Sri Lankan Airlines Limited and its Subsidiaries -2019

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 2020 comprising the statement of financial position as at 31 March 2020 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 2020, and of their financial performance and their cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Emphasis of Matter

(a) Material Uncertainty Related to Going Concern

I draw attention to Note 3, which indicates that the Company incurred a net loss of Rs.47,197.86 million during the year ended 31 March 2020 with an accumulated loss of Rs.326,341.48 million and, as of that date, the Company's current liabilities exceeded its current assets by Rs.211,645.13 million and total liabilities exceeded its total assets by Rs.273,369.08 million. Further, the Group incurred a net loss of Rs.44,139.40 million during the year ended 31 March 2020 with an accumulated loss of Rs.316,477.65 million and, as of that date, the Group's current liabilities exceeded its current assets by Rs.200,878.32 million and total liabilities exceeded its total assets by Rs.261,173.54 million.

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/ the Company's ability to continue as a going concern.

Following the spread of COVID-19 in the country, the Group/ the Company is facing implications including loss of Group's/ Company's revenue due to government imposition of travelling restrictions, delays in settlements and credit and liquidity risks.

Note 2.1 to the Financial Statements, describes the impact of COVID-19 outbreak on Group's/ Company's 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 on 17 June 2020 and the letter issued by the Secretary to the Treasury on 29 June 2020 obtained for the purpose of the statutory audit for the year ended 31 March 2020, 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.

(b) A350-900 Aircrafts Pre-delivery Payments

I draw attention to Note 6, which indicates that the pre-delivery payments as at 31 March 2020 consists of pre-delivery payments made for four Airbus A350-900 aircrafts to be delivered in 2020 and 2021 amounting to Rs. 2,528.12 million (USD 19.21 million) and as at 31 March 2020 there is an amount of USD 207.89 million as unpaid pre-delivery payments to Airbus.

As stated in Note 6, the Company has been in discussion with Airbus for a renegotiation of the agreement and therefore the Board does not anticipate a loss of pre-delivery payments or penalties arising from renegotiation. However, no decision had been taken even by 30 July 2020.

My opinion is not modified in respect of these matters.

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 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.

1.4 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.

- 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.

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.

1.5 Financial Statements

1.5.1 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.

1.5.2 Un-reconciled Control Accounts or Records

Audit Issue	Management Comment	Recommendation
As per LKAS 21- Effects of Changes in Foreign Exchange Rates, non-monetary assets acquired in foreign currency are to be translated to the reporting currency at the rate of prevailing at the date of transaction and to be maintained at the historical rate thereafter. However, the Aura system automatically values the inventory based on the exchange rate at the PO date instead of the date of transferred risk and rewards (GRN Date). Therefore, it was observed a	This is not possible to be implemented, as Engineering ERP is not replaced. The process of the planned ERP implementation to be completed in September 2022 was cancelled due to the financial constraints of the company. Currently a new RFP is being evaluated. As an interim solution, the reconciliation process has been improved to identify and	The Aura system should be developed to use the GRN date for inventory valuation.

difference of Rs.87,724,205 between the General Ledger and the Inventory system(Aura) from last year. Further, the Company had mentioned that reconciliation process had been improved. However system had not yet been implemented.	rectify new differences. Therefore, there is no movement in the difference from March 2019.

1.5.3 Unauthorized Transactions

Description of unauthorized transaction	Management Comment	Recommendation
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. Meanwhile, 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. 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.	This does not relate to the current financial year and was done in 2013 with the approval of the Board of Directors in 2013. 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.	Detailed and realistic cost benefit analysis should be done before carrying out such investment and approval of the Cabinet should be obtained and also 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.

1.5.4 Going Concern of the Organization

The following observations are made.

	Audit Issue	Management Comment	Recommendation
(a)	Bank loan facilities of USD 200 million (approximately equivalent to Rs.37,960 million) and Rupee loans of Rs.26,250 million had been obtained from government banks during the year 2017/18 increasing the indebtedness of the Company. During the year under review interest of USD14.63 million (approximately equivalent to Rs.2,776.77 million) had been paid for the USD 200 loans. No any capital payment had been done to date.	The company has been under capitalized, and the Treasury has obtained Cabinet approval to recapitalize the company upto USD 500 Mn during the period 2020-2022. The first tranche of USD 150Mn equivalent in LKR bonds was received on 18th Nov 2020. The repayment of the facilities obtained from the two state banks will form part of the overall restructuring of the company and due to the severe impact of COVID 19 on the operations, the repayment will have to be delayed until the industry recovers or a refinancing of same is done.	Management should focus on running the business economically and in a profitable way and minimize the indebtness of the Company with the help of shareholders.
(b)	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 only falls in June 2024 and the overall restructuring of SLA will address this.	Management should focus on running the business economical and profitable manner and minimize the indebtness of the Company.

1.6 Accounts Receivable and Payable

1.6.1 Receivables

Audit Issue	Management Comment	Recommendation
The VAT refund amounting to Rs.35,276,585 was outstanding for more than 8 years in	SLA has been constantly following up on the same and several meetings has been held with officers of IRD. The last corresponded has been made on 17	The Management should take necessary action to recover the VAT receivable. Meanwhile, provisions should be made whether any doubt of refund the

Reconciliation of VAT Control Account.	November 2020. However, due to COVID 19 limited operations of IRD has delayed the process and we are unable to meet with officials for finalization.	money.

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

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
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.	The events of 21 April 2019 had a significant impact on the airline. Therefore, the Business Plan was revised, and the revised business plan was approved by the Board on 25 June 2019 and submitted to the Line Ministry for treasury approval on 1 July 2019.	Action should have to be taken to get approved the Corporate plan and the Annual Budget from the line Ministry, Department of Public Enterprises, General Treasury and forward to the Auditor General at least 15 days before the commencement of the financial year.
(ii) Section 9.3.1 (i)	The Scheme of Recruitments and Promotions (SOR) of the Company had not been approved by the Ministry concerned and the concurrence of the General Treasury.	This has been sent to the ministry in 23rd Aug 2019 awaiting concurrence from the ministry.	General Treasury concurrence and the approval of the Ministry should be obtained for the SOR of the Company.

2. Financial Review

2.1 Financial Result

The operating result of the Group amounted to a loss of Rs.44,139.40 million and the Company amounted to a loss of Rs.47,197.86 million for the year under review. The corresponding loss of the Group amounted to Rs.41,700.33 million and the Company amounted to Rs.44,022.67 million in the preceding year. Therefore a deterioration amounting to Rs.2,439.07 million and Rs.3,175.19 million of the financial result was observed in the Group and the Company respectively . The reasons for the deterioration are mainly due to the increase in Exchange loss amounting to Rs.2,704.29 million and the increase in the impact of SLFRS 16 first time adoption on financing activities amounting to Rs.23,349.47 million during the year under review.

2.2 Trend Analysis of major Income and Expenditure items

	2019/20	2018/19	Improvement/(Deterioration)	
	Rs. Mn.	Rs. Mn	Rs. Mn	Percentage (%)
Revenue				
– Passenger, Cargo, Excess Baggage & Mail	164,743.85	164,928.74	(184.89)	(0.11)
– Air Terminal, Duty Free, Non Schedule services & Flight	15,407.17	15,411.58	(4.41)	(0.03)
– Other income & gains	3,046.13	4,222.74	(1,176.61)	(27.86)
Expenditure			**(Increase) / decrease**	
Aircraft Fuel Cost	55,327.75	60,672.78	5,345.03	8.80
Aircraft Maintenance and Overhaul Costs	22,820.26	26,333.09	3,512.83	13.34
Depreciation/Amortization	1,214.05	1,349.28	135.23	10.02
Selling Marketing and Advertising Expenses	14,540.51	15,775.49	1,234.98	7.83
Exchange loss	6,118.51	3,414.22	(2,704.29)	(79.21)
Net Finance cost	22,276.24	10,850.11	(11,426.13)	(105.31)

(a) Foreign Exchange loss and Net Finance Cost had been increased by Rs.2,704.29 million and Rs.11,426.13 million and as a percentage of 79.21 & 105.31 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.

(b) Except net finance cost & exchange loss other expenses have been decrease from 8 percent to 13 percent compared to the previous year.

(c) Other income and gains decreased by 28 percent due to decrease in dividend from Sri Lankan Catering by 48 percent.

2.3 Ratio Analysis

	2019/20	2018/19	2017/18	2016/17	2015/16
Current Assets to Current Liabilities(Number of Turns)	0.13	0.18	0.23	0.21	0.27
Percentage of Net Loss to Revenue	26	24	11	21	10
Increase / (Decrease) percentage in Revenue	0.1	11.7	19.3	4.6	(02)
Overall Yield (Net traffic revenue to Revenue Ton Kilometres) (Rs.)	99.03	91.32	84.24	80.08	79.06
Unit Cost (Rs.)	74.22	74.31	65.74	61.61	58.72
Breakeven Load Factor (%)	74.95	81.37	78.04	76.94	74.27
Revenue per Revenue Passenger Kilometre (Rs.)	10.15	9.43	8.62	8.43	8.17

Following Observations are made

(a) Current Assets to Current Liabilities Ratio of the Company is 0.27 in 2015/16 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 13 percent and it has increased in the year under review by 02 percent.

(c) Overall Yield had increased continuously from the year 2015/16, and compared to the previous year it has increased by 7.71 (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 2018/19. However, during the year under review it has slightly decreased by 0.09 cents from 74.31 to 74.22.

3. Operational Review

3.1 Management Inefficiencies

Audit Issue	Management Comment	Recommendation
Inflight Finance manager has manually carried out his duties such as Computation, Providing information to payroll and manual adjustments to the payment regarding the productivity payment.	This particular issue has already been identified by Key Stakeholders and same was documented in RFP.	The Management should take action to automate the process including capturing data of inflight delays and flight roster changes which

Therefore the productivity payment is solely dependent on him.	Planned to be implemented in mid-2021.	are required for the computation.

3.2 Human Resources Management

Audit Issue	Management Comment	Recommendation
The Company had entered into 05 Collective Agreements and with 05 Unions on 12 September 2014 for the period from 01 June 2014 to 31 May 2017 with effect from 01 June 2014. However, Board Approval for above agreements had been obtained on 21 September 2015, after passing one year. Even though the valid period of those agreements had been expired on 31 May 2017, action had not been taken to renew them even by November 2020. Further, Treasury concurrence with the Ministry approval for those agreements had not been obtained even up to 20 November 2020.	The current post pandemic circumstances have changed the business drastically. Nonproductive costs in the current context, arising from Collective Agreement (CA) conditions have been stopped with the cost saving initiatives implemented from April 2020. Continuation of entering into new collective agreements have not been recommended, and the Management is in the process of working for the nonrenewal of CAs. A directive from the Ministry of Finance was sought in early 2019 regarding the repudiation of the CAs. However, no formal guidance was granted. The Board of Directors of Srilanka Airlines has reviewed the strategy on way forward for CAs and approval has been granted on 29th November 2020 by the Board to follow the due process to overcome challenges associated with CAs whilst maintaining industrial harmony of the organization.	Management should take actions to exist the industrial harmony in the organization.

4. Accountability and Good Governance

4.1 Corporate Plan

Audit Issue	Management Comment	Recommendation
As per the paragraph 5.1.1 of Public Enterprise Circular No. PED/12 on 2nd June 2003 corporate plan had not been reviewed annually and continued as one Rolling Plan.	An updated five-year plan is been prepared taking into consideration the new business environment as a result of the Pandemic and will be submitted in early 2021.	The Management should be reviewed the Corporate plan annually and continued as one Rolling Plan.

4.2 Annual Action Plan

Audit Issue	Management Comment	Recommendation
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" issued No. PED/12.	This has been sent to the ministry in December 2019.	The Management should be prepared annual action plan and its progress should be reviewed for better control over the performance of the Company.

4.3 Sustainable Development Goals

Audit Issue	Management Comment	Recommendation
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.	Sri Lankan has identified the need to accelerate the progress towards development goals the achievement of the SGDs 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.	The Management should be identified the sustainable development goals and targets with the coordination of the Ministry and those should be evaluated in national basis rather than institutional basis.