Mihin Lanka (Private) Limited – 2016/2017

The audit of the financial statements of the Mihin Lanka (Private) Limited("the Company") for the year ended 31 March 2017 comprising the statement of financial position as at 31 March 2017 and the income statement and statement of comprehensive income , statement of changes in equity and cash flows statement for the year then ended and a summary of significant accounting policies and other explanatory information, 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. This report is issued in terms of Article 154(6) of the Constitution of the Democratic Socialist Republic of Sri Lanka.

1.2 Board's Responsibility for the Financial Statements

The Board of Directors ("Board") is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal control as the Board determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.3 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the company's preparation and fair presentation of the financial statements 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Board, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

2. Financial Statements

2.1 Opinion

In my opinion, the financial statements give a true and fair view of the financial position of the Company as at 31 March 2017, and of its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

2.1.1 Emphasis of Matter

I draw attention to note No.03 to these financial statements, which describes that the Government of Sri Lanka has taken a decision to cease operations of the Company with affect from 30 October 2015. Further, the Company has filed a winding up petition and a petition to appoint a provisional liquidator in the Commercial High Courts on 15th of January 2018, as per the Cabinet decision dated 8th November 2017. These financial statements have therefore been prepared on a break-up basis. My opinion is not qualified in respect of this matter.

2.1.2 Report on Other legal and Regulatory Requirements

As required by Section 163 (2) of the Companies Act No. 07 of the Companies of 2007, I state the followings:

(a) The basis of opinion and scope and limitations of the audit are as stated above.

(b) In my opinion:

- I have obtained all the information and explanation that were required for the audit and, as far as appears from my examination, proper accounting records had been kept by the Company.
- The financial statements of the Company comply with the requirement of section 151 of the Companies Act 07 of 2007.

2.2 Comments on Financial Statements

2.2.1 Going Concern of the Company

The following observations are made.

(a) The Company had recorded a loss of Rs. 2,470 million during the year under review and an accumulated loss of Rs. 19,743 million as at end of the year under review. Nevertheless, current liabilities of the Company had been exceeded its current assets by Rs. 5,267 million and the total equity of the Company as at reporting date had been declined to a negative Rs. 5,267 million, which shows the unfavourable financial position of the Company.

(b) In order to prevent further operational losses and deterioration of the financial position of the Company, Government of Sri Lanka has taken a decision to cease operations of the Company with effect from 30 October 2016 and to direct Sri Lankan Airlines to absorb the route network currently operated by the Company. Therefore, the financial statements of the Company had been prepared on a break-up basis.

2.2.2 Sri Lanka Accounting Standards (LKAS/SLFRS)

The following observations are made.

(a) As per the paragraph 08 of the Sri Lanka Financial Reporting Standard on Financial Instruments (SLRFS- 7), carrying amount of the each category of financial assets and liabilities shall be disclosed in the statement of financial position or in Notes. However no disclosure has been made relating to short term investments & liabilities.

(b) As per the paragraph 20 (b) of the Sri Lanka Accounting Standard on Statement of Cash Flows(LKAS- 07) intangible assets, impairment expense had not been adjusted in the statement of cash flow as non-cash expense in arriving the operating cash flow under the indirect method.

2.2.3 Accounts Receivable and Payable

The following observations are made.

(a) The total receivable balance as at 31 March 2017 was Rs. 196,273,498 and out of that Rs. 27,356,619 had remained without been recovered over one to six years. Details are given bellow.

Customer	**Amount** **Rs.**	**Credit Date**
HO Sales	313,610	Dec 2015
Charter revenue	363,000	Oct 2011
Mihin Lanka Ticket	13,718,866	Apr 2012
Danat a Dubai	1,985,875	Feb/Mar 2012
Badur Aviation	8,717,279	Aug/Sep 2014
World Air (Pvt) Ltd	2,257,989	Mar 2011

(b) In addition, the balances aggregating to Rs. 115 million equivalent to 59 percent of total debtors, had remained without been recovered over 90 days.

2.3 Non – compliance with Laws, Rules, Regulations and Management Decision, etc.

Instances of non-compliance with the following laws, rules, regulations and management decisions were observed in audit.

Reference to Laws, Rules, Regulations and Management Decisions	Non- compliance
(a) Public Enterprises Circular No. PED/12 dated 02 June 2003 on Public Enterprises Guidelines for Good Governance	
(i) Section 4.2.6	Quarterly Performance Reports should be forwarded to the Line Ministry and the Department of Public Enterprises in General Treasury on or before 30 days after the end of the quarter as per the formats given in Appendix 1 of the circular. However, the Company had not prepared and submitted any of those reports until ceased the operations of the Company.
(ii) Section 7.3	Guidelines on Tender Procedures are mandatory for all public enterprises. However, the procurement manual of the Company had not approved by the Line Ministry and the concurrence of the Department of Public Enterprises in General Treasury had not been obtained.
(iii) Section 7.4.5	Annual Board of Survey verification of assets of the Company had not been carried out for the year under review.
(iv) Section 9.2 (d)	The Organization Chart and the approved cadre of the Company had not been registered with the Department of Public Enterprises in General Treasury.
(v) Section 9.3.1 (i)	The Scheme of Recruitments and Promotions (SOR) of the Company had not been approved by the Board and the line Ministry with the concurrence of the General Treasury.
(b) Public Enterprises Circular No. PED 1/2015(i) dated 27th October 2016	An officer who is entitled to an official vehicle can either use the official vehicle or to avail a monthly transport allowance of Rs. 50,000, However, during year 2016/17 the Company had paid a sum of Rs. 60,000 as monthly transport allowance for seven

	officers contrary to the circular. The total excess payment paid in this regard was Rs. 840,000. Further, the Company had paid a sum of Rs. 1,680,000 as driver's allowances to such officers contrary to the circular.
(c) Section 7(j) of the Income Tax Act No 10 of 2006	The Company has not prepared the Income tax Computation for the year of assessment ("y/a") 2016/2017, since the Company is enjoying tax exemption given by the BOI agreement. However, note 6 to the income tax computation of the y/a 2015/2016, states that the company has obtained the tax exemption as per Section 7(j) of the Income Tax Act No 10 of 2006. However, such tax exemption had not been obtained from the Department of Inland Revenue.

3. Financial Review

3.1 Financial Result

The following observations are made.

(a) The Company had resulted a net loss of Rs.2,470 million as compared with the corresponding loss of Rs.1,252 million in the preceding year. Thus indicating a deterioration of Rs.1,218 million in the financial result of year under review. Reason for the deterioration is mainly due to the increase in finance cost by 185.51 per cent, amounting to Rs.567 million. Total revenue had been decreased by 31.3 per cent since the Company had operated only for seven months during the year under review due to cease of the operations.

(b) Negative value addition of the company had been varied from Rs. 2571 million to Rs.1,758 million from year 2012/13 to 2016/17. Details are given below.

Description	2016/17	2015/16	2014/15	2013/14	2012/13
	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000
Profit / (Loss) after Tax (before payment of dividends)	(2,469,730)	(1,251,947)	(1,406,483)	(2,591,539)	(3,291,475)
Add :-					
Employee Remuneration	631,782	888,217	690,450	726,194	519,297
Depreciation	67,897	13,278	5,869	4,683	6,891
Amortization	11,657	42,414	44,690	34,779	15,590
Total	**(1,758,394)**	**(308,038)**	**(665,474)**	**(1,825,883)**	**(2,751,697)**

The Negative Value addition of the Company had increased by Rs.1,450 million in the year under review mainly due to increase in loss after tax and increase in depreciation and amortization. As a result of increase in finance cost amounting to Rs. 368 million, loss after tax had increased by Rs.1,218 million during the year under review.

3.2 Analytical Financial Review

The following observations are made.

(a) The Company experienced an operating loss margin of 23.91 per cent, net loss margin of 30.70 per cent and total comprehensive loss margin of 30.70 per cent. Decreasing revenue and increasing net finance cost mainly contribute to the loss during the year under review.

(b) During the year under review the debt equity ratio was negative 152 per cent, because of the negative net worth of the Company. This indicates that creditors are not protected in case of insolvency in the normal course of the business.

(c) The current ratio was 0.34:1, which indicates adverse liquidity position of the Company.

4. Operational Review

4.1 Performance

Primary objective of the Company was to carry on business as a local and international airline or air transport undertaking and to operate air transport services for passengers and cargo as per the Articles of Association. Key Performance Indicators (KPI's) of the Company had varied during the past 05 years as follows.

KPI	2015/16	2014/15	2013/14	2012/13
Passenger Capacity (ASK Millions)	1,822	1,675	1,850	1,395
Passengers Carried (RPK Millions)	1,363	1,216	1,404	1,050
Overall Capacity (ATK Millions)	208			Not presented
Overall Load Carried (RTK Millions)	148			
Passenger Load Factor (%)	75	73	76	75
Passengers Carried (Nos. Thousands)	595	463	511	401
Cargo Carried (Tonnes)	4,764	3,435	3,134	2,504

As above Passenger Capacity, Passengers carried and Passenger Load Factor had increased in first two years and those had been decreased in the 2014/2015 and again increased in preceding year. However Passenger Capacity, Passengers carried, Passenger Load Factor and Cargo carried for the period of 7 months for the year 2016/2017 were unable to evaluate due to lack of evidences. Further, the operations of the company had ceased from 16th October 2016 as per the decision taken by the Government.

4.2 Budgetary Control

Significant deficiencies were observed between budget and the actual. Therefore, the budget had not been used as a management instrument.

4.3 Human Resource Management

Total number of employees of the Company as at 01 October 2016 was 302. After decision taken by the Government of Sri Lanka to cease operations of the Company, the Sri Lankan Airlines Limited had recruited 125 employees of the Company and 168 employees of the Company had retired voluntarily by paying compensation of Rs.165.22 million. Further, 02 employees were remaining in the Company until 31 March 2017.

5. Systems and Controls

The deficiencies observed during the course of audit were brought to the notice of the Chairman of the Company. Special attention is needed in respect of the following areas of control.

Area of Control		Weaknesses
(a)	Human Resource Management	Cadre and Scheme of Recruitment (SOR) had not been approved by the line Ministry with the concurrence of the General Treasury.
(c)	Accounting	(i) Lack of controls over the journal entry (ii) Lack of control un-reconciled accounts (iii) Non compliance with Sri Lanka Accounting Standards.
(d)	Accounts Receivable and Payable	(i) Lack of bank guarantees from travel agents (ii) Long outstanding receivables and payables without recovered and settled.