

Sri Lankan Airlines Limited – 2021/2022

1. Financial Statements

1.1 Opinion

The audit of the consolidated financial statements of the Sri Lankan Airlines Limited (“Company”) and its subsidiaries (“Group”) for the year ended 31 March 2022 comprising the statement of financial position as at 31 March 2022 and the statement of 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 the 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 2022, 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) Materiality Uncertainty Related to Going Concern

I draw attention to Note 2.1 and Note 3 to the financial statements, which describes the continuing impacts of the COVID-19 pandemic and events/ conditions related to going concern, respectively.

Note 2.1 to the financial statements describes the continuing impact of COVID-19 pandemic on Group’s/ Company’s performance and cash flows.

Note 3 to the financial statements discloses that the Group incurred a net loss of Rs.163,583 million during the year ended 31 March 2022 with an accumulated loss of Rs.529,213 million and, as of that date, the Group’s current liabilities exceeded its current assets by Rs.292,420 million and total liabilities exceeded its total assets by Rs.426,424 million. Further, Company incurred a net loss of Rs.166,370 million during the year ended 31 March 2022 with an accumulated loss of Rs.537,505 million and, as of that date, the Company’s current liabilities exceeded its current assets by Rs.302,703 million and total liabilities exceeded its total assets by Rs.437,037 million.

Having taken into account the mitigating factors disclosed in Note 3 along with the Cabinet approval on 25 October 2022 and the letter issued by the Secretary to the Treasury on 08 November 2022 obtained

confirming the support of the Government of Sri Lanka (GOSL) to the Company to continue its operations as a “Going Concern” until the entity is restructured, these financial statements have been prepared using the going concern assumption. The GOSL by way of a cabinet decision dated 28 November 2022, has approved the fleet replacement exercise for no more than ten aircraft via replacement aircraft, lease extension of existing aircrafts or a combination of both.

However, based on the best available information as of this report, the existence of such events or conditions, along with other matters as set forth in Note 3, indicate that a material uncertainty exists that may cast significant doubt on the Company’s and the Group’s ability to continue as a going concern assumption.

(b) Aircraft Pre delivery Payments

I draw attention to Note 11 to the financial statements, relating to the aircraft pre-delivery payments as at 31 March 2022 amounting to Rs.5,649 million (USD 19.21 million). 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 unfavourable to the Company.

However, in the absence of a settlement, recovery is dependent upon the outcome of the on going dispute resolution mechanism, and we have not been made aware of any additional information that contradicts with the Company’s assumption on the recoverability of the said pre-delivery payments up to the date of this report.

(c) Events Occurring After the Reporting Date

I draw attention to Note 27.3 to the financial statements, relating to the international bond default.

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 Company’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 intend to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company’s financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Company is 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.

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 Audit Observations on the preparation of 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. Issues with regard to maintenance of key accounting records such as General Ledger, Journal and Journal vouchers, payment vouchers etc. may include under this heading.

Audit Issue	Management Comment	Recommendation
(a) The company had not performed any privileged user account monitoring function for application, database and operating system levels of Aura, Finess, FMIS, Oracle, Rapid, Sabre, Skychain and AIMS systems during the financial period.	Agreed on the concept of Privileged User Account monitoring. The airline is yet to deploy a Privilege Access Management solution. This is planned in FY 2023/24 Q4. In the meantime, SIEM is collecting logs of all applications hosted on-premise. SaaS providers are sharing logs only on a request basis and are not connected with SIEM. Also, Rapid, Sabre, SkyChain, and AIMS applications are now been migrated to cloud environments.	Establishing a privileged user account monitoring function would facilitate the investigation of security breaches, program change deployments and user activities done using privileged user accounts. The company should conduct the privileged user account monitoring function periodically to ensure that only authorized activities are performed in the IT environment. Further, the company should ensure adequate security monitoring controls are available for third party

activities associated with privileged access management procedures.

(b) User accounts of resigned employees in the selected samples as at 31 March 2022 were not deactivated and remained active in Aura, Finess and Skychain systems after their respective resignation dates. Inadequate user account deactivation procedures over timely deactivation of user accounts of resigned employees could result in significant issues when allocating responsibilities for business transactions. It was further observed that user accounts of resigned employees were not deactivated on timely basis.

All the users indicated have resigned and according to ITSD records their Active Directory accounts have been already removed or deactivated at the time of receiving the account deactivation request from HR. Therefore, User Access to applications will be automatically disabled as it is necessary to users to authenticate with AD prior to accessing application accounts.

Clearance process has also been introduced since the report to ensure the timely clearance of application accounts.

It is important to promptly remove access to the company's applications from the employees who have resigned and deactivate the user accounts of resigned employees on their respective dates of resignation, at the end of the business day.

(c) Data fields such as deactivation date, last login date, creation date and user status in selected sample were not captured in the system generated user lists of Aura, Finess, FMIS, Rapid, Sabre, Skychain and AIMS systems which were collected during the audit. In order to verify adequate user account creation procedures, it is essential to maintain the user Creation Date in the system generated user lists. Due to the absence of Deactivation Date, management may not be able to verify the timely deactivation of the user accounts. Without the Last Login Date, in case of

Aura/Skychain/Rapid systems are currently in the process of getting replaced. New solution includes all recommended features.

Finesse – A change request has been initiated to modify the system as per the audit recommendations.

Finesse system agreement is expired and system is on extended support. RFP will be released for a new GH billing application to replace Finesse, recommended features will be considered in the new solution.

AIMS & Sabre Systems are

Information maintained in the system generated user lists, in addition to those currently present, data fields such as Creation Date, Deactivation Date, Last Login Date, User Status (Active/Inactive) should be addressed to mitigate the risks.

a discrepancy, management may not be able to verify the Last Login Date to the system by users. Further, without the user status it would be difficult to verify the current user account status of users in the system.

(d) Generic user accounts exist in AIMS system, as at 31 March 2022, user accounts in the sample selected are not assigned to any employee numbers and the user account names are created and maintained with generic names. Further, the company is using a practice of sharing these user accounts commonly within the departments as well. Availability of generic user accounts and the practice of sharing user accounts could result in significant issues when allocating responsibilities for business transactions.

(e) Non-utilized user accounts exist in Oracle system, at the time of our review, as at 31 March 2022, since users in the sample selected had not logged into Oracle system during the financial period. The presence of non-utilized active user accounts within a system significantly increases the

vendor hosted solutions and there are two levels of access controls build into the system for. Access logs are available in different formats.

FMIS is an inhouse developed system which also has system logs.

AIMS system is hosted in the cloud and SriLankan consumes it as a SaaS (Software-as-a-Service) product.

Access to AIMS is through a multi-layered mechanism. First layer ensures remote access to AIMS platform whilst the second layer provides access to the system.

There are shared accounts to access AIMS platform and dedicated accounts to access AIMS system. There are limited accounts provided for the whole company due to the cost and the system capacity. The accounts have been shared among specific teams whilst maintaining security and all activities have been recorded and monitored.

These user accounts were locked out. But was kept active as the user review came up as account required. (10/19 accounts belongs to alternate approvers.).

Based on the consent from non-approval users to the remaining 9 accounts have

The leading practice is to prohibit the use of generic user accounts and the practice of sharing user accounts among employees to facilitate the investigation of security breaches and also hold the employees responsible for activities performed using their respective user accounts.

It is important to promptly deactivate such user accounts from the applications, since it will help to mitigate the risk of these accounts being misused. The implication of not implementing the above the recommendation, as stated above, should, however, be

chances of an individual gaining unauthorized access to the application. Furthermore, this could result in lack of accountability and misuse of information accessible through these accounts.

been deactivated.

Accounts are deactivated during clearance process or periodic reviews. Most of the identified accounts are belong to approvers who need not to login to the system for approval as they use the workflow emailer yet they need to have an active account.

noted.

- (f) User access rights that are to be granted were not defined in the user account in the sample selected creation documentation for rapid system. Absence of user access rights that are to be granted being defined in the user account creation documentation may result in misallocation of granting user access rights which could lead to misuse of such user accounts for malicious or fraudulent purposes. It is further necessary to grant user access rights to users on a “need to know” and a “need to do” basis.

Both accounts are inactive. Hence no Access rights granted

It is imperative to maintain the information in the user account creation documentation in order to ensure that user access management procedures are adequately executed and documented. The both accounts were created on 08/10/2021 and 17/03/2022 respectively. Therefore, despite the user accounts are been deactivated by now, the observation will prevail and the company should implement the recommendation and implement appropriate actions.

1.7 Accounts Receivable and Payable

1.7.1 Receivables

Audit Issue

According to the information available to the audit, the outstanding trade debtors as at 28 February 2023 was Rs.24,049.5 Mn. Out of that a sum of Rs.2,320.1 Mn has remained over 5 years without being recovered.

Management Comment

All debtors are followed up and relevant action is taken on all outstanding items the main item included in the above 5-year balance. the status of the same are given below. Prompt action had been taken by the

Recommendation

Prompt action should be taken to recover the debtor balance.

management on the continuous follow is ongoing.

1.7.2 Payables

Audit Issue	Management Comment	Recommendation
<p>As per the Financial Statements of the Airport Aviation Service (Sri Lanka) Pvt Ltd (AASL), a sum of Rs.1,303,105,097 had shown as receivable from the Sri Lankan Airlines Limited. However, as per the Financial Statements of Sri Lankan Airlines Limited this amount had not shown as payable to the AASL.</p>	<p>Periodic reconciliations are done to identify any differences and rectify the same. There could be a timing difference in the raising and sending invoices by AASL and approving the same from the respective departments after which only the balance would be appearing on the account's payable module. However, the required provisions are made in the financial statements. Periodic reconciliations are done to identify any differences and rectify the same.</p>	<p>This balance was remained over 5 years. Balances should be checked with the source documents and confirm with the balance due for Airport Aviation Service (Sri Lanka) Pvt Ltd.</p>

1.8 Non-compliance with Laws, Rules, Regulations and Management Decisions etc.

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
<p>(a) Finance Act No.25 of 2003 Section 4(3)</p>	<p>Any operator of an aircraft that fails to pay Embarkation Levy on time to the competent authority shall be deemed in default and interest is calculated on the total amount to be paid. As per the letter No. FN/16/2/24 dated 03 February 2023 issued by the Director General of Civil Aviation Authority, the Sri Lankan Airline Limited should</p>	<p>Company's cash flow was severely impacted due to the pandemic and manage all operations and critical payments from the available cash. Company did not receive any funding from the Treasury since April 2021. Under these circumstances, company was reluctantly compelled to delay these payments to Civil Aviation Authority in Sri Lanka</p>	<p>Embarkation Levy should be paid on due date as per the instruction to avoid the interest thereon.</p>

pay an overdue interest amounting to Rs.449,133,741 for the delayed payments period from 01 January to 31 December 2022. As per the information submitted by the Civil Aviation Authority, a sum of Rs.4,540 million is due as Embarkations Levy and a sum of Rs.122 million is recorded as delayed interest thereon for the period of January to March 2023 had not been paid even as at to date.

(CAASL). However, all efforts are being made to reduce the gap and as of mid-Jun, the pay gap has been reduced to 2 Months.

(b) Direction No. EL/01/2022 issued by the Director General of Civil Aviation Authority on 11 March 2022 Paragraph 05

The exchange rates announced by the Civil Aviation Authority by weekly should be applied for the Embarkation Levy conversion. However, contrary to that the Company had used incorrect exchange rates for the Embarkation Levy conversion and paid accordingly. As a result, Embarkation Levy amounting to Rs.496,424,251 million had been over paid for the period 01 March to 15 July 2022 and the overpaid amount had remained without been recovered even as at 31 March 2023.

The recovery of the excess payment amount had been discussed and agreed upon with CAASL.

The exchange rates announced by competent authority should be applied.

CAASL had requested authority to offset the same against the delay interest payable. However, SLA has requested a waiver of the same from the Min. of Finance hence was not offset against balances due.

(c) The memorandum of understanding (MOU) signed between the Airport

As per the MOU the AASL will continue to provide space already allocated to Sri Lankan

Agreements has not been signed for the 5 Areas covered under MOU. Rent settlements were done

As per the MOU Sri Lankan Airlines Limited and AASL should entered into

and Aviation Service (Sri Lanka) Limited (AASL) and the Sri Lankan Airlines Limited (SLAL) on 29 March 2011, Airlines Limited and both parties should be entered into a lease agreement. However, without signed a lease agreement the lease rent for 5 spaces is being paid by the SLAL to the AASL since year 2011. Another 7 activities and spaces of the AASL is being used and lease rent paid by the SLAL on the awarding letters without signing the lease agreements. according to the terms of the MOU. Other 7 Areas Bulk stores - settlement done based on the offer letter. Caro T-5 – Agreement expired and settlement done based on the offer letter. 5 Office areas occupied later at the Airport Terminal – settlement done based on the offer letters. a lease agreement.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a loss of Rs.163,583 million and the corresponding loss in the preceding year amounted to Rs.49,705 million. Therefore deterioration amounting to Rs.113,878 of the financial result was observed. The reasons for the deterioration are mainly due to the increase in Aircraft fuel cost by Rs.32,190 million and Exchange loss increase by Rs.122,937.

2.2 Trend Analysis of major Income and Expenditure items

	2021/22	2020/21	2019/20	2018/19	Improvement/(Deterioration) 2020/21- 2021/22	
	Rs. Mn	Rs. Mn	Rs. Mn.	Rs. Mn	Rs. Mn	Percentage (%)
Revenue						
– Passenger, Cargo, Excess Baggage & Mail	123,376	43,979	164,744	164,929	79,397	181
– Air Terminal, Duty Free, Non Schedule Services & Flight	9,561	6,715	15,407	15,412	2,846	42
– Other income & gains	699	20,629	3,046	4,223	(19,930)	(97)
Expenditure					Increase/(Decrease)	
Aircraft Fuel Cost	42,759	10,569	55,328	60,673	32,190	305

Aircraft Maintenance and Overhaul Costs	23,088	13,695	22,820	26,333	9,393	69
Depreciation/Amortization	14,188	16,296	1,214	1,349	(2,107)	(13)
Selling Marketing and Advertising Expenses	7,180	2,034	14,541	15,775	5,146	253
Exchange Loss	37,812	6,895	6,119	3,414	30,917	448
Net Finance Cost	129,795	35,148	22,276	10,850	94,647	269

Following observation are made.

- Foreign Exchange loss and Net Finance Cost had increased by Rs.30,917 million and Rs.94,647 million and as a percentage of 448 & 269 respectively in the year under review comparing with the preceding year due to finance charges and exchange loss on lease liabilities with the adoption of SLFRS 16.
- Except net finance cost & exchange loss other expenses had increased from 12 percent to 304 percent compared to the previous year.
- Other income and gains had decreased by 96 percent due to decrease in dividend from Sri Lankan Catering by 48 percent.

2.3 Ratio Analysis

	2021/22	2020/21	2019/20	2018/19	2017/18	2016/17
Current Assets to Current Liabilities(Number of Turns)	0.15	0.13	0.13	0.18	0.23	0.21
Percentage of Net Loss to Revenue	125.15	89	26	24	11	21
Increase / (Decrease) percentage in Revenue	162.23	(72)	(0.1)	11.7	19.3	4.6

Following observation are made.

- The Current Assets to Current Liabilities Ratio of the Company is 0.21 in 2016/2017 and it has been go down gradually to 0.13 up to 2020/21 and slight increased by 0.02 in the year under review. Thereon it is indicating the weak working capital status of the company.
- Percentage of Net Loss to Revenue had increased in the preceding year by 63 percent and it has increased in the year under review by 46 percent.

3. Operational Review

3.1 Management Inefficiencies

Audit Issue

According to the need assessment of the Sri Lankan Airlines Limited (SLA) 27 aircrafts required and currently operates with the 24 aircraft fleet. Out of that eight aircrafts are out of service as at 20 April 2023 and lease rentals aggregating to Rs.4,956 million had been paid for the out of service of aircrafts for the year 2021 to 20 April 2023.

Management Comment

- Aircrafts ANA, ANB, AND, ANE & ANF were unserviceable due to engine failures and placed on long term storage awaiting serviceable engines. Engine unavailability which is a global issue and the management is currently working on a plan to restore the same to operations. The manufacturer has agreed to provide spare engines until the original engines are repaired.
- ABQ was on lease return check and both engines identified with internal failures.
- Aircraft ALH inducted for the pre-planned mandatory heavy maintenance check on 18th Oct 2022 and released to operation on 06th April 2023.
- Aircraft ALN was inducted for pre-planned mandatory heavy maintenance check on 02nd March 2023 and release to operation on 20th April 2023.

Recommendation

Action should be taken to expedite the maintenance process.

4. Accountability and Good Governance

4.1 Corporate Plan

Audit Issue

As per the Chapter 2.3 of the Guidelines on Corporate Governance for State Owned Enterprises dated 16 November 2021, the strategic plan shall be updated each year (Rolling Plan) in line with the changes in the business environment shall be submitted to the General Treasury, not later than 15 days before the commencement of the ensuing year. However, the Company had not prepared the strategic plan covering the year 2022/23.

Management Comment

Based on the study of the SOE Restructuring Unit, the GOSL at a Cabinet meeting held on 13 March 2023 has approved in principle the divestment of SLA including SLC.

Accordingly, the management has been instructed by the Ministry of Finance to refrain from entering into any material business transactions which may negatively impact the divestment.

Considering the above a business plan was not updated last year. This was also explained to the COPE committee at the meeting. The current plan is to manage the airline in a profitable manner until the restructuring /privatization process is complete.

Recommendation

The strategic plan should be updated as per circular with the restructuring plan.

4.2 Annual Action Plan

Audit Issue

- (a) Although the Action Plan should clearly identify the financial and physical targets, the Action Plan prepared for the year 2021/2022 had not covered such targets.
- (b) The continuation programs had identified in the Action Plan prepared and submitted to the Line Ministry and these programmes had not been identified in the Action Plan prepared for the Company.

Management Comment

Though this has not been included in the initial document subsequently the same has been incorporated based on the format provided by the line ministry.

Though the same is not specifically mentioned in the budget presentation submitted to the board same is included in the plan, will include as a separate item from 2024/25.

Recommendation

The action plan should be prepared as per Guidelines on Corporate Governance for State Owned Enterprises introduced by Public Enterprise Circular No. 01/2021 dated 16 November 2021.

The continuation programs had identified in both Action Plan

4.3 Risk Committee

Audit Issue

According to the Chapter 4.3 of Public Enterprise Circular No; 01/2021 and dated 16 November 2021, Risk Committee should be appointed and met quarterly to identify and assess the risk that could have an impact on the business of the operation. However, only one committee meeting had been conducted during November 2021 to March 2023.

Management Comment

On 13th December 2021, the Board appointed the members of the BRC. On 28 January 2022 the Board having perused the draft TOR prepared by the Company Secretary, recommended that a Consulting firm. In June 2022 Board's guidance was sought on the appointment of a risk officer to carry out the function of ERM; where upon the recommendation of the CEO, the Board decided to postpone the 2 decision of appointing a Risk Officer and, conducting BRC meetings until September 2022 for reviewing, owing to the on-going fuel and financial crisis faced the GoSL. Thereafter with Board resignations and delay in appointing new members to the Board and its subcommittees, the holding of the inaugural meeting of the BRC delayed.

Recommendation

Risk Committee should be appointed and met quarterly as per the circular.