Mihin Lanka (Private) Limited - 2016

The audit of the financial statements of the Mihin Lanka (Private) Limited ("the Company") for the year ended 31 March 2016 comprising the statement of financial position as at 31 March 2016 and the income statement and statement of comprehensive income, statement of changes in equity and cash flow 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. To carry out this audit, I was assisted by a firm of Chartered Accountants in public practice.

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 Mihin Lanka (Private) Limited as at 31 March 2016, and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

2.2 Emphasis of Matter

I draw attention to Note No.03 to the financial statements, which describes that the Government of Sri Lanka has taken a decision to cease operations of the Company with effect from 30 October 2016. Therefore, these financial statements have been prepared on a break-up basis. My opinion is not qualified in respect of this matter.

2.3 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 had been kept by the Company, and
- the financial statements of the Company comply with the requirements of Section 151 of the Companies Act 07 of 2007.

2.4 Comments on Financial Statements

2.4.1 Going Concern of the Company

The following observations are made.

(a) The Company had recorded a loss of Rs.1,252 million with an accumulated loss of Rs.17,274 million during the year under review. Further, current liabilities of the Company had exceeded its current assets by Rs.2,826 million and the net assets of the Company as at 31 March 2016 shown a negative figure of Rs.2,797 million. Therefore, the liability of the Company to continue as a going concern without the financial assistance from the General Treasury and other financial institutions is in doubtful.

(b) Bank loan facilities of Rs.3,300 million and US dollars 10 million had been obtained from the Government banks for the settlement of creditors and dues to employees. Those facilities had been underwritten by the Government of Sri Lanka, through the Ministry of Finance.

2.4.2 Comply with Sri Lanka Accounting Standards (LKAS)

The following observations are made.

(a) **LKAS 01 – Presentation of Financial Statements:** An asset account with a debit balance of Rs.231,375,026 and a liability account with a credit balance of Rs.1,167,446,104 had been offset in the financial statements of the year under review, although it is not permitted do so.

(b) **LKAS 16 – Property, Plant and Equipment:** An assessment of the useful life and the residual value had not been performed at the end of year under review on the fully depreciated assets costing Rs.106,012,297 which are still used by the Company.

(c) **LKAS 19 – Employee Benefits:** An actuarial valuation had not been conducted by a qualified valuer on defined benefit obligation of the Company. As a result, the provision for gratuity as at 31 March 2016 had been overstated by Rs.80,315,098.

(d) **LKAS 21- The Effects of Changes in Foreign Exchange Rates**: The Company has to use the spot rate for its foreign exchange transactions. If the rates approximate the actual rate, it is allowed to use an average rate for all transactions. However, it was observed that the Company had used two different rates to recognize the revenue and expenditure until December 2015. In addition, some of the transactions had been converted by using inappropriate exchange rates.

2.4.3 Accounts Receivable and Payable

Receivables amounting to Rs.7,425,000 had been remained in the accounts without being recovered for more than five years, while an outstanding payable balance amounting to Rs.60,569,624 had been shown in the accounts without being settled for more than ten years.

2.4.4 Lack of Evidence for Audit

Confirmations for security deposits of Rs.25,605,758 and verification details relating to fixed assets totaling Rs.152,576,764 had not been made available for audit although they were called for.

2.5 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
Public Enterprises Circular No.PED/12 dated 02 June 2003 on Public Enterprises Guidelines for Good Governance	
(i) Section 7.3	Guidelines on Tender Procedures are mandatory for all separate 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, General Treasury had not been obtained.
(ii) Section 7.4.5	Annual Board of Survey and Special Boards of Survey had not been appointed to carry out verification of 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 Results

According to the financial statements presented, the operations of the Company had resulted in a pre-tax net loss of Rs.1,252 million for the year under review as compared with the corresponding pre-tax net loss of Rs.1,381 million in the preceding year, thus indicating an improvement of Rs.129 million in the financial result for the year under review. Decrease of finance cost by Rs.141 million in the year under review was the main reason attributed for this improvement in the financial results.

3.2 Value Addition of the Company

The value addition of the Company for the year under review was negative of Rs.252 million after taking into account the employee remuneration, depreciation and amortization of Rs.888 million, Rs.13 million and Rs. 42 million respectively and this negative value addition had improved by Rs.413 million in the year under review as compared with the previous year negative value addition of Rs. 665 million.

3.3 Analytical Financial Review

The following observations are made.

(a) Although the gross profit margin for the year under review was 1.84 per cent, the net profit margin was negative 10.25 per cent. Significant increase in selling and marketing expenses had mainly attributed for the net loss incurred during the year under review.

(b) The debt equity ratio as at the end of the year under review was negative 363 per cent, due to negative net worth of the Company. This indicates that the creditors are not protected in case of insolvency in the normal course of business.

(c) In addition to the adverse debt equity ratio, the current ratio was 0.72:1, thus indicates the adverse liquidity (working capital) position of the Company.

(d) The debt collection period for the year under review was 39 days while it was 41 days in the preceding year. Hence, there was a slight improvement in debt collections.

4. Operating Review

4.1 Performance

According to the Articles of Association of the Company the primary objectives are; to carryon business as a local and international airline or air transport undertaking and to operate air transport services for passengers and cargo.

The following observations are made in achieving the above objectives during the year under review.

(a) The expected targets to be achieved during the year under review had not been set out by the Company. However, according to the information made available for audit, some actual progress of the Company are summarized and given below.

Key Performance Indicators (KPIs)	2015/16	2014/15	2013/14	2012/13	2011/12
Passenger Capacity (ASK Millions)	1,822	1,675	1,850	1,395	1,102
Passengers Carried (RPK Millions)	1,363	1,216	1,404	1,050	797
Overall Capacity (ATK Millions)	208		-	Not available -	110
Overall Load Carried (RTK Millions)	148			-	Not available -
Passenger Load Factor (%)	75	73	76	75	72
Passengers Carried (in thousands)	595	463	511	401	351
Cargo Carried (Tonnes)	4,764	3,435	3,134	2,504	1,808

(b) Passenger revenue, excess baggage revenue and cargo revenue had increased by 16 per cent, 32 per cent and 41 per cent respectively as compared with the preceding year. This was mainly due to introduction of four new stations namely MCT (Muscat), MAA (Chennai), CCU (Kolkata) & MLE (Male) and improvement in flight frequencies related to Dhaka station.

4.2 Budgetary Control

Significant variances were observed between the budgeted and actual income and expenditure thus, indicating that the budget had not been made use of as an effective instrument of management control.

4.3 Human Resources Management

Total number of employees of the Company as at 01 October 2016 was 302. After the decision taken by the Government of Sri Lanka to cease the operations of the Company, Sri Lankan Airlines Limited had recruited 125 employees of them and 168 employees had retired voluntarily by paying a sum of Rs.165.22 million as compensation. Further, 02 employees are still working at the Company and the contracts with 07 consultants had ended on 31 December 2016. However, 06 employees who retired under the Voluntary Retirement Scheme (VRS) had reattached to the service for a period of six month from 01 January 2017 to 30 June 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.

	Control Area	Observations
(a)	Assets Management	- Board of Survey/Verification of Assets not performed. - Assets not coding.
(b)	Accounting	- Lack of controls over approval process of the journal entries. - Un-reconciled accounts / records. - Non-compliance with Sri Lanka Accounting Standards.
(c)	Accounts Receivable and Payable	Long outstanding receivables and payables.
(d)	Planning and Controlling	Unrealistic budgetary targets.