

## **Sri Lankan Airlines Limited and its subsidiaries -2020/2021**

---

### **1. Financial Statements**

---

#### **1.1 Opinion**

---

The audit of the financial statements of the Sri Lankan Airlines Limited (“Company”) and the consolidated financial statements of the Company and its subsidiaries (“Group”) for the year ended 31 March 2021 comprising the statement of financial position as at 31 March 2021 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 read in conjunction with provisions of the National Audit Act No. 19 of 2018. 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 Group as at 31 March 2021, and of their financial performance and their 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 believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

#### **1.3 Emphasis of Matters**

---

##### **(a) Material Uncertainty Related to Going Concern**

---

I draw attention to Note 3 to the financial statements, which indicates that the Company incurred a net loss of Rs.45,231.46 million during the year ended 31 March 2021 with an accumulated loss of Rs.371,733.52 million and, as of that date, the Company’s current liabilities exceeded its current assets by Rs.221,308.99 million and total liabilities exceeded its total assets by Rs.289,265.27 million. Further, the Group incurred a net loss of Rs.49,704.51 million during the year ended 31 March 2021 with an accumulated loss of Rs.366,284.57 million and, as of that date, the Group’s current liabilities exceeded its current assets by Rs.214,635.95 million and total liabilities exceeded its total assets by Rs.281,490.87 million.

As stated in Note 3 to the financial statements, these events or conditions, along with other matters as set forth in Note 3, indicate a material uncertainty that may cast significant doubt on the Company and the Groups ability to continue as a going concern.

Note 2.1 to the financial statements, describes the impact of COVID-19 outbreak on the Company and the Groups future prospects, performance and cash flows. The Management has described how they plan to deal with these events and circumstances as the outbreak is prevailing at the time of finalizing these financial statements.

Having taken into account the mitigating factors as disclosed in Note 3 along with the Cabinet approval dated 7 February 2022 and the letter issued by the Secretary to the Treasury on 24 February 2022 obtained for the purpose of the statutory audit for the year ended 31 March 2021, 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 the going concern assumption.

**(b) A350-900 Aircrafts Pre-delivery Payments**  
-----

I draw attention to Note 6 to the financial statements, which indicates that the aircraft pre-delivery payments as at 31 March 2021 amounting to Rs.2,528.12 million (USD 19.21 million) has been reclassified under Note 11-Trade and Other Receivables as at the end of the year under review.

As stated in Note 6, the Company has sent a Letter of Demand to Airbus S.A.S. and Airbus SE claiming the return of the pre-delivery payments with interest. There is no information available to the Management of the Company at this point of time to believe that the outcome of the recovery of pre-delivery payments could be unfavorable to the Company.

However, the recovery is dependent upon the outcome of a possible legal action in the absence of a settlement, and I have not been made aware of any additional information that contradict with the Company’s assumption on the recoverability of the said pre-delivery payments up to the date of this report.

My opinion is not modified in respect of these matters.

**1.4 Responsibilities of Management and Those Charged with Governance 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 determine 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 Group’s ability to continue as a going concern, disclosing, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the Group or to cease 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.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Company and the Group are required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared of the Company and Group.

## 1.5 Audit Scope

-----

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 scepticism 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 my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If 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 auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

The scope of the audit also extended to examine as far as possible, and as far as necessary the following;

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of information to enable a continuous evaluation of the activities of the Company and whether such systems, procedures, books, records and other documents are in effective operation;

- Whether the Company has complied with applicable written law, or other general or special directions issued by the governing body of the Company;
- Whether the Company has performed according to its powers, functions and duties; and
- Whether the resources of the Company had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

## 1.6 Financial Statements

### 1.6.1 Internal Control over the preparation of financial statements.

Entities are required to “devise and maintain” a system of internal accounting controls sufficient to provide reasonable assurance that , transactions are executed in accordance with management’s general or specific authorization, transactions are recorded as necessary to permit preparation of financial statements in conformity with the applicable reporting standards , and to maintain accountability for assets, access to assets is permitted only in accordance with management’s general or specific authorization, and the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

### 1.6.2 Non-Compliance with Sri Lanka Accounting Standards

Non Compliance with the reference to particular Standard	Management Comment	Recommendation
<p><b>Framework for the Preparation and Presentation of Financial Statements &amp; SLFRS 16</b></p>	<p>Management is in the view that those buildings should not be considered as assets of the Company due to no legal ownership.</p>	<p>Economic benefit of those assets have been enjoying by the Company without any disturbances. Therefore, Company should rectify the status of ownership of the assets and identity the assets as fixed assets or lease hold assets.</p>
<p>Though the Company occupies buildings taken over from Air Lanka previously Air Ceylon, action had not been taken to transfer the legal ownership of those buildings to the Company.</p> <p>Further, as per the valuation done by the corporate valuer as at 31 March 2018 the market value of above buildings was Rs.38.6 million. However, management had not taken action to account these assets as per Framework for the Preparation and Presentation of Financial Statements &amp; SLFRS 16 based on substance of enjoying economic benefits.</p>		

### 1.6.3 Unauthorized Transactions

Description of unauthorized transaction	Management Comment	Recommendation
<p>The Decision 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 had been taken by the Board of Directors of the Company in 2013 without obtaining approval of the Cabinet of Ministers and without making a proper cost benefit analysis.</p> <p>Meanwhile, the Company is in negotiation with Airbus SAS Company to amend the purchase agreement of four (04) no. of A350-900 aircrafts which were scheduled 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 million) had been paid to Airbus as pre-delivery payment. However, no final decision had been taken until 31 March 2022. However, 6 No. of A330-300 Aircrafts were purchased, sold and leased back in 2013 and 2014.</p> <p>Further, 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. Moreover, it was revealed in the Judgement of the Crown Court in the United Kingdom, that employees of the Airbus had agreed to make payments to a company own by the wife of then Chief Executive Officer of Sri Lankan Airlines relevant to this transaction. No action had been taken by the Company against former CEO and recovers the damages.</p>	<p>In the judgment of the Crown Court in the United Kingdom approving the Deferred Prosecution Agreement between the Serious Fraud Office and Airbus SE, it is mentioned that employees of Airbus SE had agreed to make payments to a company owned by the wife of a former executive of SLA to influence the purchase of six (6) A330-300 and four (4) of A350-900 aircraft and leasing four (4) A350-900 aircraft by SLA. Based on the legal advice received, SLA has informed Airbus S.A.S its claim including the requirement to rescind the A350-900 Purchase Agreement and recover PDPs paid along with compensation by a letter (Letter before Action) dated 29 September 2020. Airbus has communicated their interest in an amicable settlement and it is being actively pursued with the advice of the Attorney General's Department. SLA has also sought advice from the Attorney General's Department as to whether civil action can be instituted against the former CEO claiming damages and awaiting a response.</p>	<p>Detailed and realistic cost benefit analysis should be done before carrying out such investment and approval of the Cabinet should be obtained. The Company should decide the mix of aircrafts which should be purchased after a proper cost benefit analysis to avoid such uneconomic transactions in future.</p> <p>Further action should be taken against Airbus and former CEO to recover the damages to the Company.</p>

#### 1.6.4 Going Concern of the Organization

-----  
The following observations are made.

<b>Audit Issue</b> -----	<b>Management Comment</b> -----	<b>Recommendation</b> -----
(a) The company has been under capitalized. Hence the Cabinet approval had been granted to the Treasury to recapitalize the company up to USD 500 million during the period 2020-2022. The first tranche of USD 150 million equivalent in Rs.26,890 million was released on 18 Nov 2020 and the second tranche of USD 90 million equivalent in Rs.17,850 million was released in April 2021. However, those funds had been utilized for working capital purposes of the Company.	Considering the significant impact of the pandemic to the entire airline industry, the capital infusion was provided for working capital purposes in 2020/21 in order to sustain the operation of the Airline.	The capital infusion should be utilized for investing activities instead of working capital purposes.
(b) Bank loan facilities of USD 200 million (approximately equivalent to Rs.37,960 million) and Rupee loan of Rs.26,250 million had been obtained from government banks during the year 2017/18 increasing the indebtedness of the Company. Up to the date of this report, none of these loans had been repaid and an amount of Rs.6,563.88 million and an amount of Rs.6,253.04 million had been paid as loan interest respectively in the year 2019/20 and 2020/21. Further, new loan facilities of USD 75 million had been obtained from two state banks during the year under review for working capital purposes.	The repayment of the facilities obtained from the two state banks is expected to form part of the overall restructuring of the company and due to the severe impact of COVID 19 and the subsequent situation in the country which was not conducive for tourism.	Management should focus on running the business economically and in a profitable way and minimize the indebtedness of the Company.
(c) In June 2019 the Company had reissued five year international bonds to the value of US Dollars 175 million (approximately equivalent to Rs.33,215 million) with the interest rate at 7 per cent per annum to settle the bond matured in June 2019 under the Government Guarantee due to unfavorable financial position of the Company. The repayment of the bond falls in June 2024.	The repayment of the bond is in June 2024 and is being addressed as part of the overall external debt restructuring by the Ministry of Finance under the guidance of the international advisors appointed for this purpose.	Management should focus on running the business economical and profitable manner and minimize the indebtedness of the Company.

## 2. Financial Review

### 2.1 Financial Result

The operating result of the Company for the year under review amounted to a loss of Rs.45,231.46 million and the corresponding loss in the preceding year amounted to Rs.47,197.86. Therefore an improvement amounting to Rs.1,966.40 million of the financial result was observed. The reasons for the improvement are mainly due to the decrease in Employee cost amounting to Rs.4,999.21 million and the increase in other income and gains due to reversal of provision for Withholding tax on foreign supplier payments amounting to Rs.16,433.45 million during the year under review.

### 2.2 Trend Analysis of major Income and Expenditure items

	2020/21	2019/20	Improvement/(Deterioration)	
	Rs. Mn.	Rs. Mn	Rs. Mn	Percentage (%)
<b>Revenue</b>				
– Passenger, Cargo, Excess Baggage & Mail	43,979.12	164,743.85	(120,764.73)	(73)
– Air Terminal, Duty Free, Non Scheduled services & Flight Catering	6,714.73	15,407.17	(8,692.44)	(56)
– Other income & gains	20,628.65	3,046.13	17,582.52	577
<b>Expenditure</b>			<b>(Increase) / decrease</b>	
Aircraft Fuel Cost	10,569.38	55,327.75	44,758.37	81
Aircraft Maintenance and Overhaul Costs	13,695.34	22,820.26	9,124.92	40
Depreciation/Amortization	16,295.62	19,013.83	2,718.21	14
Selling, Marketing and Advertising Expenses	2,033.93	14,540.51	12,506.58	86
Exchange loss	6,894.60	6,118.51	(776.09)	(13)
Net Finance cost	35,147.97	40,073.31	4,925.34	12

- (a) Passenger, Cargo, Excess Baggage & Mail revenue and Air Terminal, Duty Free, Non Scheduled services & Flight Catering revenue had been decreased by 73 per cent and 56 per cent respectively during the year under review due to travel restrictions in case of Covid 19 pandemic.
- (b) Other income and gains increased by 577 percent due to reversal of provision for Withholding tax on foreign supplier payments amounting to Rs.16,433.45 million during the year under review.
- (c) Foreign Exchange loss had been increased by Rs.776.09 million and as a percentage of 13 per cent in the year under review comparing with the preceding year due to depreciation in Sri Lanka Rupee value.

### 2.3 Ratio Analysis

	2020/21	2019/20	2018/19	2017/18	2016/17
Current Assets to Current Liabilities(Number of Turns)	0.13	0.13	0.18	0.23	0.21
Percentage of Net Loss to Revenue	89	26	24	11	21
Increase / (Decrease) percentage in Revenue	(72)	(0.1)	11.7	19.3	4.6
Overall Yield (Net traffic revenue to Revenue Ton Kilometres) (Rs.)	146.86	99.03	91.32	84.24	80.08
Unit Cost (Rs.)	105.23	74.22	74.31	65.74	61.61
Breakeven Load Factor (%)	71.65	74.95	81.37	78.04	76.94
Revenue per Revenue Passenger Kilometre (Rs.)	21.80	10.15	9.43	8.62	8.43

Following Observations are made.

- (a) Current Assets to Current Liabilities Ratio of the Company is 0.21 in 2016/17 and it has been go down gradually to 0.13 in the year under review. Thereon it is indicating the weak working capital status of the Company.
- (b) Percentage of Net Loss to Revenue had increased in the preceding year by 02 percent and it has increased in the year under review by 63 percent.
- (c) Overall Yield had increased continuously from the year 2016/17, and compared to the previous year it has increased by 47.83 (Net traffic revenue to Revenue Ton Kilometres - Rs) during the year under review.
- (d) The unit cost had increased gradually from the year 2016/17 up to 2020/21. During the year under review it has increased by Rs.31.01 from 74.22 to 105.23.



### 3. Accountability and Good Governance

#### 3.1 Sustainable Development Goals

##### Audit Issue

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.

##### Management Comment

Sri Lankan has identified the need to accelerate the progress towards development goals the achievement of the SDGs and demonstrated its commitment and support by executing many worthwhile projects over years. Sri Lankan has conducted number of projects in relation Good Health and Well-being, Quality Education and Clean Water and Sanitation. This has been incorporated to the updated Business plan.

##### Recommendation

The sustainable development goals and targets should be identified by the Management as per the SDG goals and evaluated as per criteria established.