditing Standards website at : <http://slaasc.com/auditing/auditorsresponsibility.php>. This description forms part of our auditor's report.

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 Fund.

CHARTERED ACCOUNTANTS

Colombo
23 May 2019

THE MERCANTILE SERVICE PROVIDENT SOCIETY
STATEMENT OF INCOME & EXPENDITURE

For the year ended 31 December,

	Note	2018 <u>Rs.</u>	2017 <u>Rs.</u>
Interest income	4	2,570,260,820	2,305,585,641
Other operating income	5	13,472,504	87,490,728
Net losses from financial investment	6	(33,596,025)	(48,137,003)
Total income		2,550,137,300	2,344,939,366
Administration expense	7	(34,021,635)	(33,278,144)
Finance expense	8	(397,551)	(371,825)
Total expenses		(34,419,186)	(33,649,969)
Income over expenditure before taxation		2,515,718,114	2,311,289,397
Income tax expense	9	(322,673,564)	(207,263,446)
Income over expenditure for the year before distribution		2,193,044,550	2,104,025,951
<u>Distribution</u>			
Income paid to resigned members in 2018 at the rate of 2017 of 10% (2016 - 10%)		(230,959,015)	(138,145,238)
Income distributed to active members at 10% (2017-10%)		(1,905,812,269)	(1,852,357,510)
Total distribution		(2,136,771,284)	(1,990,502,748)
Transferred to revenue reserve		56,273,266	113,523,203

The annexes notes to the financial statements form an integral part of these financial statements.

THE MERCANTILE SERVICE PROVIDENT SOCIETY
STATEMENT OF FINANCIAL POSITION

<i>As at 31 December,</i>		2018	2017
	Note	<u>Rs.</u>	<u>Rs.</u>
Assets			
Non Current Assets			
Property, plant and equipment	10	1,178,005	1,623,580
Loans to members	11	4,024,030,504	3,699,108,205
Financial investments	12	20,801,700,874	19,173,452,960
Total Non Current Assets		<u>24,826,909,382</u>	<u>22,874,184,745</u>
Current Assets			
Cash & cash equivalents	13	315,035,709	399,149,829
Other receivable	14	296,519,056	226,341,763
Total Current Assets		<u>611,554,765</u>	<u>625,491,592</u>
Total Assets		<u>25,438,464,147</u>	<u>23,499,676,337</u>
Reserve and Liabilities			
Reserve			
Member account	15	25,077,826,484	23,399,759,292
Revenue reserve	16	128,467,740	84,658,510
Total Reserves		<u>25,206,294,225</u>	<u>23,484,417,802</u>
Non Current Liabilities			
Employee benefits	17	9,305,860	9,424,760
Total Non Current Liabilities		<u>9,305,860</u>	<u>9,424,760</u>
Current Liabilities			
Other creditors	18	8,262,352	1,771,622
Current taxation		214,601,711	4,062,153
Total Current Liabilities		<u>222,864,063</u>	<u>5,833,775</u>
Total Liabilities		<u>232,169,923</u>	<u>15,258,535</u>
Total Reserve and Liabilities		<u>25,438,464,147</u>	<u>23,499,676,337</u>

The annexed Notes to the Financial Statements form an integral part of these Financial Statements.

Mr. Averell Goonetilleke
Chief Executive Officer

The Committee is responsible for the preparation and presentation of these Financial Statements;
Approved for and on behalf of the Committee:

Mr. D.S.T.H. Mudalige
Chairman

Mr. D.K. Hulangamuwa
Secretary

23rd May 2019
Colombo.

THE MERCANTILE SERVICE PROVIDENT SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

1 REPORTING ENTITY

1.1 Domicile and Legal Form

Mercantile Service Provident Society ("the Fund") is a defined contribution plan established on 20th December 1939. The registration office of the Fund is situated at No.212, De Saram Place, Colombo 10.

1.2 Principal Activities and Nature of Operations

The principal activity of the Fund is to manage the funds received from members.

1.3 Number of Employees

The total number of employees of the Fund as at 31st December 2018 was 13. (2017 – 14).

2 BASIS OF PREPARATION

2.1 Statement of Compliance

The Statement of Financial Position, Statement of Income and Expenditure together with the notes, (the "Financial Statements") of the Fund as at 31st December 2018 and for the year then ended have been prepared in accordance with new Sri Lanka Accounting Standards (SLAS) prefixed both SLFRS (corresponding to IFRS) and LKAS (corresponding to IAS), promulgated by the Institute of Chartered Accountants of Sri Lanka and complies with the requirements of the Companies Act No 07 of 2007.

2.2 Basis of Measurement

The financial statements have been prepared on the historical cost basis except for the following material items in the statement of financial position:

- Investments have been stated at their fair values other than investments that have a fixed redemption maturity value and have been acquired to match the obligations of the plan.

2.3 Comparative Information

The previous year figures and phrases have been reclassified whenever necessary to conform to current year presentation.

2.4 Functional and Presentation Currency

All values presented in the Financial Statements are in Sri Lankan Rupees and rounded to the nearest rupee value.

2.5 Use of Estimate and Judgment

The preparation of the Financial Statements in conformity with SLAS's requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

THE MERCANTILE SERVICE PROVIDENT SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

Information about critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the Financial Statements is included in the following notes:

- Current taxation (Note 3.1.a)
- Defined benefit plan (Note 3.5.b)
- Provisions and contingencies (Note 3.7)

3 SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these Financial Statements.

3.1 Income Tax Expenses

Income tax expense comprises of current & deferred tax expense recognized in the statement of income and expenditure.

a) Current Taxation

The Fund's liability to taxation has been computed in accordance with the provisions of the Inland Revenue Act No 10 of 2006 and amendments thereto.

b) Deferred Taxation

The Fund does not account for deferred taxation since there will not be any material temporary differences arising on the current tax computation based on the provisions of the Inland Revenue Act No 24 of 2017.

ASSETS AND BASES OF THEIR VALUATION

Assets classified as current assets in the statement of financial position are cash and those, which are expected to be realized in cash during the normal operating cycle of the Fund or within one year from the reporting date whichever is shorter. Assets other than current assets are those, which the Fund intends to hold beyond a period of one year from the reporting date.

3.2 Property, Plant and Equipment

a) Recognition and Measurement

Property, Plant & Equipment are recorded at cost less accumulated depreciation which is provided for on the bases specified in 3.2(c) less accumulated impairment losses if any.

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the assets to a working condition for their intended use, the costs of dismantling and removing the items and restoring the site on which they are located, and borrowing costs on qualifying assets.

b) Subsequent costs

The cost of replacing a part of an item of property, plant and equipment is recognised in the

THE MERCANTILE SERVICE PROVIDENT SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Fund, and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognised in profit or loss as incurred.

c) Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset.

The estimated useful lives for the current and comparative periods are as follows:

Asset category	Useful life
Furniture & fittings	10 years
Office equipment	5 years
Computer equipment	5 years

Depreciation is provided proportionately from the date of purchase up to the date of disposal of property, plant and equipment.

Depreciation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate.

d) Impairment of Property, Plant and Equipment

The carrying value of property, plant and equipment is reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying value exceed the estimated recoverable amount the assets are written down to their recoverable amount. Impairment losses are recognized in the statement of comprehensive income unless it reverses a previous revaluation surplus for the same asset.

3.3 Financial Instruments

Retirement benefit plan investments shall be carried at fair value other than Investments that have a fixed redemption value and that have been acquired to match the obligations of the plan and investments which are held for which an estimate of fair value is not possible.

Initial and subsequent recognition

Financial instruments of the Fund comprise treasury bonds, debentures, fixed deposits and share investments.

The Fund initially recognizes financial assets on the trade date at which the Fund becomes a party to the contractual provisions of the instrument. Share investments are measured subsequently at fair value and debentures, treasury bonds, fixed deposits and commercial paper investments are measured subsequently at amortised cost using Effective Interest Rate.

The Fund derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all the risks and rewards of ownership of the financial assets are transferred. Any interest in transferred financial assets that it created or retained by the Fund is recognized as a separate asset or liability.

THE MERCANTILE SERVICE PROVIDENT SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Fund has a legal right to offset the amounts intends either to settle on a net basis or realize the assets and settle the liability simultaneously.

Marketable securities have fixed redemption value and that have been acquired to match the obligation of the plan are carried at amount based on their ultimate redemption value assuming a constant rate of return to maturity.

The fund has matched all investments in marketable securities other than investment in equity securities, with fixed redemption value to an obligation and therefore all investments are carried at amortised cost.

3.4 Impairment of Assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. All impairment losses are recognised in the statement of income and expenditure.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortised cost the reversal is recognised in the statement of income and expenditure.

LIABILITIES AND PROVISIONS

Liabilities classified as current liabilities in the statement of financial position are those obligations payable on demand or within one year from the reporting date. Items classified as non current liabilities are those obligations, which expire beyond a period of one year from the reporting date.

All known liabilities have been accounted for in preparing the financial statements. Provision and liabilities are recognized when the fund has a legal or constructive obligation as a result of past events and it is probable that an outflow of economic benefits will be required to settle the obligation.

3.5 Employee Benefits

a) Defined contribution plans – The Mercantile Service Provident Fund and Employee's Trust Fund (ETF)

All employees who are eligible for Mercantile Service Provident Society Fund and Employees Trust Fund contributions are covered by relevant contribution funds in line with respective statutes and regulations.

b) Defined Benefit Plan

The Fund computes the gratuity liability based on Gratuities Act rather than any formula based internal model into consideration the lower number of employees the Fund had as at reporting date.

The liability is not externally funded nor actuarially valued.

THE MERCANTILE SERVICE PROVIDENT SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

3.6 Non-derivative financial liabilities

The Fund initially recognises debt securities issued and subordinated liabilities on the date that they are originated. All other financial liabilities (including liabilities designated at fair value through profit or loss) are recognised initially on the trade date at which the Fund becomes a party to the contractual provisions of the instrument.

The Fund derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Fund has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

The fund has the following non-derivative financial liabilities: other creditors.

Such financial liabilities are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortised cost using the effective interest method.

3.7 Provisions and contingencies

A provision is recognised if, as a result of a past event, the Fund has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognised as finance cost.

STATEMENT OF INCOME AND EXPENDITURE

3.8 Revenue Recognition

3.8.1 Interests

Interest income and expenses are recognised in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash receipts or payments through the expected life of the financial asset or liabilities (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liabilities. When calculating the effective interest rate, the fund estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

The calculation of the effective interest rate includes all transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

3.8.2 Dividends

Dividend income is recognised when the right to receive income is established. Usually this is the ex-dividend date for equity securities. Dividends are presented in other operating income from other financial instruments at fair value through profit or loss based on the underlying classification of the equity investment.

3.8.3 Net trading income

Net trading income comprises gains less losses related to trading assets and liabilities, and

THE MERCANTILE SERVICE PROVIDENT SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

includes all realized and unrealized fair value changes, interest, dividends and foreign exchange differences.

Gains and losses on the sale of investments are calculated as the difference between net sales proceeds and the original or amortised cost and are recorded on occurrence of the sale transaction.

3.9 Expenditure Recognition

Operating Expenses

All expenditure incurred in day-to-day operations of the fund and in maintaining the property, plant & equipment in a state of efficiency has been charged to revenue in arriving at the excess or deficit over the expenses for the year.

Provision has also been made for all known liabilities and depreciation on property, plant and equipment.

CASH FLOW STATEMENT

The cash flow statement has been prepared using the indirect method of preparing cash flows in accordance with the Sri Lanka accounting standard (LKAS) 7, Cash Flow Statements.

Cash and cash equivalents comprise short term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value. The cash and cash equivalents include cash in-hand, balances with banks and short term deposits with banks.

THE MERCANTILE SERVICE PROVIDENT SOCIETY
NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December,

	2018	2017
	<u>Rs.</u>	<u>Rs.</u>
4. Interest income		
Interest on fixed deposits	626,424,255	260,585,776
Interest on commercial papers	13,835,566	41,190,818
Interest on treasury bonds	1,187,807,416	1,364,733,577
Interest on debentures	223,169,921	182,652,177
Interest on savings account	25,262,545	18,491,096
Interest on housing loans granted	389,574,566	342,623,399
Interest income from fund managers	-	1,888,751
EIR adjustment to interest income on members loans	104,186,551	93,420,047
	<u>2,570,260,820</u>	<u>2,305,585,641</u>
5. Other operating income		
Contributors' fee	15,668,000	14,976,465
Gain / (Loss) on disposal of shares	(13,612,983)	41,255,010
Insurance handling fee	4,919,911	4,729,046
Dividend income	6,497,576	26,530,207
	<u>13,472,504</u>	<u>87,490,728</u>
6 Net losses from financial investments		
Unrealised Loss on shares	(33,596,025)	(48,137,003)
	<u>(33,596,025)</u>	<u>(48,137,003)</u>
7 Administration expenses		
Staff costs (Note 7.1)	20,966,030	19,786,152
Secretarial Charges	2,501,582	2,358,434
Rent and security charges	2,727,413	2,560,864
Printing and stationery	501,757	563,441
Depreciation	473,654	479,555
Postage and telephone	417,812	469,938
Electricity and water	731,453	722,517
Computer processing charges	3,016,614	2,816,134
Computers and general ledger maintenance expenses	71,723	309,405
Audit fee	819,037	616,877
Fund managers fee	-	1,083,446
General expenses	1,760,910	1,478,406
Stamp duty	33,650	32,975
	<u>34,021,635</u>	<u>33,278,144</u>

THE MERCANTILE SERVICE PROVIDENT SOCIETY
NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December,

	2018	2017
	<u>Rs.</u>	<u>Rs.</u>
7 Administration expenses (Cont.)		
7.1 Staff costs		
Salaries and wages	16,428,657	15,590,987
Employees provident fund	2,665,280	2,484,526
Employees trust fund	426,397	402,203
Over time payments	32,323	36,236
Provision for Employee benefits	1,413,373	1,272,200
	<u>20,966,030</u>	<u>19,786,152</u>
8 Finance expense		
Bank charges	397,551	371,825
	<u>397,551</u>	<u>371,825</u>
9 Income tax expenses		
Current tax expenses	322,673,564	43,604,345
(Over)/under provision in respect of prior year	-	7,880,944
With holding taxation	-	19,304,799
Notional tax	-	136,473,358
	<u>322,673,564</u>	<u>207,263,446</u>

- 9.1 During the year 2018, the Fund has changed the basis of income tax computation with the implementation of the Inland Revenue Act No 24 of 2017. Under the previous Act, the liability was computed based on interest income. However with the implementation of the new Inland Revenue Act, the tax liability is computed based on net profit.

During the year the Fund had used a computation basis of 3 months to 9 months based on the old Inland Revenue Act and new Inland Revenue Act respectively.

10 Property, plant and equipment

For the year ended 31 December 2018

	Furniture & fittings Rs.	Office equipment Rs.	Computer equipment Rs.	Total 2018 Rs.	2017 Rs.
Cost					
Balance as at 1st January	1,933,998	1,227,670	3,449,559	6,611,227	6,023,111
Additions during the year	-	28,078	-	28,078	588,116
Balance as at 31 December	<u>1,933,998</u>	<u>1,255,748</u>	<u>3,449,559</u>	<u>6,639,305</u>	<u>6,611,227</u>
Accumulated depreciation					
Balance as at 1st January	1,481,044	1,196,200	2,310,403	4,987,647	4,508,092
Charge for the year	88,999	15,312	369,343	473,654	479,555
Balance as at 31 December	<u>1,570,043</u>	<u>1,211,512</u>	<u>2,679,746</u>	<u>5,461,301</u>	<u>4,987,647</u>
Carrying Value					
As at 31 December 2018	<u>363,955</u>	<u>44,237</u>	<u>769,813</u>	<u>1,178,005</u>	
As at 31 December 2017	<u>452,954</u>	<u>31,470</u>	<u>1,139,156</u>		<u>1,623,580</u>

THE MERCANTILE SERVICE PROVIDENT SOCIETY
NOTES TO THE FINANCIAL STATEMENTS

As at 31 December,

11 Loans to members

	2018	2017
	<u>Rs.</u>	<u>Rs.</u>
Loans to members (Note 11.1)	3,151,214,178	2,922,706,956
Prepaid expenses (Note 11.2)	872,816,325	776,401,249
	<u>4,024,030,504</u>	<u>3,699,108,205</u>

11.1 Loans to members

Balance as at 01 January	2,922,706,956	2,615,310,199
Loans granted during the year	1,135,713,125	1,089,762,550
Interest receivable on loans	23,882,185	19,217,211
Last year accrued interest payment	(19,217,211)	(16,894,010)
Amortisation of fair value adjustment - interest income	104,186,551	93,420,047
	<u>4,167,271,606</u>	<u>3,800,815,997</u>
Less:		
Repayment received during the year	(805,705,830)	(663,220,561)
Repayment receivable	(9,749,971)	(7,653,505)
Fair value adjustment in the members loans on initial recognition (Note 11.2)	(200,601,627)	(207,234,975)
	<u>(1,016,057,428)</u>	<u>(878,109,041)</u>
	<u>3,151,214,178</u>	<u>2,922,706,956</u>

11.2 Prepaid expenses

Balance as at 01 January	776,401,249	662,586,321
Fair value adjustment in members loans on initial recognition	200,601,627	207,234,975
Amortisation recognised in the members accounts	(104,186,551)	(93,420,047)
Balance as at 31 December	<u>872,816,325</u>	<u>776,401,249</u>

12 Financial investments

The Fund's financial instruments are summarised by the following categories:

As at 31 December,

	2018	2017
	<u>Rs.</u>	<u>Rs.</u>
Investments in government securities	9,144,697,175	13,360,579,231
Other investments	11,550,157,904	5,343,963,620
Investments in equity securities	106,845,795	468,910,109
	<u>20,801,700,874</u>	<u>19,173,452,960</u>

13 Cash and Cash Equivalents

As at 31 December,

	2018	2017
	<u>Rs.</u>	<u>Rs.</u>
Cash at bank	315,024,988	399,115,349
Cash in hand	10,721	34,480
	<u>315,035,709</u>	<u>399,149,829</u>
Bank Overdrafts	-	-
Cash and cash equivalents as per the Cash flow Statement	<u>315,035,709</u>	<u>399,149,829</u>

THE MERCANTILE SERVICE PROVIDENT SOCIETY
NOTES TO THE FINANCIAL STATEMENTS

As at 31 December,

	2018	2017
	<u>Rs.</u>	<u>Rs.</u>
14 Other receivable		
Loan repayment receivables	9,749,971	7,653,505
Contribution receivable	214,553,371	210,691,238
Contributors fee receivable	310,000	962,000
Other receivable	668,388	177,198
WHT Receivable	30,251,894	-
Notional tax receivable	35,643,581	-
Advance payments	5,341,851	6,857,822
	<u>296,519,056</u>	<u>226,341,763</u>
15 Member account		
Balance as at 01 January	23,399,759,292	21,180,196,632
Contribution received	3,495,854,503	3,267,232,783
Insurance maturity proceeds received	15,687,165	13,767,329
Income distributed	2,136,771,284	1,990,502,748
Amortization adjustment in member loans (Note 15.1)	(104,186,551)	(93,420,047)
Transfer of fair value adjustment to members account (Note 16.2)	104,186,551	93,420,047
	29,048,072,243	26,451,699,492
Less:		
Under paid interest of retired members	(13,047,070)	(10,414,470)
Outstanding loan balances of retired members	(647,695,108)	(522,741,960)
Insurance paid out	(164,078,006)	(157,634,864)
Payments to retired members	(3,145,425,575)	(2,361,148,906)
	(3,970,245,759)	(3,051,940,200)
Balance as at 31 December	<u>25,077,826,484</u>	<u>23,399,759,292</u>

15.1 Amortisation adjustment to members loans refers to the Amortisation of the initial adjustment made to loans granted at beneficial rates on initial recognition.

As at 31 December,

	2018	2017
	<u>Rs.</u>	<u>Rs.</u>
16 Revenue reserve		
Balance as at 01 January	84,658,510	38,302,903
Surplus/(Deficit) of income over expenditure for the year after distribution	56,273,266	113,523,203
Payable to retired members (Note 16.1)	91,722,515	26,252,451
Transfer of fair value adjustment to members account (EIR adjustment) (Note 16.2)	(104,186,551)	(93,420,047)
Balance as at 31 December	<u>128,467,740</u>	<u>84,658,510</u>

16.1 As per the Fund's policy, all the balances payable to retired members which are outstanding for more than 5 years are transferred to Revenue Reserve with the intention of paying them in case if the member requests subsequently. Accordingly, during the year Fund has transferred Rs. 91.7 Mn. (2017 - Rs. 26.2 Mn.) balances payable to retired members to Revenue Reserve.

16.2 The EIR adjustment made to investment and interest income recognised on members loans based on fair value adjustments have been transferred to members account.

THE MERCANTILE SERVICE PROVIDENT SOCIETY
NOTES TO THE FINANCIAL STATEMENTS

As at 31 December,

17 Employee benefits

Balance as at 01 January

Provision for the year

Payments made during the year

Balance as at 31 December

	2018	2017
	<u>Rs.</u>	<u>Rs.</u>
	9,424,760	8,217,282
	1,413,373	1,272,200
	10,838,133	9,489,482
	(1,532,273)	(64,722)
	<u>9,305,860</u>	<u>9,424,760</u>

The Fund computes the gratuity liability based on Gratuities Act than other formula based internal model after taking into consideration the lower number of employees the Fund had as at reporting date.

The liability is not externally funded nor actuarially valued.

As at 31 December,

18 Other creditors

Sundry Creditors

	2018	2017
	<u>Rs.</u>	<u>Rs.</u>
	8,262,352	1,771,622
	<u>8,262,352</u>	<u>1,771,622</u>

NOTICE OF MEETING

THE SEVENTY NINTH ANNUAL GENERAL MEETING of the Mercantile Service Provident Society will be held at the Ceylon Chamber of Commerce, 50, Nawam Mawatha, Colombo 2, on 12th July 2019 at 4.00 p.m.

BUSINESS

1. To confirm the Minutes of the Seventy Eighth Annual General Meeting held on 22nd June 2018.
2. Report and Accounts - To receive the Report of the Committee for the year 2018 and the Statement of Accounts for the year ended 31st December 2018, with the Report of the Auditors thereon.
3. Committee - To elect four members to the Committee under Rule 7 (i) (d).
4. Auditors - To re-appoint Auditors and authorise the Committee to determine their remuneration.
5. Any other business of which due notice shall have been given.

By Order of the Committee

DUMINDA HULANGAMUWA

Secretary

Colombo, 23rd May 2019