## Sri Lankan Airlines Limited – 2016/2017

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The audit of the financial statements of the Sri Lankan Airlines Limited ("The Company") and consolidated financial statements of the Company and its subsidiaries ("Group") for the year ended 31 March 2017 comprising the statement of financial position as at 31 March 2017 and the statement of profit and loss and other 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. This report is issued in terms of Article 154(6) 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. The financial statements of the subsidiary were audited by a firm of Chartered Accountants in public practice.

### 1.2 Board's Responsibility for the Financial Statements

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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

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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

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### 2.1 Opinion

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In my opinion, the consolidated financial statements give a true and fair view of the financial position of the Group 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.

**Emphasis of Matter**

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I draw attention to Note 3 to the consolidated financial statements, which indicates that the Group incurred a net loss of Rs. 28,339.51 Million during the year ended 31 March 2017 and, as of that date, the Group's current liabilities exceeded its current assets and total liabilities exceeded its total assets by Rs. 91,904.32 Million and Rs.107,793.52 Million respectively. As stated in Note 3, these events and conditions, along with other matters as set forth in Note 3, indicate that a material uncertainty exists 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 18 July 2017 as notified by letter dated 26 July 2017 confirming the support of the Government of Sri Lanka (GOSL) to the Company to continue its operations as a "Going Concern" based on the letter issued by the Secretary to the Treasury on 23 December 2016, these financial statements have been prepared using going concern assumption. My opinion is not modified in respect of this matter.

#### 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 following:

(a) The basis of opinion, 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,

- The financial statements of the Company give a true and fair view of the financial position 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.

- The financial statements of the Company and the Group comply with the requirements of Sections 151 and 153 of the Companies Act No.07 of 2007.

## 2.2 Comments on Financial Statements

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### 2.2.1 Going Concern of the Company

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The following observations are made.

(a) Due to unfavourable financial position, the Company had issued international bonds of US Dollars 175 million with interest at 5.30 per cent per annual interest in the year 2014 and fully backed by a Government Guarantee until June 2019.

(b) Bank loan facilities of USD 150 million (approximately equivalent to Rs. 22,725 million) had been obtained from government banks as a short term loan during the year under review.

### 2.2.2 Sri Lanka Accounting Standards (LKAS)

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As per the paragraph 88 of the Sri Lanka Accounting Standard on Financial Instrument recognition and Measurement (LKAS) 39, Company had not prepared a detailed forecast of the hedge cash flows and had not monitored the effectiveness of the same on an ongoing basis. Further, management had failed to attribute the movement in the foreign exchange reserve as foreign exchange gains/ losses realized and unrealized during the year and present appropriately in the financial statements.

### 2.2.3 Accounting Deficiencies

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

### 2.2.4 Unexplained Differences

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The following observations are made.

(a) As per the general ledger, the Ground handling revenue for the year was Rs. 8,998,423,082 and as per the schedule it was Rs. 8,989,331,409. Hence, there was a difference of Rs. 9,091,673 between two balances.

(b) There was an un-reconciled difference of Rs. 67,398,195 in inventory balance shown in the General Ledger (Oracle) and inventory module in AuRA system.

(c) There was a difference of Rs. 7,874,346 in maintenance reserve balance shown in the schedules and audit balance confirmations.

## 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 |
|---|---|
| Public Enterprises Circular No. PED/12 dated 02 June 2003 on Public Enterprises Guidelines for Good Governance | |
| (i) Section 7.4.5 | The company had not carried out Annual Board of Survey to verify the assets of the Company. |
| (ii) 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. |
| (iii) 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. 28,930 million for the year under review as compared with the corresponding loss of Rs. 12,622 million in the preceding year. Thus indicating an increase of Rs. 16,308 million in the financial result of year under review. Reason for the increase is mainly due to the payment of cancellation fee of three A350-900 aircraft lease agreement cost of Rs. **14,362.81** million (USD 98 million) for the year under review.

Details of the Value addition of the Company from the year 2012/2013 to 2016/2017 are given below.

| Description | 2016/2017 | 2015/2016 | 2014/2015 | 2013/2014 | 2012/2013 |
|---|---|---|---|---|---|
| | **Rs.Mn** | **Rs.Mn** | **Rs.Mn** | **Rs.Mn** | **Rs.Mn** |
| Loss after Tax | (28,929.99) | (12,621.69) | (16,494.66) | (32,408.34) | (26,088.57) |
| **Add :-** | | | | | |
| Employee Remuneration (Excluding crew cost) | 18,797.05 | 10,693.32 | 9,213.90 | 8,352.93 | 7,938.49 |
| Tax paid to Government | | | | | |
| ESC & NBT | | | | | Exempted |
| VAT | - | 61.14 | 103.88 | 74.63 | 76.21 |
| Stamp duty | - | 2.19 | 0.84 | 23.23 | Nil |
| Other Duties – NR Tax | - | 20.23 | 12.56 | Nil | Nil |
| Franchise fees to Airport Aviation | 383.59 | | | | |
| Supply of capital as interest | (6,922.92) | | | | |
| Depreciation | 2,041.63 | 2,683.91 | 2,275.98 | 1,602.79 | 1,187.02 |
| **Total** | **(14,630.64)** | **839.11** | **(4,887.51)** | **(22,354.76)** | **(16,886.85)** |

Value addition of the Company had decreased by Rs. 15,469.75 million in the year under review mainly due to increase in loss after tax. As a result of increase in compensation for cancellation of Aircraft Lease Agreement by Rs. **11,801.26** million, loss after tax had been increased by Rs. 16,308.3 million during the year under review.

## 3.2 Analytical Financial Review

Important ratios are given below.

| | 2016/2017 | 2015/2016 | 2014/2015 | 2013/2014 | 2012/2013 |
|---|---|---|---|---|---|
| Current Assets to Current Liabilities(Number of Turns) | 0.21 | 0.27 | 0.48 | 0.42 | 0.77 |
| Percentage of Net Loss to Revenue | 21 | 09 | 13 | 27 | 22 |
| Increase / (Decrease) percentage in Revenue | 4.6 | (02) | 09 | 02 | 29 |
| Overall Yield (Net traffic revenue to Revenue Ton Kilometres) (Rs.) | 80.08 | 79.06 | 80.32 | 77.26 | 74.31 |
| Unit Cost (Rs.) | 64.79 | 59.72 | 61.88 | 64.96 | 64.68 |
| Breakeven Load Factor (%) | 80.91 | 75.54 | 77.03 | 84.07 | 87.03 |
| Revenue per Revenue Passenger Kilometre (Rs.) | 8.4 | 8.2 | 8.2 | 7.8 | 7.6 |

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) Although the percentage of Net Loss to Revenue of the Company had decreased from the year 2013/2014 to 2015/2016, It had changed by showing increase of the 12 per cent in the year under review.

(c) Overall Yield of the Company had increased gradually from the year 2012/2013 to 2014/2015, and also it had increased in the year under review by 1.02 comparing to the preceding year. (Net traffic revenue to Revenue Ton Kilometers - Rs.)

(d) The unit cost had increased of Rs. 5.07 in the year under review when compared with the preceding year.

## 4 Management Inefficiencies

The following observations are made.

(a) Company had granted credit facilities for two parties without due approvals and guaranties. Further, outstanding balances of few debtors had exceeded bank guarantee limits which lead to non-recoverability of debtor balances in the event of default by the customers.

(b) Management had not taken actions to renew the agreements in overseas stations on a timely basis to avoid disputes.

(c) The Company had not documented policy frame work for calculation of major maintenance cost of Aircrafts.

(d) The Company had incurred an expense with a net value of Rs. 70 million approximately in respect of deportee expense. This expense consisted of controllable cost which was incurred due to the maladministration of the check in staff and as a result, the passengers had to be reported back to Sri Lanka after rejection by the travel country's authorities due to various short falls of the travel documents.

(e) Due to the erroneous classification of inventory items amounting to Rs. 19,097,367 had been reclassified as property plant and equipment and amounting to Rs. 1,529,966 reclassified vice versa without due approval and coordination with finance division during the year under review. Therefore ordinary approval process of purchasing Property Plant & Equipment could be violated and depreciation charges could be under/over value.

(f) The Company had not placed a formal policy to review the level of slow moving and obsolete stocks periodically and make adequate provisions. The general provision was made providing one per cent after deducting specific provisions. However, during the year under review provision had been made equivalent to the 20.9 per cent for routable item and 16 per cent for general inventory based on a policy paper.

## 5 Operational Review

### 5.1 Performance

As per the Articles of Association, the objectives of the Company are summarized below.

(a) Operating international scheduled, non-scheduled air services for the carriage of passengers, freight and mail as the designated carrier of Sri Lanka

(b) Providing Air Terminal services at Bandaranaike International Airport (BIA) and Mattala Rajapaksa International Airport (MRIA)

(c) Sale of duty free goods on-board

(d) Marketing inbound and outbound holiday packages constitute other main activities

(e) Providing third party aircraft maintenance

(f) Flight operation services

(g) Conducting aviation related trainings constitute ancillary activities of the Company.

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

| **KPI** | **2016/2017** | **2015/2016** | **2014/2015** | **2013/2014** | **2012/2013** |
| --- | --- | --- | --- | --- | --- |
| Passenger Capacity (ASK Millions) | 15,608.10 | 15,790.28 | 16,180.27 | 15,780.54 | 15,944.31 |
| Passengers Carried (RPK Millions) | 12,455.05 | 12,727.66 | 12,963.71 | 12,810.95 | 12,968.74 |
| Passenger Load Factor (%) | 79.80 | 80.60 | 80.12 | 81.18 | 81.34 |
| Overall Capacity (ATK Millions) | 2,167.92 | 2,165.21 | 2,224.87 | 2,187.18 | 2,186.96 |
| Overall Load Carried (RTK Millions) | 1,475.29 | 1,484.77 | 1,519.93 | 1,466.74 | 1,513.70 |
| Overall Load Factor (%) | 68.05 | 68.57 | 68.32 | 67.06 | 69.22 |
| Passengers Carried (Nos. Thousands) | 4,446 | 4,328 | 4,348 | 4,175 | 4,255 |
| Cargo Carried (Tonnes) | 116,221 | 102,082 | 101,878 | 94,410 | 101,100 |
| Aircraft in service at year end | 24 | 21 | 21 | 21 | 22 |
| Aircraft Utilization (Blk Hrs per day) | 12.44 | 12.02 | 12.90 | 12.76 | 12.82 |

The following observations are made.

(a) Passenger Capacity and Passengers carried had decreased by 182.18 ASK millions and 272.61 RPK millions respectively during the year under review; also, Passenger Load Factor had decreased by 0.8 per cent.

(b) Although Overall Capacity had increased by 2.71 ATK million and Overall Load Carried had decreased by 9.48 RTK millions respectively during the year under review, Overall Load Factor had decreased by 0.52 per cent.

(c) Aircrafts in service had increased in the year under review by 3 and aircraft utilization had increased by 0.42 (Blk Hrs per day) compared with the preceding year.

(d) It was observed that there were significant delays in the charter flight schedule and actual operations in fine instances reason for delays cannot be ascertained due to lack of documentation.

## 5.3 Air Lanka (Private) Limited

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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. Following observations are made on it.

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

(b) Financial statements of Air Lanka (Private) Limited had not been prepared up to 31 March 2015. Further, financial statements for the year ended 31 March 2016 and 2017 had been prepared and submitted to audit on 19 January 2018.

(c) As per the answer of the Chairman, the purpose for continuation of this subsidiary is to protector the name of Air Lanka.

## 5.4 Identified Losses

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The following observations are made.

(a) Due to the cancellation of Lease Agreement relating to one A – 350 Aircrafts, the Company had incurred a loss of Rs. 14,362.81 million during the year under review.

(b) The Company had entered into a termination agreement on 04 October 2016 with a Lessor to cancel three A-350 aircrafts which were scheduled to be delivered during the third quarter of 2016/2017. As a result, the Company had to pay US Dollars 90.5 million in installments from October 2016 to June 2017 and also audit revealed that the security deposit already paid for aircrafts amounted to US Dollars 7.5 million could not be recovered.

(c) Inventories worth Rs. 1,860,917 had been misplaced and provision had been made in the accounts during the year under review. Those items had lost after issuing to the Pakistan International Air ways for the maintenance activities of Air crafts given under the wet lease agreement. Further company had not implemented a proper procedure to document the inventories which were issued to outside from the main where house.

## 5.5 Human Resource Management

The Board approved cadre and actual cadre position of the Company as at 31 March 2017 is given below.

| Service Category | Approved Cadre | Actual Cadre | Excess Cadre |
|---|---|---|---|
| Executives | 1,365 | 1,299 | 66 |
| Supervisors/Technical Officers/Salesman | 1,297 | 1,224 | 73 |
| Clerical and Allied | 2,152 | 1,998 | 154 |
| Skilled and Semi-skilled Workers | 1,737 | 1,620 | 117 |
| Minor employees and unskilled | 911 | 844 | 67 |
| Trainees | 75 | 36 | 39 |
| **Total** | **7,537** | **7,021** | **516** |

(a) Some of the important figures and ratios on staff performance are given below.

| Description | 2016/2017 | 2015/2016 | 2014/2015 | 2013/2014 | 2012/2013 |
|---|---|---|---|---|---|
| No of Employees | 7,021 | 6,959 | 6,987 | 6,578 | 6,359 |
| Revenue per employee (Rs.) | 19,294,059 | 18,606,181 | 18,881,084 | 18,483,708 | 18,803,412 |
| Capacity per employee (Tonne–km) | 308,776 | 311,139 | 318,430 | 332,499 | 343,916 |
| Load carried per employee (Tonne-km) | 210,126 | 213,359 | 217,537 | 222,976 | 238,041 |

(i) Average strength of the staff had increased gradually during the last five years.

(ii) Capacity and load carried per employee had decreased gradually from the year 2012/2013 up to the year under review.

(b) **Privilege Air Tickets issued to Staff**

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The following observations are made.

(i) Details pertaining to cost of air tickets issued to Board of directors on privilege basis during the year under review had not been made available for audit though the audit has called information in several times.

(ii) Twelve thousand six hundred and seven (12,607) privilege air tickets valued for Rs. 12,293,324 had been issued concessional basis for two thousand nine hundred three (2,903) employees of the Company during the year under review.

## 6. Systems and Controls

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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.

| | Areas of systems and control | Observations |
|---|---|---|
| (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.<br>(ii) Weak procedures for inventory movements.<br>(iii) Inventory modules had not been updated to timely basis. |
| (c) | Information Technology | (i) Limitation for including decimal quantities of inventory items in the engineering division.<br>(ii) Ground Handling system was not linked to the Rapid system |