Sri Lankan Airlines Limited and its subsidiary 2017/2018

1.1 **Opinion**

The audit of the accompanying financial statements of the Sri Lankan Airlines Limited ("Company") and the consolidated financial statements of the Company and its subsidiary ("Group") for the year ended 31 March 2018 comprising the statement of financial position as at 31 March 2018 and the statement of profit or loss and other comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, 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. My comments and observations which I consider should be report to Parliament appear in this report. 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 March 2018, 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 (SLAuSs). 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 am independent of the Company in accordance with the Code of Ethics issued by CA Sri Lanka (Code of Ethics) and I have fulfilled my other ethical responsibilities in accordance with the Code of Ethics. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Emphasis of Matter - Material Uncertainty Related to Going Concern

I draw attention to Note 03 to the consolidated financial statements, which indicates that the Group and the Company incurred a net loss of Rs.18,585.15 million and Rs.17,213.57 million respectively during the year ended 31 March 2018 and, as of that date, the Group's and the Company's current liabilities exceeded its current assets by Rs.94,205.97 million and Rs.100,268.11 million and total liabilities exceeded its total assets by Rs.125,582.89 Million and Rs.132,196.34 million respectively. As stated in Note 3, these events and conditions, along with other matters as set forth in Note 3, indicate a material uncertainty that may cast significant doubt on the Group's ability to continue as a going concern. Having taken into account the mitigating factors as disclosed in Note 3 along with the Cabinet approval on 05 February 2019 as notified by the letter of Secretary to the President dated 13 February 2019 and the letter issued by the Secretary to the Treasury on 28 February 2019 confirming the support of the Government of Sri Lanka (GOSL) to the Company to continue its operations as a "Going Concern", these financial statements have been prepared using going concern assumption. My opinion is not modified in respect of this matter.

1.3 Board's Responsibilities and those charged with Governance for the Financial Statements

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The Board of Directors ("Board") is responsible for the preparation of these financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, and for such internal controls as Board 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, board 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 intends to liquidate the Group or to cease the operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's and Group's financial reporting process.

1.4 Auditors' Responsibilities for the Audit of the Financial Statements

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My objective is 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 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 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 and the Group'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 Group's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's 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 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 my audit.

2. Financial Statements

2.1 Going Concern of the Company

The following observations are made.

(a) Bank loan facilities of USD 200 million (approximately equivalent to Rs.31,115 million) and Rupee loans of Rs.26,250 million had been obtained from government banks during the year under review and preceding year, increasing the indebtedness of the Company.

(b) Further, the Company had obtained a loan of USD 125 million at an interest rate of LIBO+3.3% from the Credit Suisse Bank in the year 2017/2018 under the approval of the Board of Directors while submitting the air ticket income of the United Arab Emirates, Kuwait and Saudi Arabia as security.

2.2 **Unexplained Difference**

As per the general ledger, ground handling revenue for the year under review was Rs.9,899,407,032 and as per schedule which was obtained from the in house built ground handling billing system, it was Rs.9,901,436,925. Hence, there was a difference of Rs.2,029,892 and the reason for the difference could not been identified in audit, because of the Company is using an outdated system for ground handling billings.

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 5.1.3	Updated copies of the Corporate Plan approved by the Board together with the updated Annual Budget had not been forwarded to the line Ministry, Department of Public Enterprises, General Treasury and the Auditor General at least 15 days before the commencement of the financial year.
(ii) Section 7.4.5	Annual Board of Survey had not been carried out to verify the assets of the Company.
(iii) Section 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.
(iv) Section 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.

3. **Financial Review**

3.1 **Financial Result**

The Company had resulted in a net loss of Rs. 17,213.57 million for the year under review as compared with the corresponding loss of Rs. 28,929.99 million in the preceding year. Thus indicating an increase of Rs. 11,716 million in the financial result of the Company in year under review.

Further, The Group had resulted in a net loss of Rs.18,585.15 million for the year under review as compared with the corresponding loss of Rs.28,339.51 million in the preceding year. Thus indicating an increase of Rs.9,754.36 million in the financial result of the Group in year under review.

Reason for the increase is mainly due to the decrease in other operating expenditure by Rs.1,722.92 million in the year under review and the cancellation fee of three A350-900 aircraft lease agreement cost of Rs. 14,362.81 million (USD 98 million) in the preceding year.

Details of the Value addition of the Company from the year 2013/2014 to 2017/2018 are given below.

Description	**2017/18**	**2016/17**	**2015/16**	**2014/15**	**2013/14**
	(Rs.Mn)	**(Rs.Mn)**	**(Rs.Mn)**	**(Rs.Mn)**	**(Rs.Mn)**
Profit / (Loss) after Tax (before payment of dividends)	(17,213.57)	(28,929.99)	(12,428.27)	(16,494.66)	(32,408.34)
Add :-					
Employee Remuneration (Excluding crew cost)	19,482.99	18,797.05	10,693.32	9,213.90	8,352.93
Tax paid to Government					
Other Duties – NR Tax	-	-	-	(61.63)	(50.36)
Franchise fees to Airport Aviation	442.86	383.59	318.48	252.57	229.24
Supply of capital as interest	(8,820.16)	(6,922.92)	(5,819.34)	(5,009.46)	(6,196.92)
Depreciation	1,779.49	2,041.63	2,683.91	2,275.98	1,602.79
Total	**(4,328.39)**	**(14,630.64)**	**(4,551.90)**	**(9,823.29)**	**(28,470.66)**

Value addition of the Company had increased from Rs.(14,630.64) million in 2016/2017 to Rs.(4,328.39) million in 2017/2018 by Rs.10,302.25 million mainly due to decrease in loss after tax.

3.2 Analytical Financial Review

Important ratios are given below.

	2017/18	**2016/17**	**2015/16**	**2014/15**	**2013/14**
Current Assets to Current Liabilities(Number of Turns)	0.23	0.21	0.27	0.48	0.42
Percentage of Net Loss to Revenue	11	21	10	13	27
Increase / (Decrease) percentage in Revenue	19.3	4.6	(02)	09	02
Overall Yield (Net traffic revenue to Revenue Ton Kilometres) (Rs.)	84.37	80.08	79.06	80.32	77.26
Unit Cost (Rs.)	69.10	64.79	59.72	61.88	64.96
Breakeven Load Factor (%)	81.90	80.91	75.54	77.03	84.07
Revenue per Revenue Passenger Kilometre (Rs.)	8.6	8.4	8.2	8.2	7.8

The following observations are made.

(a) Current Assets to Current Liabilities Ratio of the Company is continuously below one which shows the weak working capital of the Company.

(b) Percentage of Net Loss to Revenue had decreased in the years 2014/15, 2015/16 and it had decreased in the year under review by 10 percent.

(c) Overall Yield had increased from the year 2013/14 up to 2016/17, and also it had increased in the year under review by 4.29 (Net traffic revenue to Revenue Ton Kilometres - Rs).

(d) The unit cost had increased of Rs. 4.31 in the year under review when compared with the preceding year.

4 Operational Review

4.1 Corporate Plan

Six Corporate Plans had been prepared as follows within a period of 9 years from 2010 to 2019.

(i) The Company had prepared a Corporate Plan internally for the period of 5 years from 2010/11 to 2014/15

(ii) The Plan in above (i) was confirmed by the Intervistas and VIA Capital Partners Consulting Company for the period of 5 years from 2011/12 to 2015/16

(iii) The Seabury Consultant had prepared a revised plan for the period of 6 years from 2013 – 2018

(iv) The Restructuring Plan had been prepared by the Company amalgamating the Sri Lankan Airlines and the Mihin Lanka (Pvt) Ltd for the period of 3 years from 2015/16 to 2017/18

(v) The Nyras, a Foreign Consulting Company had prepared a plan for the period of 4 years from 2018/19 to 2021/22 with the intermediation of the Ministry of Finance in the year 2017.

The following observations are made in this regard.

(a) As per the paragraph 5.1.1 of Public Enterprise Circular No. PED/12 on 2nd June 2003 above mentioned corporate plans had not been reviewed annually and continued as one Rolling Plan.

(b) The Intervistas and VIA Capital Partners Consulting Company had been paid a sum of USD 450,000 equal to Rs.51.5 million in the year 2010 for the confirmation of corporate plan (ii) above and Nyras Consulting Company had been paid a sum of GBP 248,961.75 equals to Rs.47 million in 2015/2016 and GBP 949,401 equals to Rs.221.2 million with Rs.19.9 million for local expenditure for the period of October 2016 to November 2018 regarding the preparation of corporate plan (v) above.

(c) Separate Board approval had not been obtained for the Revised Plan prepared by the Seabury Institution for the period of 2013 – 2018 and the payment for the plan could not be identified separately due to agreement with the above Company had been entered for consultating for refleeting programme of the Company.

4.2 Action Plan

The Company had not prepared the action plan clearly identifying the responsibilities of Managers with goals and targets to be achieved during the Plan period as per the para 5.1.2 of Hand Book on “Public Enterprises Guidelines for Good Governance”.

4.3 **Performance**

The following observations are made in this regard.

(i) Key Performance Indicators (KPI's) of the Company had varied during the past 05 years as follows.

KPI	**2017/18**	**2016/17**	**2015/16**	**2014/15**	**2013/14**
Passenger Capacity (ASK Millions)	18,487.54	15,608.10	15,790.28	16,180.27	15,780.54
Passengers Carried (RPK Millions)	15,280.78	12,455.05	12,727.66	12,963.71	12,810.95
Passenger Load Factor (%)	82.65	79.80	80.60	80.12	81.18
Overall Capacity (ATK Millions)	2,549.88	2,167.92	2,165.21	2,224.87	2,187.18
Overall Load Carried (RTK Millions)	1,749.14	1,475.29	1,484.77	1,519.93	1,466.74
Overall Load Factor (%)	68.60	68.05	68.57	68.32	67.06
Passengers Carried (Nos. Thousands)	5,839	4,446	4,328	4,348	4,175
Cargo Carried (Tonnes)	132,958	116,221	102,082	101,878	94,410
Aircraft in service at year end	26	24	21	21	21
Aircraft Utilization (Blk Hrs per day)	13.25	12.44	12.02	12.90	12.76

The following observations are made.

- Passenger Capacity and Passengers carried had increased by 2,879.44 ASK millions and 2,825.73 RPK millions respectively during the year under review; also, Passenger Load Factor had increased by 2.85 percent.

- Overall Capacity had increased by 381.96 ATK million and Overall Load Carried had increased by 273.85 RTK millions respectively during the year under review, Overall Load Factor had increased by 0.55 percent.

- Aircrafts in service had increased in the year under review by 2 and aircraft utilization had increased by 0.81 (Blk Hrs per day) compared with the preceding year.

4.4 **Air Lanka (Private) Limited**

According to the information made available for audit, Air Lanka (Private) Limited is a subsidiary of the Company which had been incorporated in 2003 to carry out domestic and international airline services including passenger and cargo services and other related services. The following observations are made in this regard.

(a) Although over 15 years has been passed since incorporation, the commercial operations had not been carried out by the Air Lanka (Private) Limited as at the end of year under review.

(b) As per the answer of the Chairman, the objective for continuation of this subsidiary is to protect the name of Air Lanka.

4.5 **Management Inefficiencies**

The following observations are made.

(a) Ground handling charges amounting to Rs.304,909,699 had been reversed due to revision in the ground handling charges without the approval of the counter party. However the Company had still charged the revised rates to the airlines which resulted in disputes and significant reversal of revenue.

(b) The goods in transit valued at Rs.35,188,030 had not been recognized as inventory as at the end of year under review and liabilities thereon had not been recognized when the risk and rewards had been transferred to Sri Lankan Airlines when importing inventories from Original Equipment Manufacturer and those goods had been received in April 2018.

(c) The cost of professional fees amounting to USD 68,285 equivalent to Rs.14,070,424 incurred in obtaining the Credit Suisse Bank loan had not been capitalized and amortized over the tenure of the loan as per LKAS 39 “Financial Instruments: Recognition and measurement”.

(d) Property, Plant and Equipment shall be initially recognized when it is available for use as per Paragraph 55 of LKAS 16 “Property, Plant and Equipment”. However, it was observed that few assets had been recognized on invoice payment date instead on the date of goods received. Therefore, an amount of Rs.9,765,070 of depreciation had been understated in the year under review.

(e) Even though the lease periods of two leased assets had been ended at the end of the year under review, the net book value of Rs.8,775,104. had been shown in the accounts due to the improper application of depreciation policy by the Company contrary with paragraph 27 of LKAS 17 “Finance Leased Assets”.

(f) An assessment for impairment had not been carried out on rotables (Reusable engineering spare parts) at the end of each reporting period to identify whether there are any impairment indicators as per LKAS 36 “Impairment of Assets”.

(g) Though the Company had occupied buildings from Air Ceylon, those buildings had not been considered in revaluation. Further, action had not been taken to transfer the ownership of those buildings to Sri Lankan Airlines Limited after ceasing of the operations of Air Ceylon.

4.6 **Operating Inefficiencies**

The following observations are made.

(a) Though the Company had implemented minimum and maximum inventory levels to manage the inventories effectively, deviations had been observed in 30 no of stock items.

(b) Slow moving items of non-rotable inventories (non-reusable engineering spare parts) which had been in stores more than 08 years, to the value aggregating Rs.965,442,866 had been identified. It was 17 per cent of total non rotable inventory balance as at the end of year under review. However, the Company had not implemented a formal policy to periodically review the level of inventory and proper control system over planning and procuring non-rotable inventories in order to eliminate excess purchases.

(c) As per the agreement the Company had not charged interest amounting to Rs. 6,153,073 from Pakistan International Airline for the delaying lease rental payment from September 2016 to February 2017 and further, the Company had not submitted bills for additional services.

4.7 **Uneconomic Transactions**

The Company is in negotiation with Airbus SAS Company to amend the purchase agreement of four (04) no. of A350-900 aircrafts which is to be delivered in 2020 and 2021 to replace with A321 NEOs and/or A330 NEOs and as at the reporting date amounting to Rs.2,528.12 million (USD 19.21 Mn) had been paid to Airbus as pre-delivery payment. However, no final decision had been taken until the date of this report.

4.8 **Identified Losses**

A sum of Rs. 16,924.36 million had paid as compensation in the process of revocation of lease agreements for obtaining four (04) A350-900 aircrafts on lease which was scheduled to be delivered in the year 2016/2017.

5. **Achievement of Sustainable Development Goals**

Due to failure of Sri Lankan Airlines Ltd in being aware of the United Nations Sustainable Development Agenda for the year 2030, action had not been taken to identify the sustainable development goals and targets relating to the activities thereof, along with milestones in respect of achieving those targets, and the indicators for evaluating the achievement of such targets.

6. **Accountability and Good Governance**

6.1 **Procurements**

In respect of refleeting of 14 no. of Aircrafts and Termination of Lease Agreements on 04 no. of A350-900 Aircrafts, major audit issues highlighted in two special reports submitted to Parliament on 24 January 2019 and 05 August 2019 are given below.

(i) The Company had not adhered to Government Procurement Guidelines in obtaining consultative services for the entire process, selecting companies for purchasing six (06) A 330-300 aircrafts and four (04) A350-900 aircrafts, leasing another four (04) A350-900 aircrafts and sell and lease back of above six (06) A 330-300 aircrafts, within 08 years from the year 2013.

(ii) The decision for purchasing aircrafts had been taken by the Board of Directors of the Company without obtaining approval of the Cabinet of Ministers and without making a proper cost benefit analysis.

7. **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.

(a)	Human Resource Management	Cadre and Scheme of Recruitment had not been duly approved.
(b)	Asset Management	(i) Board of Survey had not been carried out annually. (ii) Engineering Inventory Module had not been updated on timely basis.
(c)	Contract Administration	Delay in extension of the periods of contract agreements and lack of agreements
(d)	Planning and Controlling	Defects in acquisition of aircrafts and no post investment review mechanism had been implemented.