

Airport and Aviation Services (Sri Lanka) Limited – 2017

The audit of financial statements of the Airport and Aviation Services (Sri Lanka) Limited (“the Company”) for the year ended 31 December 2017 comprising the statement of financial position as at 31 December 2017 and the statement of comprehensive income, statement of changes in equity and statement of cash flows 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 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.

1.4 Basis for Qualified Opinion

- (a) The statement of financial position includes property, plant and equipment relating to the Mattala Rajapaksha International Airport (MRIA) with a carrying amount of Rs.24 Billion as at 31 December 2017. There had been a downturn in the operations of MRJA from commencement and presently there are no international flight movements except few domestic flights.

I consider these to be indicators of impairment in accordance with LKAS 36, Impairment of assets, as the economic performance of MRIA has deteriorated at the date of this report with full potential of the airport not expected to be realized in the near future. However, management has not carried out an impairment assessment to check whether there is any indication that MRIA may be impaired, on the basis of it being a separate cash generating unit, and thereby has not carried out an impairment test to determine whether any impairment write down should be applied to the amounts recorded in the statement of financial position at 31 December 2017. In the absence of information to assess the recoverable amount of the property, plant and equipment of MRIA, I am unable to satisfy myself as to the carrying amount of such property, plant and equipment as at 31 December 2017.

Further I draw attention to Note 11 (iii) to the financial statements. Even though there were discussions held with Government of India (GOI), the proposal from GOI still has not finalized.

- (b) I draw attention to Note 2.1.1 to the financial statements which explains the basis for amalgamating the financial statements of the Company with the Government Grant for Capital Expenditure (Voted Fund) and the Retained Revenue Fund. Based on the decision of the Cabinet of Ministers dated 17 August 2005, the Secretary to the Treasury has directed the Company to fulfill the following conditions by his letter No.PE/GOCO/1/1 dated 04 February 2006.
- i.** Action being taken to value the land and building of airport presently owned by the Government and other movable and immovable assets held by the Company
 - ii.** Taking over the liabilities relating to Airport Development presently serviced by the Government of Sri Lanka, and
 - iii.** Issuance of shares to the Government of Sri Lanka for the net assets thus transferred

However, the company had taken over only the liabilities neither valuing the Land and Buildings and other movable and immovable assets owned by the Government and brought to the accounts nor issuing shares to the Government of Sri Lanka for the net assets transferring.

- (c) Foreign loans obtained by the Government of Sri Lanka relating to Katunayake Airport Development Project, Colombo International Airport Development Project, 02 loans relating to Modernization of Ratmalana Air Traffic Control System had been recorded as liability in the accounts of the Company based on the letter issued by the Secretary to the Treasury on 04 February 2006 without any loan agreement. The total loan outstanding as at 31 December 2017 in respect of the above loans was Rs.10,139 Million. It was further observed these loans are also shown as liabilities in the Republic Account by duplicating of recording the loans.

Further, foreign loan obtained for Mattala Rajapakshe International Airport (MRIA) had also been transferred to the Company by General Treasury through a Memorandum of Understanding (MOU) without any valid loan agreement or transfer. The outstanding loan balance as at 31 December 2017 was Rs.24,643 Million which is equivalent to USD 159 Million.

2. Financial Statements

2.1 Qualified Opinion

In my opinion, except for the effects of the matters described in paragraph 1.4 of this report, the financial statements give a true and fair view of the financial position of the Airport and Aviation Services (Sri Lanka) Limited as at 31 December 2017 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

2.1.1 Report on Other Legal and Regulatory Requirements

As required by Section 163 (2) of the Companies Act, No.07 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 explanations that were required for the audit and as far as appears from my examination, proper accounting records have been kept by the Company.
 - The financial statements of the Company comply with the requirements of Section 151 of the Companies Act, No. 07 of 2007.

2.2 Comments on Financial Statements

2.2.1 Accounts Receivable

Receivable balances aggregating Rs.18,078,565 were outstanding for more than two years as at the end of the year under review without being recovered.

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

The following Instances of non-compliance with Laws, Rules, Regulations and Management Decisions were observed in audit.

Reference to Laws, Rules, Regulations and Management Decisions	Non- compliance
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(a) Section 14 of the Civil Aviation Act, No.14 of 2010	A Master Plan on establishment or expansion of aerodromes had neither been prepared nor approved by the Civil Aviation Authority of Sri Lanka up to 31 December 2017.
(b) International Civil Aviation Organization (ICAO) Standards and the Examination Report issued by the	The Head of Security Services had not been appointed permanently. Further, as per National Civil Aviation Security Programme, a specialized security

Civil Aviation Authority of Sri Lanka in the year 2015	programme had not been implemented.
(c) Public Enterprises Circular No. PED/12 of 02 June 2003 on Public Enterprises Guidelines for Good Governance.	
(i) Paragraph 4.2.2	Even though monthly financial statements should be tabled at every monthly Board meetings including statements on liquidity position and borrowings, procurements of material values and statement on human resources, those statements had not been tabled.
(ii) Paragraph 4.2.5	Age analysis of debtors, creditors, and stocks and statements identifying slow moving and obsolete stocks had not been reviewed by the Board on a monthly basis.
(iii) Paragraph 5.1	The Company had not prepared a Corporate Plan by determining its future directions
(iv) Paragraph 5.2.4	The Company had not placed its draft budget to the Board for the approval, three months before the commencement of the financial year.
(v) Paragraph 7.2 and 7.3	Operational manuals had not been revised and updated regularly and action had not been taken by the Company to obtain approvals for operational manual from Line Ministry, and the Concurrence of the Department of Public Enterprises, General Treasury
(vi) Paragraph 7.4.5	Annual and Special Boards of Survey had not been carried out in order to verify the assets of the Company.
(vii) Paragraph 9.2 (d)	The Organization Chart and the approved Cadre of the Company had not been registered with the Department of Public Enterprises, General Treasury.
(viii) Paragraph 9.3.1 (i)	The Scheme of Recruitments and Promotions (SOR) of the Company had not been approved by the Ministry concerned with the concurrence of the General Treasury.

(ix) Paragraph 9.14

HRM Manual of Procedures had not approved by Board by obtaining the concurrence of the General Treasury.

(d) Public Enterprises Circular No. PED 03/2016 dated 29 April 2016

The Company has borne Pay As You Earn (PAYE) tax and tax on tax of Rs. 19,849,402 during the year under review on behalf of its employees without deducting those from salaries of the respective employees.

3 Financial Review

3.1 Financial Results

According to the financial statements presented for audit, the operations of the Company had resulted in a pre-tax net profit of Rs.10,820 million for the year under review as compared with the corresponding pre-tax net profit of Rs.6,909 million for the preceding year, thus indicating an improvement of Rs.3,911 million in the financial results of the year under review. Increase of operating revenue and net finance income by Rs.2,481 million and Rs.1,369 million respectively were the main reasons attributed for this improvement.

3.2 Analytical Financial Review

3.2.1 Significant Accounting Ratios

According to the information made available some important accounting ratios of the Company for the year under review and preceding four years are given below.

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Current Assets Ratio (Number of times)	2.78	2.65	2.09	1.68	1.29
Quick Assets Ratio (Number of times)	2.71	2.60	2.06	1.65	1.23
Net Profit Ratio (Percent)	52	38	15	40	39
Earnings per Share (Rs.)	43,574	34,598	4,084	17,058	17,768
Return on Net Assets (Percent)	37	42	7	32	48
Revenue per Passenger (Rs.)	2,085	1,938	1,846	1,785	1,652

The following observations are made in this connection.

(a) Increase in short term bank deposits by 146 per cent was the main reason attributed for the increase in current ratio and quick assets ratio.

- (b) The net profit ratio had increased by 4 per cent during the year under review due to increase in revenue by 14 per cent and increase in finance income by 47 per cent. As a result the earnings per share had also been increased by 26 per cent.

4 Operating Review

4.1 Performance

- (a) The physical performance of the Company for last five years from 2013, based on the Key Performance Indicators (KPI) which mentioned in the Corporate Plan of the Company is given below.

Key Performance Indicator	Actual Achievements				
	2017	2016	2015	2014	2013
Number of International Flight Movements	62,850	61,637	56,156	54,960	51,972
Number of Total Passenger Movements	9,957,502	9,466,248	8,505,740	7,780,724	7,330,421
Number of Transit Passengers	1,501,679	1,285,756	1,227,451	1,273,037	1,370,266
Transit Passengers to Total Passengers Ratio	1:6.6	1:7.4	1:6.9	1:6.1	1:5.3
Cargo Movements (Metric Tons)	274,044	248,347	220,422	209,607	194,020
Total Cost per Flight Handled (Rs.'000)	202	216	256	171	177

Annual Targets on Key Performance Indicators (KPI's) had not been set out by the Company. Therefore, it was unable to compare the actual performance against the expected targets, in audit.

4.2 Management Activities

The following observations are made.

- (a) As per management decision, a building to the value of Rs. 75,190,191 had been disposed on 31 May 2017 for the construction of a hotel. However, only a sum of Rs. 5,800,000 was realized from disposal of this building. Therefore, the Company had sustained a huge loss of Rs. 69,390,191 from this disposal.
- (b) The contract for implementation of an Enterprise Resource Planning (ERP) System had been awarded to a private contract on 29 June 2012 to the value of Rs.248.6 million for 08 months. The Company had paid a sum of Rs.27 million to the contractor and the contract period had been extended in four instances up to 31 October 2016. However, the contractor had failed to complete the contract even up to 31 December 2016. Therefore, the performance bond amounting to Rs.24.86 million had been en-cashed on 03 January 2017. The loss incurred to the Company was Rs.2.6 million. Further, the contractor had filed a case against the Company for the recovery of performance bond.
- (c) A land had been purchased from a private party by spending a sum of Rs.7 million in the year 2012, for the purpose of constructing a circuit bungalow. Subsequently, Divisional Secretariat, Katharagama had informed that this land is belonging to the Government and thereafter, the Divisional Secretary of Katharagama had granted the land on 30 years lease basis to the Company. Further, the Company had filed a case against the private party in this connection.
- (d) High risk was identified in implementing the Information Technology System and continuation of this System is in doubt due to requiring the continuous modification and system is running without integration between the modules and other related systems.
- (e) The Board has decided to introduce a self-managed special fund instead of insurance policy by its decision No. 050/2013 dated 04 December 2013. However, the Company had not taken action to build up such fund even up to 31 December 2017.
- (f) Property, Plant and Equipment at a total cost of Rs. 13,262,977,618 had been fully depreciated as at 31 December 2017. Among them, an asset to the cost of Rs.2,534,638,577 had been fully depreciated for over 20 years. However, action had not been taken to revalue usable assets and dispose un-usable assets.

4.3 Unsettled Audit Matters

The following observations are made.

- (a) The Company had paid a compensation of Rs.2.5 million in the year 2012 to an employee who had resigned voluntarily from the service in the year 2011.
- (b) Sum of Rs. 8.7 Million had been reimbursed by the Company as custom duty for the years 2007 and 2008 though the project was completed in 31 December 2006.

Agreements were not presented to the audit though the additional works had been performed.

- (c) Output VAT amounting to Rs. 92 million had been paid under the additional agreements after completion of Development Project of Bandaranayke International Airport Stage I Step I. Further, the payment of Rs. 150 million had been paid without approved additional estimates.

4.4 Human Resources Management

As per the Finance Circular No.124 of 24 October 1997 issued by the Ministry of Finance and Planning, covering up duties of a vacant post should be limited to a period of 03 months. However, four Deputy Divisional Heads had been appointed for the vacant posts on acting basis between the periods ranging from 01 to 05 years.

5. Systems and Controls

Deficiencies observed in the systems and controls of the Company were brought to the notice of the Chairman of the Company from time to time. Special attention is needed in respect of the following areas of control.

Control Area -----	Observations -----
(a) Human Resources Management	Unavailability of approved Cadre and Scheme of Recruitments and Promotions.
(b) Accounting	Lack of an aggregated comprehensive accounting system in the Company.
(c) Receivables and Payables	Prevailing long outstanding balances in the accounts without being recovered / settled.
(d) Asset Management	(i) Attention to be paid to conduct the Board of Survey (ii) Non availability of assets coding and properly updated assets register.
(e) IT General Controls	Lack of properly designed computerized finance system to compatible with current working environment.