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DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

Eighth Parliament

(Third Session)

SECOND REPORT OF THE COMMITTEE ON PUBLIC NTERPRISES

(Report Submitted to Parliament by the Committee on Public Enterprises Regarding the Replacement of the Fleet of Aircraft of the Srilankan Airlines Limited and the Termination of the Agreement for the Acquisition of 08 Aircraft of A 350-900 Model Entered into in the Years 2013 and 2014)

Presented on 21st day of August 2019 by

Hon. Sunil Handunneththi

Chairman of the Committee on Public Enterprises

Ordered to be printed by Parliament of Sri Lanka on 21st day of August 2019

Committee on Public Enterprises

Eighth Parliament (Third Session)

As per the Speaker's Announcement made in Parliament on 11th January 2019, the following 16 Members of Parliament were appointed to the Committee on Public Enterprises for the Third Session of the Eighth Parliament by the Committee of Selection on 10th January 2019 in terms of Standing Order 120 (1):

1. Hon. Sunil Handunneththi, M.P. (Chairman)
2. Hon. Rauff Hakeem, M.P.
3. Hon. Ravindra Samaraweera, M.P.
4. Hon. Sujeewa Senasinghe
5. Hon. (Dr.) Harsha de Silva, M.P.
6. Hon. Ajith P. Perera, M.P.
7. Hon. Wasantha Aluvihare, M.P.
8. Hon. Ranjan Ramanayake, M.P.
9. Hon. Ashok Abeysinghe, M.P.
10. Hon. Anura Priyadarshana Yapa, M.P.
11. Hon. Lakshman Senevirathna, M.P.
12. Hon. Chandrasiri Gajadheera, M.P.
13. Hon. Mahindananda Aluthgamage, M.P.
14. Hon. Dayasiri Jayasekara, M.P.
15. Hon. Jayantha Samaraweera, M.P.
16. Hon. Mavai S. Senadhiraja, M.P.

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Chairman's Note

As the national carrier, Sri Lankan Airlines has become a crucial factor that defines not just the economy of the country but also the very existence of the whole country.

At present, Sri Lankan Airlines has a deficit asset base of minus level and has inherited a state of operational loss that increases year by year. Total operational loss reported so far is 116 billion (= 11,600 crore) rupees, equivalent to 866 million United States dollars approximately. The total loss for the period 2009-2019 is 240 billion rupees (24,000 crore). At the same time, in addition to the losses concerned, the total of loans that are owed by the Sri Lankan Airlines to state banks and state institutions including the Ceylon Petroleum Corporation is 146 billion rupees (833 million United States dollars).

How did the national carrier of Sri Lanka, which is located at one of the most valuable air navigation hub of the world, turned into most debt-stricken public enterprise suffering large losses? What are the true reasons behind these losses? Was it solely due to natural causes that this state monopoly suffered so much loss or had there been some overriding factors? These are matters that have to be unveiled through an independent inquiry. A separate investigation must be conducted for this purpose. Without stopping at that, the persons responsible for this huge loss should be identified, brought to books and subjected to punishment.

This Report pertaining to the Sri Lankan Airlines, which is presented to Parliament today, is not a detailed investigation into that loss. Instead, it is a Report of the investigation into one transaction which was instrumental in escalating the loss of the Sri Lankan Airlines, which had been suffering a loss. The transaction to acquire eight aircraft of A 350-900 class shown in detail is one of the principal transactions unveiled when the Sri Lankan Airlines was summoned before the Committee being a public enterprise accountable to Parliament. As it unfolded before our Committee that the "Airbus

Deal" had not been conducted in a transparent manner so that no loss would be caused to the government, we assigned the Auditor General to prepare a detailed report in this regard and submit it to this Committee with relevant documents. The Auditor General and his staff did justice to the Report and prepared it and submitted it to the Committee. Anybody who peruses this Report will understand the extent to which the Sri Lankan Airlines and political authorities had acted without forethought in purchasing and the subsequent cancellation of the agreement.

The manner in which tens of millions of rupees of public funds have been paid to consultative firms is a very good example for such action. The aircraft purchasing agreements in the years 2013 and 2014 and 2016, 2017 as well the process of cancelling the agreements both alike prove the fact that it is not only due to management inefficiencies that Sri Lankan Airlines has sustained losses but also due to political interferences carried out by the political authority.

It should be stressed at this juncture that such transactions which waste public money should be stopped immediately while it is essential to impose laws necessary to bring the individuals who commit this kind of financial crimes before the law.

I take this opportunity to express my gratitude to the Auditor General and his staff who worked with diligence to submit this Report in Parliament, Secretary to the Committee and her colleagues at the Office of the Committee on Public Enterprises, and the staff of the Interpreters' Office who translated this report expeditiously, as well as all Members of the Committee on Public Enterprises who worked actively without party differences during this investigation.

Sunil Handunneththi
Chairman
Committee on Public Enterprises

Third Session of the Eighth Parliament

Third Report of the Third Session of the

Committee on Public Enterprises

Introduction

The Auditor General, under the Committee on Public Enterprises of Parliament, examines including the accounts, all government corporations, all enterprises and other businesses transferred to the government under any written law and companies registered under the companies Act No. 07 of 2007 or considered to have been registered thus, of which 50% of the shares are borne by the government, a state owned company or a Local Authority.

Accordingly, the Committee on Public Enterprises hereby presents its report on the re-fleeting programme of Sri Lankan Air Ltd. and the terminating of the agreement for the acquisition of eight A350-900 aircraft which was made in years 2013 and 2014 as the Third Report of the Third Session of the Committee of the Eighth Parliament.

At the meeting of the Committee on Public Enterprises held on 20 September 2017 to look into the activities of Sri Lankan Airlines Ltd., the Committee requested for a report on the re-fleeting programme of Sri Lankan Airlines Ltd. Hence, a special audit report prepared by the Auditor General was tabled at Parliament on 02 April 2019 (Annex 2.1). In order to formulate this report, the Committee took into consideration, the facts mentioned in the aforementioned report as well as the facts mentioned in the final report submitted by the Auditor General (Annex 2.2) on the examination carried out with respect to the termination of the agreement for the acquisition of eight A-350-900 aircraft which was made in years 2013 and 2014 by Sri Lankan Air Ltd.

Hence the abovementioned reports were prepared subject to the limitations of the powers, resources and time available to the Auditor General, the question whether any illegal or criminal activities have taken place has not been investigated by the Auditor General. Therefore, the Auditor General opines that it would be appropriate to obtain the assistance of specialized institutions in the event that such an investigation is deemed necessary.

In order to discuss the matters relevant to this report, officers of the Ministry and officers of Sri Lanka Airlines Ltd. were called before the Committee on 12-02-2016 and 06-09-2017 during the First Session of the Eighth Parliament and on 03-04-2019 and 19-06-2019 during the Third Session of the Eighth Parliament.

History of Sri Lankan Air

- Air Ceylon Ltd. was established on 09 March 1951 through the Air Ceylon Incorporation Act no. 07 of 1951.
- As per a Cabinet decision, 'Air Ceylon' was closed down on 20 December 1978 and 'Air Lanka Ltd.' was established on 11 January 1979.
- In 1998, 40% of the shares of 'Air Lanka' which was a public enterprise, were sold to the Emirates Group and the name 'Air Lanka' was changed to 'Sri Lankan Airlines.' On 07 May 1997, the company was incorporated under the name 'Sri Lankan Airlines Ltd.' as per Section 20 of the Companies Act no. 17 of 1982.

Situation that prevailed in 2008 and the operating loss of the Company

When Emirates withdrew from management of Sri Lankan Airlines Ltd. in 2008, the operating loss of the company was Rs. 4,428 million. At the time, the company had a total of 14, i.e., five A320 aircraft, four A330-200 aircraft, and five A340-300 aircraft in operation.

Main objective of re-fleeting programme of Sri Lankan Airlines

The objective was to identify, assess and present the most suitable options to strategically upgrade the business units of Sri Lanka Airlines and become an essential partner the development of tourism industry, airport, import & export industry and foreign employment in order to take optimum advantage of the opportunities for growth which emerged with the settling of the problematic situation in Sri Lanka.

The idea of re-fleeting Sri Lanka Airlines had been proposed under this objective on several occasions. Accordingly, the Company had presented a five-year strategic business plan for the 2010/2011 to 2014/2015 period.

Out of the core strategies for low cost carrier, regional carrier and network carrier, Sri Lankan Airlines had selected 'network carrier'.

In to the plan, several sectors have been proposed for restructuring.

1. Financial restructuring (recapitalization)
2. Institutional restructuring
3. Entering into shared ventures with Airport and Aviation Services Ltd. and the Sri Lanka Tourism Promotion Bureau
4. Setting up a legal and financial framework

Business plan and the re-fleeting programme of the Company

In year 2011, the Company had formulated a five-year business plan for the period from 2010/2011 to 2014/2015. One of the activities stated in the plan is the replacement of 13 narrow-body aircraft which were to reach the end of their life-span in the 2013-2021 period. This activity had been identified as the "re-fleeting" programme.

The management of the Company had decided to add 14 new wide-body aircraft in place of the 13 aircraft which would be decommissioned to during the 2013-2021 period. Accordingly, six new A330-300 aircraft and four A350-900 aircraft which was a model launched in 2013 were to be acquired on operating lease basis. Furthermore, four more aircraft of the same model were to be purchased from the manufacturer, sold-and-leased-back on operating lease basis. Accordingly six A330-300 aircraft were sold and leased-back on operating lease basis in 2014/2015. Furthermore, the Company had entered into an agreement with the manufacturer on 28 June 2013 to purchase four A350-900 aircraft while further agreements had been made on 27 September 2013 and 12 November 2014 to acquire four more aircraft of the same model on operating lease basis.

In year 2015, the Company had re-drafted a restructuring plan which was approved by the Cabinet on 24 June 2015. In the aforementioned plan, it is proposed not to commission the eight A350-900 aircraft regarding which purchase agreements had been made. Accordingly the Board of Directors had decided in 2015 to obtain the services of a consultancy firm to come to a reasonable solution after engaging in discussions with the leasing companies with whom agreements had been made to acquire four A350-

900 aircraft on operating lease basis. Therefore the Company had sought assistance from a foreign consultancy firm while assistance of another foreign consultancy firm attached by the Ministry of Finance too was received in addition. With the assistance of the consultants, agreements were made with the leasing company to acquire aircraft on operating lease basis for the re-fleeting programme. However, given the fact that a need for four A350-900 aircraft no longer existed at the time, the Company entered into termination agreement with the leasing company in year 2016, agreeing to pay USD 171.77 million as compensation. Subject to the conditions of the termination agreement made with the leasing company, USD 56 million was deducted and the balance USD 115.77 million, i.e., Rs. 16,924 million was paid by the Company in years 2016 and 2017 as the total compensation amount. Furthermore it is observed that the agreement for the installation of VIP kits in two A330-300 aircraft in 2015 too had been terminated.

In addition, negotiations to terminate the agreement made to purchase four A350-900 aircraft directly from the manufacturer are under way as at the date of the report. It has been disclosed that the manufacturer has proposed stopping the manufacturing of aircraft of the model agreed, and providing a different model aircraft (A321 Neo) instead.

The fleet proposed in the plan and the restructuring the utilization of aircraft

The Company had the following aircraft in its fleet by March 2011:

Type of aircrafts	Amount
A 320	05
A 330	05
A 340	05
Total	15

It had been envisioned to decommission two A320 aircraft and commission three A320 aircraft by March 2012 and further one A340 aircraft was to be commissioned in April 2011.

Proposed fleet

It was envisioned to make following changes in the fleet over the course of next five years. Accordingly, details of the proposed fleet are as follows:

It had planned to make following changes in the fleet of aircrafts within next 5 years. Accordingly particulars of the fleet of aircrafts are as follows.

Type of aircraft	Seating capacity	2011/12	2012/13	2013/14	2014/15	2015/16
A 320	150	6	9	9	9	9
A 330 – 200	287	5	8	10	13	13
A 340 – 300	314	6	5	3	2	1
Total		17	22	22	24	23

Aircraft operation activities and a proposed air-route network for the proposed fleet had been introduced. In addition, Committee observed that Seabury Consultation firm had prepared an amended plan for the 2014-2018 5-year period.

Under this plan too, an amended fleet, amended utilization plan, and amended air routes had been proposed.

However, it was observed at the Committee that the targets given in this plan were unrealistic and extremely difficult to achieve.

Planning to obtain consultancy services

The refleeting programme was a vital component in the five-year strategic plan approved by the Board of Directors on 27 June 2011. Through the Board paper dated 11 January 2012, a decision was taken to select a suitable consultancy firm for this task. It was disclosed that accordingly, proposals were received from the following four (04) consultancy firms:

7.6.1.2. Proposals had been called from 04 institutions to obtain consultative services as per the above Board Paper.

Institution	Total period of the project	Cost of the contract	Date of the e mail	Date of the proposal
DVB	24 weeks/06 months	US$ 375,000	07.09.11	14.09.11
Ascend	08 weeks	76,000 GBP	07.09.11	14.09.11
				26.09.11
Skyworks	24 weeks	US$ 2,800,000	19.10.11	15.11.11
Seabury	32 weeks	US$ 800,000	07.09.11	14.09.11
				11.11.11
				09.01.12

Recommending Seabury as the consultant

Out of the above, Seabury had been recommended as the consultation firm. This institution has been paid USD 612,345 for this purpose (Report 2.1, Annex 15)

A committee had been appointed to obtain Board approval for the refleeting.

Obtaining Board approval

The committee had prepared a report for the Board which consisted of several recommendations. The five (05) Board members who were present, had given approval to present this report at the Board meeting which was held in Battaramulla, at the official residence of the Speaker of Parliament.

As per the said Board approval, a Cabinet Paper had been drafted and submitted to the Cabinet Office on 27 March 2013.

Steps taken to acquire aircraft

As per the Board decision made on 01 March 2013, the management of the Company has taken the following steps to acquire aircraft:

- Acquisition of Six A 330-300 aircraft and Eight A350-900 aircraft: Agreements in this regard have been made with the Airbus Company.
- Entering into agreements to acquire four A350-900 aircraft on operating lease basis
- Authorization for entering into agreements: Through a power of attorney, the Board of Directors had granted authority to 15 officers of Sri Lankan Airlines Ltd. in year 2014 to alone, or jointly, prepare

and sign agreements pertaining to purchasing aircraft and leasing aircraft on behalf of the Company in the refleeting programme of Sri Lanka Airlines Ltd..

- Financing the sell-and-lease-back process and the Pre-Delivery Payments (PDP) of the A330-300 aircraft: The Board paper dated 03 June 2013 had been prepared to seek approval for obtaining consultancy services from Seabury regarding the financing of the sell-and-lease-back process and the Pre-Delivery Payments of the A330-300 aircraft. Furthermore, the Board of Directors had decided on 11 June 2013 to pay USD 35,000 as the non-refundable withholding fee for consultancy services plus USD 500,000/- as the total success fee for the agreement made with the leaseholder with respect to six aircraft.

Installing VIP kits in A330-300 aircraft

Although the Board paper on refleeting dated 28 February 2013 does not mention the installation of any VIP kits, the Board paper dated 27 March 2013 cites the installation of a VIP kit worth USD 15 million to be used during visits of the Head of State as one of the reasons behind selecting Airbus Company. However, the Board paper does not include any information about additional costs that may have to be borne or any agreements that need to be made in relation to the VIP kits. Furthermore, this agreement was amended on 02 December 2013. Through these amendments Sri Lankan Airlines and Airbus Company had entered into an agreement called "outfitting agreement" which covered aspects of designing, manufacturing, installation, checking and interior design of VIP kits.

However, the aforementioned agreement about the VIP kit had been terminated on 24 February 2015. This agreement had been terminated as per a written request made by Sri Lankan Airlines. Although the credit memorandum for USD 15 million issued by the Airbus Company for the VIP kit had been fully utilized for the manufacturing of the said VIP kit, Sri Lanka Airlines would still be liable for the responsibilities contracted in the agreement to purchase the VIP kit. The ownership of the VIP kit still remained with the Airbus Company.

The Airbus Company had been given the authority to sell the VIP kit to a third party before 30 June 2016. All expenses borne by the Airbus Company for the VIP kit were to be deducted from the proceeds of the sale of the VIP kit and Sri Lankan Airlines was to be given a credit memorandum for the balance. This would be called the "VIP kit settlement credit memorandum" and be used to set off future payments to be made to the Airbus Company.

Termination of the VIP kit agreement

- The agreement made on 28 June 2013 to install a VIP kit on board an A330-300 aircraft had been amended in two occasions, i.e., on 02 December of the same year and in March 2014. It was observed that the management of the Company has entered into this responsibility without sufficient prior planning and proper understanding of the matter.
- In place of the VIP kit for the USD 15 million entitled as a discount for purchasing 10 aircraft from the Airbus Company, the company had given the option of deducting the entitled discount from amounts payable for other goods and services purchased from them. However, Sri Lankan Airlines lost the entitlement for the discount from the Airbus Company for the re-sale of A350 and A330 aircraft because almost 20 months had lapsed between the date on which the agreement was made to install VIP kits to 24 February 2015, the date on which it was terminated.
- Agreements had been made to acquire A350 and A330 aircraft for the Company in years 2013 and 2014. Accordingly six A330 aircraft had been acquired by the Company within the relevant time period. However, agreements had been made later to re-sell those aircraft. Accordingly, it is observed that the Company has not paid sufficient attention to the aircraft requirement of the Company when making decisions regarding re-fleeting. (Ref: Report 2.2, para 7.6)
- At the meeting between Sri Lankan Airlines and Aircap Company held on 23 November 2015, it had been recommended to call for quotations from three consultancy companies to appoint a suitable representative to re-sell A350-900 aircraft (Annex 19 of report 2.2). When these companies were recommended, procurement guidelines of the government had not been followed.

Failure to achieve targets given in the five year business plan

In the five year business plan for the 2010/11-2014/15 period introduced by the Sri Lankan Airlines in year 2011 a programme for re-fleeting the wide body aircraft belonging to the Company had been introduced. Accordingly 10 aircraft, i.e., six A330-300 aircraft and four A350-900 aircraft were to be purchased directly from the Airbus Company while agreements had been made with the International Lease Finance Company and Aircap Company to acquire four A350-900 aircraft on operating lease basis. Therefore, six A330-300 aircraft were to be acquired during 2014/2015 years. According to the agreements, Sri Lankan Airlines had purchased these aircraft to sell-and-lease-back.

Agreements had been made to lease three A350-900 aircraft from International Lease Finance Company and to lease one aircraft from Aircap Company on operating lease basis. These four aircraft were to be acquired in years 2016/2017. However, Sri Lankan Airlines had been continuously sustaining losses by then. The net loss of the Group was USD 47.1 million in 2015/2016 which increased to USD 90 million by 2016/17. There was a balance of USD 300 million in bank loans while USD 45 million was payable to the Ceylon Petroleum Corporation with USD 15 million payable to the Airport and Aviation Company by March 2016. When these facts are taken into consideration, the Company was in a difficult financial status, which rendered it difficult to pay a total of USD 174.96 million for the A 350-900 four aircrafts over a course of 12 years at a monthly leasing installment of USD 1.215 million per aircraft in 2016 and 2017.

Accordingly, services of two international consultancy firms called Skyworks and Nyras had been obtained to assess alternative options and give advice on the termination of the agreements made for the delivery of four A350-900 aircraft which had been ordered. When consultants are selected and employed, procurement guidelines issued by the National Procurement Agency in August 2007 and November 2007 on the selection and employment of consultants should be followed (Report 2.1, Annex 77). However, it was observed that the said guidelines had not been followed.

Furthermore, the Board of Directors of the Company had sought a legal opinion from Mr. Anil Thiththawella, AAL, on 11 December 2015

regarding the liabilities of terminating the agreements for aircraft. Since A350-900 aircraft are high capacity aircraft, a decision had been taken to terminate the lease agreements in view of the requirements of Sri Lankan Airlines.

Furthermore, the pledged four A350-990 aircraft which are to be purchased directly from the Airbus Company are due in 2020/2021. In response to the decision made by the Cabinet Sub Committee on economic management to make a counter offer instead of purchasing four wide body aircraft from the manufacturer, the manufacturing company had offered Eight A321 Neo aircraft in April 2018.

Entering into agreements with the Airbus Company and with leasing companies to replace the fleet of wide body aircraft

A re-fleeting programme for the fleet of wide body aircraft belonging to Sri Lankan Airlines had been implemented as per the five year business plan for 2010/11-2014/15 period presented by Sri Lankan Airlines in 2011. Accordingly, agreements had been made with the Airbus Company and operating lease companies to re-fleet the fleet of wide body aircraft as follows:

Table 01 – Details of the agreements with Airbus Company and leasing companies

Type of Aircraft	Quantity	The Institute	Date entered into agreements	Due period of delivery of Aircrafts
A 330-300	06	Airbus Company	19.06.2013	2014/2015
A 350-900	04	Airbus Company	28.06.2013	2020/2021
A 350-900	03	International Lease Finance Company	27.09. 2013	2016/2017
A 350-900	01	Aercap Company	12.11. 2014	2016/2017
Total Aircrafts	14			

The manner in which the proposal to terminate the agreement for the acquisition of A350-900 aircraft made under the re-fleeting programme

The Cabinet must issue instructions to formulate a new restructuring plan.

- Having considered the Cabinet Memorandum titled 'Obtaining capital for Sri Lankan Airlines and Mihin Air' bearing number 15/0451/638/001 dated 17 April 2015 submitted by the Minister of Aviation, the Cabinet gave the following (Report 2.2 Annex 08) decisions on 22 April 2015.
- Separate business plans should be prepared for Sri Lankan Airlines and Mihin Air and submitted to the Cabinet subcommittee on economic affairs.
- A plan suitable for the amalgamation of Sri Lankan Airlines and Mihin Air as stated in the budget proposals presented for the year 2015 by the Minister of Finance on 29 January 2015 should be formulated expeditiously and submitted to the Cabinet subcommittee on economic affairs.
- Treasury Secretary was instructed to issue a guarantee or a letter of credibility with respect to the settlement of overdue amounts payable to the Ceylon Petroleum Corporation in order to ensure uninterrupted supply of fuel to Sri Lankan Airlines and Mihin Air.
- As per the above decision of the Cabinet, a restructuring plan had been formulated by a committee comprising of three officers from Sri Lankan Airlines and one consultant. Cabinet approval for this restructuring plan (Report 2.2 Annex 09) had been obtained as follows:

Date	Function
26 May 2015	Submission of the said Plan to the Board of Directors of the Company and obtaining the approval on the same day.
28 May 2015	Submission of the said Plan to the Minister of Aviation
29 May 2015	Submission of the said Plan to the Prime Minister and the Minister of Finance
01 June 2015	Submission of the said Plan to the Cabinet Sub-committee on Economic Management
05 June 2015	Submission of the Plan to the Committee appointed by the Cabinet Sub-committee on Economic Affairs and recommendation of the first option of 02 proposals, mentioned in the Plan by the said Sub-committee, that is "continuing operations of Sri Lankan Airlines Ltd. within the existing corporate structure, under a comprehensive restructuring plan by amalgamating with Mihin Lanka Ltd."
09 June 2015	Approving the recommendation of the said Committee by the Cabinet Sub-committee on Economic Management
24 June 2015	Granting the Cabinet Approval

Proposed restructuring plan (2015/16 – 2017/18)

A restructuring plan for Sri Lankan Airlines and Mihin Air for the 2015/16 to 2017/18 period had been formulated and submitted to the Cabinet in June 2015. Approval for this plan was received on 24 June 2015. Among the major recommendations made in this report were ;

i.) Suspending flights to Frankfurt, Paris and Rome which were causing losses. With that, reducing the total number of flights per week to Europe from 18 to 7 from 2015/16 to 2016/17.

ii.) Amalgamating Sri Lankan Airlines and Mihin Lanka and carrying out joint business activities efficiently.

iii.) Right sizing of the fleet

Table 04 – Re-fleeting Plan of Aircrafts

Aircraft Type	Number of Aircrafts proposed by the Plan		Number of Aircrafts operated as at 15 September 2015
	2016/17	2017/18	
A 320-200	06	03	06
A 321-200	02	02	02
A 320-NEO	-	04	-
A 330-200	03	02	07
A 330-300	07	07	03
A 340-300	-	-	03
	18	18	21

i) Reducing the loss of Sri Lankan Airlines from USD 93.7 million in 2015/16 to USD 23.4 million in 2017/18

ii) Sourcing funds to overcome the debt burden of the Sri Lankan Airlines and reach a stable and sustainable status, as follows;

Table 05 – Funding Plan

(US $ Million)

	2014/15	2015/16	2016/17	2017/18	Total
Providing Government capital	125	70	60	-	255
By selling 49 per cent shares of the Sri Lankan Catering Limited	-	85	-	-	85
Converting the Ground Handling Unit to a subsidiary and by selling 40 per cent shares of the said company	-	-	140	-	140
Total	125	155	200	-	480

Implementation of the proposed restructuring plan

- The restructuring plan proposed by the Chairman of the Company at the Board meeting held on 26 June 2015 was approved by the Cabinet on 24 June 2015 (Report 2.1, Annex 10).

i. Implementation of the abovementioned plan was further discussed at Board meetings held on 03 and 25 August 2015. The following recommendations which were included in the Board paper CEO/2015/06/80 presented on 24 July 2015 were given approval by the Board on 25 August 2015 (Report 2.1 Annex 11)

ii. Reducing the fleet of wide body aircraft from 13 to 10 and reducing the fleet of narrow body aircraft to 08 bringing the total fleet down to 18 from 21.

iii. Increasing flights in the London route to 09 flights a week during winter 2015.

iv. Increasing the efficiency of the Group, jointly with Mihin Air.

v. Carrying out assessments to find a partner for codeshare operations in the European routes.

vi. Finding the best solution for the eight A350-900 aircraft which will be added and the three A330-200 aircraft which will be handed over to the leasing companies in 2017.

vii. Appointing an external party that could handle negotiations pertaining to (V) above. In order to select a suitable external party, expressions of interest should be called from a minimum of three parties and a suitable party should be selected before 31 August 2015 after obtaining approval from the Board of Directors.

viii. In order to minimize cost with the exception of costs such as staff costs, direct operating costs, cost of restructuring air routes, negotiations should be carried out with the contractors involved in contracts with high values.

ix. Sourcing USD 480 million as funds by means of the capital contribution of USD 255 million from the government of Sri Lanka and the proceeds of the sale of minority shares of special business units (Sri Lankan Catering and Ground Handling) amounting to USD 225 million.

x. Obtaining a loan of USD 86 million from the Bank of Ceylon in August 2015 facilitated by the Ministry of Finance.

xi. Obtaining letters of assurance from the Treasury Secretary in order to obtain short term loans worth USD 30 billion from the Bank of

Ceylon and People's Bank to settle the outstanding amount payable to Ceylon Petroleum Corporation.

xii. Although the above restructuring plan stated that it would be implemented on 01 October 2015, the Board of Directors had decided on 25 August 2015 that the date of implementation of the Network Optimization shall be 01 April 2016.

xiii. Terminating the agreements made for the four A350-900 aircraft which were to be acquired on operating lease basis, and paying the relevant compensation.

- Proposals and decisions of the Board of Directors dated August 03, 2015. (Annexure 12 of Report 2.1)
- Decision of the Board of Directors dated August 25, 2015. (Annexure 13 of Report 2.1)
- Director Board paper dated September 11, 2015. (Annexure 14 of Report 2.1)
- Decision of the Board of Directors dated September 21, 2015. (Annexure 15 of Report 2.1)
- Recommendations (Presentations) made by the Skyworks Consultancy Company to the Board of Directors on October 22 and 25, 2015 and the decisions taken by the Board of Directors based on them.
- Director Board paper dated November 27, 2015. (Annexure 19 of Report 2.1)

- Requesting the assistance of Airbus company

  In a letter, the Chairman of the Sri Lankan Airlines had requested the Chief Operating Officer of the Airbus Company to change the dates of delivery of A350-900 aircraft. Based on the request, the Airbus Company had sent a team to Colombo and after analyzing the business plan of the Sri Lankan Airlines, at the meeting held on December 22,

2015 they had informed the matter should be solved with the Aercap Company as the aforesaid deal had been reached with the said company.

- Board of Directors meeting held on January 26, 2016 - Obtaining legal opinion with regard to the responsibility of terminating the aircraft deal (Annexure 20 of Report 2.1)

- Discussion held with the Chief Risk Officer of the Aercap

  The Chief Risk Officer of the Aercap had held a meeting held on 07.01.2016 with the Sri Lankan Airlines in Colombo. At the meeting it had been informed that the Sri Lankan Airlines will have to pay a compensation of USD 250 million if A350-900 aircrafts are not obtained.
- The presentation made to the Minister of Public Enterprises Development by the Skyworks Consultancy Company on January 22, 2016.

  (Annexure 21 of Report 2.1)

In the presentation, the Skyworks Consultancy Company had proposed 03 alternatives. Information in this regard are as follows.

i) Alternative A - Obtaining three A350-900 aircraft to fly to European destinations.

ii) Alternative B - Removing A330-300 aircraft after obtaining three A350-900 aircrafts.

iii) Alternative C - Not to obtain A350-900 aircraft.

After assessing the aforesaid alternatives the Skyworks Company had stated that
it is appropriate to implement alternative 'C'. Therefore, according to the directive of the Aercap Company, the final decision should have been confirmed before January 29, 2016 after obtaining instructions of the law firm.

- Board of Directors meeting held on January 26, 2016
- Board of Directors meeting held on February 09, 2016 (Annexure 23 of Report 2.1)
- Board of Directors meeting held on February 26, 2016 – Terminating

  an agreement of an A350-900 aircraft. (Annexure 24 of Report 2.1)
- Decision reached by the Board of Directors on March 09, 2016 (Annexure 25 of Report 2.1)
- Meeting of the Board of Directors on March 24, 2016
- Meeting of the Board of Directors on July 28, 2016 (Annexure 26 of Report 2.1)
- Recommendations and approvals of the Cabinet Committee on Economic Management (CCEM)
- Terminating the lease agreement of the A350-900 aircraft reached with the Aercap Company and paying the compensation.

➢ At the CCEM meeting held on April 05, 2016 following decisions were reached regarding the activities of the Sri Lankan Airlines. (Annexure 27 of Report 2.1)

Appointing a committee to restructure the Sri Lankan Airlines comprised of the Secretary to the Ministry of Finance, Secretary to the Ministry of Public Enterprise Development, Advisor to the Ministry of National Policies and Economic Affairs, Chairman of Sri Lankan Airlines and Chairman of Department of Public Enterprises.

➢ If required obtaining the assistance of the experts of the field for the aforesaid committee.

- Sending out Request for Proposals (RFP) to invest in Sri Lankan Airlines and reporting the progress to CCEM.
- Obtaining loans worth USD 65 million for Sri Lankan Airlines and USD 5 million for Mihin Lanka Airlines from State Banks (in order to settle the essential financial requirements including the fee for early termination of the lease agreement of A350-900 aircraft, which was reached with the Aercap Company).
- The Secretary to the Ministry of Public Enterprise Development had been informed on the aforesaid decisions on April 18, 2016 by the Prime Minister's Office. In an unnumbered letter dated April 20, 2016 the Chairman of the Sri Lankan Airlines had been informed that in the CCEM meeting held on April 05, 2016 it was decided that the termination fee of the lease agreement of A350-900 aircraft reached with the Aercap Company by the Minister of Public Enterprise Development will be borne by the government. (Annexure 28 of Report 2.1)

Obtaining consultancy services for the termination of the agreement

Entering into agreement with the Skyworks Company to obtain consultancy services

It had been stated that Expressions of Interest (EOIs) had been received from Skyworks Company and 02 other companies in terms of the decision of the Board of Directors dated September 21, 2015. (Annexure 15 of Report 2.1) Proposals had been obtained from the DVB Bank Consultancy Company and from the "Nyras" Company, of which services had been obtained by the Sri Lankan Airlines earlier for the same purpose without any agreement, after sending Requests for Proposals (RFP) to both the companies. Proposals received in this manner were evaluated by a group comprised of 07 officers and eventually the "Skyworks" Company was chosen.

Making payments to the Consulatncy Company

A payment of USD 355,451.09 or Rs.52 million (when Sri Lankan Rupee value of a US Dollar is considered as 146) had been made as mentioned below during the period the from September 25, 2015 to April 11, 2016 to "Skyworks" Consultancy Company for providing consultancy services. (Annexure 56 of Report 2.2) Table 13 – How the payments were made to the "Skyworks" Consultancy Company

Table 13- The manner in which payments had been made to "Skyworks"

Date	Amount Paid (US $)	Reason
2015.09.25	100,000.00	Monthly work fee
2015.10.21	100,000.00	Monthly work fee
2015.12.02	52,832.21	Monthly work fee
2015.12.29	50,692.38	Monthly work fee
2016.02.10	50,379.99	Out of pocket expenses
2016.04.11	1,546.51	Out of pocket expenses
Total	355,451.09	

Obtaining consultancy services from Nyras Company

Selecting "Nyras" Consultancy Company

No clear information was received on how the "Nyras" Consultancy Company was selected, which had been rejected on the earlier occasion for the same task.

However, the decision of the Board of Directors dated January 26, 2016 (Annexure 22) stated that the Ministry of Finance had selected "Nyras" Consultancy Company to assess the suitability of implementation of the new restructuring plan of the Sri Lankan Airlines.

Making payments to Consultancy Company

During the period from December 22, 2015 to September 02, 2016 the Sri Lankan Airlines had made a payment of GBP 248,961.75 or Rs.47

million (when Sri Lankan Rupee value of a British Pound is considered as 184.95) to the "Nyras" Consultancy Company as mentioned below. (Annexure 60 of Report 2.2)

Table 14 – How the payments were made to the "Nyras" Company

Date	Amount paid (GBP)	Purpose
2015.12.22	25,000.00	Consultancy fees agreed with the Ministry of Finance
2016.01.21	25,000.00	-Do-
2016.01.29	15,000.00	-Do-
2016.02.19	40,000.00	Consultancy fees agreed by the Sri Lankan Airlines
2016.02.25	40,000.00	-Do-
2016.02.26	40,000.00	-Do-
2016.03.08	30,000.00	-Do-
2016.05.24	2050.00	Payment of casual allowance
2016.05.24	1800.00	-Do-
2016.05.24	1434.00	Reimbursement of air travel fees
2016.05.24	3750.00	Paying consultation assistant services
2016.05.24	600.00	Payment of casual allowance
2016.05.24	9060.00	payments for assisting the discussions held in April 2016
2016.09.02	15,267.25	Payment for providing a report to Sri Lankan Airlines and Ceylon Petroleum Corporation on reduction of fuel prices in the months of June and July 2016
Total	**248,961.75**	

Sri Lankan Airlines had paid GBP 65,000 for carrying out the tasks of the Ministry of Finance till January 2016 and that amount has been reimbursed by the Ministry of Finance and Planning on May 20, 2016 as mentioned below. (Annexure 61 of Report 2.2)

Table 15 - The amount reimbursed by the Ministry of Finance and Planning out of the payments made to the "Nyras" Consultation Company

Table 15- Amounts reimbursed by the Ministry of Finance and Planning out of the payments made to the "Nyras" consultancy company.

Invoice No.	Date of Invoice	GBP	Rs.	Amount Reimbursed (Rs.)
291031	2015.12.22	25,000	5,406,425	5,406,425
293814	2016.01.31	15,000	3,202,950	2,625,325
292989	2016.01.22	25,000	5,338,250	5,338,250
Total		65,000	13,947,625	13,370,000

Termination of the agreements

Sri Lankan Airlines had entered into 02 agreements to terminate and amend 04 agreements reached to obtain A350-900 aircraft on the basis of operational leasing and information in this regard are as follows.

Table 16 – Information regarding the termination of operational leasing agreements

Name of the Operating Lease Company	Date of Agreement	Particulars on the Agreements Terminated
i) Aercap Global Aviation Trust (AGAT)	06 April 2016	Termination of the operating lease agreement relating to one of the A350-900 aircrafts, dated 2014.11.12. (Annexure 63)
ii) International Lease Finance Corporation (ILFC)	04 October 2016	Termination of 03 operating lease agreement Nos, 79,80, and 81 relating to A350-900, dated 27 September 2013.

(Annexure 40)

Paying compensation to the Operational Leasing Company

Paying compensation to Airbus (Aercap) Company under the agreement dated 06th of April 2016

Under this agreement Sri Lankan Airlines had paid USD 17,770,000 (including the security deposit of USD 2,500,000) on 05 occasions during the period from September 15, 2014 to May 04, 2016 as mentioned below.

Table 18 – How the compensation with regard to the termination of operational leasing agreement of A350-900 aircraft was paid

Date	Amount paid (USD)
2014.09.15	250,000
2014.11.14	250,000
2016.05.04	3,270,000
2016.05.04	12,000,000
2016.05.04	2,000,000
Total	17,770,000

Paying compensation to International Lease Finance Lease Finance Company under the agreement dated October 04, 2016.

Under this Sri Lankan Airlines had paid a compensation of USD 98 million (including security deposit of USD 7.5 million for 03 aircraft) during the period from August 08, 2013 to June 02, 2017. (Annexure 64)

Audit Observations

- The above process not being in accordance with the provisions of the Civil Aviation Services Act No.14 of year 2010.

  Whereas the Minister of Civil Aviation Services should have presented his recommendations to the cabinet with regard to the preparation of a national civil aviation policy relevant for Sri Lanka, timely reviewing and analyzing,
  neither the recommendations had been presented nor the approval had been obtained from the cabinet by January 25, 2018, which is the audited date, other than a draft of the National Civil Aviation Services Policy being prepared by a committee.
  Furthermore, a suitable national policy on air travel —passenger and goods transporting — catering to long term socio-economic

requirements of Sri Lanka is yet to be identified.

- Observations on operational results of the company.
- Observations on the five year strategic plan drafted by the company.
- Observations on implementing the five year strategic plan as estimated by the VIA Capital Partners, a partner company.
- Observations with regard to restructuring fields.
- Observations on the proposed aircraft fleet.
- Observations on the proposed air route network.
- Observations with regard to obtaining consultation services on replacement of wide-body aircraft fleet.
- Observations on obtaining consultation services from Seabury Pvt Ltd.
- Observations with regard to obtaining approval for replacement of aircraft fleet.
- Observations with regard to reaching agreements in purchasing airbus.
- Observations on vesting authority to reach agreements.
- Lease after sale and pre-payment financing of A 330 300 aircraft.
- Lease after sale and pre-payment financing before delivery of six A 330 300 aircraft.
- Observations with regard to performance of six A 330 300 aircraft after purchasing.
- Observations with regard to purchasing of VIP cabin for A330 300 aircraft.
- Observations with regard to interim leasing of A 330 300 aircraft to Pakistani Airlines.

System and administrative flaws

It was observed that the following system and administrative flaws require special attention.

Planning

- Despite various plans drafted since 2010 a proper committee has not been appointed.
- Procurement guidelines have not been followed when selecting consultation companies to validate the plans drafted by the company.
- Proper administrative systems were not in place to implement the plans and no post review had been carried out.
- The company had carried out the following tasks without a cost-benefit analysis, which is conducted after a proper study.
- Amending the programme to replace aircraft on June 24, 2015.
- Directly purchasing four A350-900 aircraft and obtaining four more aircraft of the same type on operational leasing.
- Agreeing to pay compensation to relevant financial companies for terminating operational lease agreements.
- Entering into additional conditions in order to reduce USD 56 million out of the agreed compensation of USD 154 million reached with Aercap Company for terminating the lease agreement.
- Termination clauses had not been included in any of the agreements reached under the aircraft replacement programme. It was observed therefore the company had to pay the compensation proposed by the leasing company.

Asset Management

- Failure to conduct a proper cost-benefit analysis when expanding the aircraft fleet.
- A proper analysis had not been carried out when choosing a method to acquire aircraft.
- Government's procurement guidelines have not been followed when acquiring aircraft.

Recommendations of the special audit report issued by the Auditor General with regard to re-fleeting of aircraft and termination of agreements to acquire eight A350-900 aircraft reached in the years of 2013 and 2014

- A National Civil Aviation Policy relevant to Sri Lanka should be prepared while a flight policy, which suit to the economic and social policy of Sri Lanka, should be identified and the necessity of the fleet of aircraft should be determined accordingly.
- Ensuring sponsorship of the government for the maintenance and repairing of aircraft and entering in to agreements with Ceylon Petroleum Corporation after conducting discussions to obtain fuel for aircrafts at a minimum price.
- Expanding and developing air flight operations, maintenance and repairs of aircraft, supply of foods and training of aviation by way of obtaining foreign investments up to 90% establishing State-Private partnerships as per the drafted policy.
- Future strategic plans of Sri Lanka Air Lines Limited should be prepared after a proper and rational analysis and the Board of Directors should approve them after a quantitative study.

- In terms of the procurement of goods and services, action should be taken as per the procurement guidelines and the procurement provisions approved by the Treasury should also be followed.
- Relevant approval should be obtained from the Cabinet of Ministers referring important matters, which require such approval.
- Matters such as the amount and the types of the fleet of aircraft required by the Company, introduction of new air routes, termination of flights in existing air routes, increasing/ decreasing the number of flights should be determined after an analysis made on proper social and economic facts.
- When restructuring activities of company are carried out, the Management

  should make performance evaluation, supervision and follow up action to ensure that all proposed tasks are performed after preparing an action plan for the purpose.
- A specific control framework should be introduced by the Treasury on Public Liability Companies.
- Clearance should be obtained from Attorney General for all important international and local agreements entered in to by the Company.
- All important decisions with regard to the activities of Sri Lankan Airlines should be taken in accordance with a long term plan prepared after conducting a proper study.
- When obtaining consultative services the company should act as per the provision in Consultation Guidelines and Consultation Handbook issued in August and November 2007 respectively.

- Recommendations should be obtained from advisors with regard to the activities of the company and they should be implemented in a commendable manner.
- Sending more than one officer for discussions and when reaching agreements with external parties to represent the company in order to ensure transparency and honesty.
- Obtaining approval from the Cabinet of Ministers to matters, which require such approval, by sending them in advance with adequate information.

Conclusions of the special audit report issued by the Auditor General with regard to re-fleeting of aircraft and termination of agreements to acquire eight A350-900 aircraft reached in the years of 2013 and 2014

- It is hereby concluded that the Sri Lankan Airlines had not taken action to adhere the requirements of the procurement procedure in obtaining consultative services, selecting companies for purchasing and leasing aircrafts in the re-fleeting process of aircraft.
- It is hereby concluded that the decision, which had been taken by the Manager of the Company to add 14 modern aircraft to the fleet within 08 years without obtaining approval of the Cabinet of Ministers and without making a proper cost benefit analysis, is a decision taken beyond his authority and therefore the officers are responsible for the failure resulted in that decision.
- It is hereby concluded that the Management, which held office during the period relevant to this whole process, shall be responsible for the total loss including the loss of Rs. 17,058.1 million paid in the process of revocation of lease agreements for obtaining 04 A 350-900 aircraft on lease, which can be clearly identified, and for

the compensation, which would have to be paid at the termination of agreements on 04 A350-900 aircraft to be delivered in year 2020/2021.

- It hereby concluded that the Management of the Company shall be responsible for the unavailability of funds for development activities including the re-fleeting of aircraft as planned, due to payment of USD 355.5 million out of USD 375 million, which was provided for re-fleeting process, to Ceylon Petroleum Corporation by the Management for setting current liabilities.
- Since this report was prepared within the limits such as powers, resources and time available with the Auditor General, no examination was made by me exceeding such limits as to whether any illegal or criminal activity, which cannot be determined by Auditor General, had been committed. It is hereby further concluded that it is advisable to obtain the assistance of expert institutions, if such examination is to be carried out.
- Since the Sri Lankan Airlines had terminated the agreements relevant for obtaining four A350-900 aircraft on operational lease without an adequate cost-benefit analysis, the company had to spend USD 115.77 million or Rs.17,058.1 without receiving any timely benefits in the nature of goods and services. Furthermore, it is observed that the possibility of making a same kind of a payment to the manufacturer of A350-900 aircraft cannot be disregarded as the agreement to purchase four aircraft had been terminated and discussions are underway to purchase alternative aircraft from the same manufacturer.

Observations of the Committee

It was observed by the committee that attention should have been drawn on the adverse impact that can create upon the country's economy by having to pay a large sum of USD 115.77 million or Rs.17,058.1 million as compensation when it was decided to terminate the agreements to acquire aircraft as an institution that had net assets at a negative level.

Whereas it was observed by the committee that opinion of the Attorney General had not been sought to terminate the agreement to acquire aircraft and the termination agreement had been prepared under the guidance of "Aviation Legal Experts", a legal consultant firm situated in England.

The committee also observed that only the officials from the Ministry of Finance and the Sri Lankan Airlines had taken part in the discussion held to terminate the agreement to acquire aircraft and no official from the Ministry of Public Enterprise Development, which is the subject ministry, had participated in the discussion.

Observations of the committee

1. While accepting all the recommendations and the conclusions of the Auditor General's report, the committee submits them to the Parliament for approval and implementation.
2. The committee also recommends having an open dialogue in the Parliament after the report is presented.