

PERSPECTIVES ON
INTERNATIONAL FINANCIAL
REPORTING AND AUDITING IN
THE AIRLINE INDUSTRY

STUDIES IN MANAGERIAL AND FINANCIAL ACCOUNTING

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**PERSPECTIVES ON
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AIRLINE INDUSTRY**

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INVESTOR IN PEOPLE

To my wife Oytun and to my daughter Ece
Thank you for their indefatigable support and immense patience.
Can Öztürk
July 2021

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FOREWORD

This book is the outcome of the practices of international financial reporting and international auditing in the airline industry. Accountability and responsibility for this book lie with Can Öztürk.

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PREFACE

Perspectives on international financial reporting and auditing in the airline industry is a research book which combines international financial reporting and auditing practices in the sector-specific and global context. It has been developed considering the paper of Tan, Tower, Hancock, and Taplin (2002) titled as “Empires of the sky: Determinants of global airlines’ accounting-policy choices,” the book of Lavi (2016) titled as “the impact of IFRS on industry” and current Accounting Guides and Airline Disclosure Guides of the International Air Transport Association’s Industry Accounting Working Group.

The book consists of two sections. First section focuses on observations related to international financial reporting and second section covers observations related to international auditing in the airline industry.

The first section includes four chapters. The first chapter provides an overview of financial reporting in the global airline industry considering the accounting framework adopted by airlines whether they are publicly accountable or not. Following Chapter 1, Chapters 2–4 adopt an IFRS approach in the global context. Chapter 2 focuses on the comparability of financial statements in the airline industry in the context of the diversity of IFRS accounting policy choices; Chapter 3 analyzes the cumulative effect of the adoption of IFRS 15 and IFRS 16 and the compliance level of disclosures of IFRS 16 from a lessee standpoint on the financial statements of Air France – KLM; and Chapter 4 discusses the segment reporting in the airline industry under IFRS 8.

The second section includes one chapter. It analyzes different aspects of International Standards on Auditing in the airline industry considering ISA 570, ISA 700, ISA 701, ISA 701 of the UK, ISA 705, and ISA 706 within the framework of the IFRS adopted airlines.

My wish is that readers whose interests relate to airline financial reporting and auditing find this book informative and inspiring further research.

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July 2021

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As a professor of accounting and a traveler keen on air travel, analysis of the financial statements of airlines in terms of international financial reporting and auditing has been one of my research interests that I have been willing to focus on in my academic career since 2011. However, such an opportunity did not take place until I saw the call for paper announcement of the book serial of Emerald titled as *Studies in Managerial and Financial Accounting* and I submitted my book proposal. This research book took almost three years of mine. In this context, I would like to thank all the Emerald editorial team members that contributed to making this dream come true but particularly to Dr Anne Farrell, Dr Charles Richard Baker, and Aiswarya Mahathma Suritha.

I would like to thank Dr Anne Farrell of Miami University who is the project editor of this book serial, for giving me the opportunity to prepare this research book and for making my dream come true so that I can specialize in airline financial reporting and auditing from a global perspective. In addition, I truly appreciate her patience and support due to my request of deadline extensions.

It has been almost 20 years since I recognize Dr Charles Richard Baker of Adelphi University. I was his MBA student at the University of Massachusetts Dartmouth in 2003. He has been one of my leading accounting professors in my academic career. This book project provided him to contribute to my academic career once again. I would like to thank Dr Baker for his time to check my writing as an experienced researcher on airline accounting. I truly appreciate his support.

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All errors are my own and come with apologies.

Can Öztürk
July 2021

PART I

INTERNATIONAL FINANCIAL
REPORTING

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CHAPTER 1

OVERVIEW OF FINANCIAL REPORTING IN THE AIRLINE INDUSTRY

ABSTRACT

This chapter focuses on the diversity of financial reporting frameworks in the airline industry considering past and present. While diversity of financial reporting frameworks existed in the past, currently, the majority of listed and non-listed airlines, whose financial statements are publicly available, are inclined to adopt International Financial Reporting Standards (IFRS), leading toward uniformity in financial reporting frameworks because their country of incorporation or the stock exchange where they are listed either require or permit them to do so. Airlines operating in the United States prepare their financial statements under United States Generally Accepted Accounting Principles and some of Asian-Pacific countries still use their own national accounting standards in financial reporting. In addition, this research points out that the primary determinant of IFRS adoption in the airline industry is the fact that the majority of airlines are listed in national or foreign stock exchanges where IFRS adoption is required, but there are some company-specific determinants for listed and non-listed IFRS adopting airlines. Finally, this chapter also sets forth that there are jurisdictional versions of IFRS in the global context from the perspective of financial statements of airlines leading to some obstacles in understanding the financial reporting framework.

Keywords: Airline industry; financial reporting framework; diversity; uniformity; International Financial Reporting Standards; United States Generally Accepted Accounting Principles

1. INTRODUCTION

The airline industry is one of the largest global industries served by national firms, with operating profits of \$45.9 billion in 2018 and \$43.2 billion in 2019 on revenue of \$812 billion in 2018 and \$838 billion in 2019 (Hanlon, 2007, p. 9; IATA, 2019a, 2020a). The industry provides travel service to almost every country in the global context with aircraft fleet of 29,507 in 2018 and 29,697 in 2019 (IATA, 2019b, 2020b). It has played a crucial role in the creation of a global economy in terms of both its own operations and its impacts on related industries, including but not limited to, aircraft manufacturing and tourism. More than 65 million jobs in 2018 and 88 million jobs in 2020 are globally supported in aviation and related tourism, of which 10.2 million people in 2018 and around 11 million people in 2020 work directly in the aviation industry, including airlines, air navigation service providers, airports, the civil aerospace sector, which manufactures aircraft systems, frames, and engines (ATAG, 2018, 2020).

Historically, major technological developments have occurred during the growth phase of the airline industry such as the introduction of jet airplanes for commercial use in the 1950s, and the development of wide-body “jumbo jets” in the 1970s (Belobaba, 2015, pp. 1–2). Starting from 1978, the economic deregulation of airlines has been in effect leading to cost efficiency, operating profitability, and competitive behavior affecting both domestic air travel within each country and the continuing evolution of a highly competitive airline industry.

The airline industry has its own unique characteristics: (1) high growth rate versus low levels of profitability; (2) highly competitive structure; (3) monopolistic or oligopolistic structure; and (4) capital-intensive structure.

(1) The industry has a high rate of growth accompanied by low levels of profitability (Hanlon, 2007, p. 5; AICPA, 2016). As an evidence of growth, indicators show that airlines transported approximately 960 million passengers in 1986, 1.6 million in 1999, 4.4 billion in 2018 and 4.5 million in 2019 (Yergin, Evans, & Vietor, 2000; Isack & Tan, 2008; IATA, 2019b, 2020b).

On the other hand, profitability of the industry has been sensitive to economic factors such as the ability to attract and retain business and leisure passengers, the effects of political and strategic issues like hostilities, acts of war, terrorist attacks, and expansionism (AICPA, 2016; Isack & Tan, 2008; Lyth, 1996), disease and epidemics like COVID-19, the cost and availability of aircraft insurance, fluctuations in the cost of aviation fuel, competitive pricing policies, and government regulation (AICPA, 2016) as well as high operating costs for wages, jet fuel, maintenance, and depreciation expenses (Straszheim, 1969; Isack & Tan, 2008) versus changes in average fare levels and passenger demand (AICPA, 2016). Profitability indicators show that airlines are less profitable due to increases in expenses of \$766 billion in 2018 and \$795 billion in 2019 with a particular focus on increases in fuel costs, with net income of \$27.3 billion in 2018 and \$26.4 billion in 2019 (IATA, 2019a, 2020a).

(2) It is a highly competitive industry due to the following parameters: fare pricing, customer service, routes served, flight schedules, types of aircraft, safety record and reputation, code-sharing relationships, in-flight entertainment systems, and frequent-flyer programs (AICPA, 2016).

(3) It shows a monopolistic or oligopolistic structure. While the paper of Tan, Tower, Hancock, and Taplin (2002) included 80 airlines from 52 countries for an average of 1.5 airlines from each country, this chapter includes 79 airlines from 44 countries for an average of 1.79 airlines from each country. The same structure exists today.

(4) It is capital-intensive. The aircraft fleet is either owned or leased. Before leases were accounted for according to IFRS 16 under International Financial Reporting Standards (IFRS) and ASC 842 under United States Generally Accepted Accounting Principles (US GAAP) (Marşap & Yanık, 2018), airlines had reported approximately 80% of the aircraft fleet on the statement of financial position (i.e., around 80% of airline's aircraft fleet is owned or leased under finance leases) and approximately 20% of its aircraft fleet as well as various buildings (under off balance sheet leases) (Tan et al., 2002). However, currently, all leased assets and liabilities regardless of whether they are under finance or operating lease will be reported on the statement of financial position as soon as an airline adopts IFRS 16 or ASC 842 so that the statement of financial position reflects the liquidity, solvency, and debt/equity structure of an airline.

The objectives of this chapter are to indicate the diversity of the historical financial reporting framework in the airline industry, to determine the trend of IFRS adoption in the airline industry as of the year 2018, to indicate the determinants of IFRS adoption in the industry and set forth the jurisdictional versions of IFRS from the perspective of IFRS financial statements of airlines.

Within the framework of these objectives, this chapter is important because it gives users of airline-related financial information the opportunity to be informed about an industry that is financially sensitive in nature through a common denominator in the reporting of financial situation, financial performance, and cash flows at the financial reporting framework level.

This chapter has the following structure: Section 2 presents a literature review of financial reporting of airlines in the context of diversity and harmonization; Section 3 explains the data, accounting period for the data, constraints of the research and the research methodology; Section 4 discusses the diversity of financial reporting frameworks adopted by airlines considering past and present; Section 5 summarizes the determinants of IFRS adoption in the airline industry and jurisdictional versions of IFRS. Finally, Section 6 presents concluding remarks along with main findings.

2. LITERATURE REVIEW ON FINANCIAL REPORTING CONSIDERING DIVERSITY, HARMONIZATION, AND AIRLINE INDUSTRY

Accounting diversity is the difference between accounting and reporting practices of different countries in (a) accounting measurement, (b) financial disclosure, and (c) auditing practices (Choi & Levich, 1991).

Diversity in accounting has been part of the debate in the airline industry since 1992. Industry-specific primary areas of accounting leading to diversity were determined through KPMG's and International Air Transport Association

(IATA)'s 1992 survey of airlines' annual reports. This survey detected diversity of adopted accounting policies in airline financial reporting in the following areas (Tan et al., 2002): (1) unrealized foreign-exchange differences; (2) frequent-flyer accounting; (3) aircraft depreciation; (4) revenue recognition; (5) maintenance costs; and (6) lease accounting.

As a result of these observations, the IATA Accounting Policy Task Force issued 6 Airline Accounting Guidelines between 1994 and 1997 to minimize diversity and to improve the comparability of financial statements of airlines: (1) AAG 1: Translation of Long-Term Foreign Currency Borrowings; (2) AAG 2: Frequent-Flyer Programme Accounting; (3) AAG 3: Components of Fleet Acquisition Cost and Associated Depreciation; (4) AAG 4: Recognition of Revenue; (5) AAG 5: Accounting for Maintenance Costs; and (6) AAG 6: Accounting for Leases of Aircraft Fleet Assets.

To observe the effects of these guidelines on airline financial reporting, Tan et al. (2002) examined the level of diversity in airline reporting from the perspectives of measurement and disclosure using a sample of 80 airlines considering their 1997/1998 annual reports. The results of this research indicate that airline financial reporting became more uniform, and comparability of airline financial reporting was improved.

In 2016, the IATA Industry Accounting Working Group (IAWG) issued four Airline Disclosure Guidelines to provide comparability of financial statements in the airline industry. These guidelines cover (1) Hedge Accounting under IFRS 9; (2) maintenance accounting; (3) aircraft acquisition cost and depreciation; and (4) segment reporting (IATA, 2016a, 2016b, 2016c, 2016d).

In 2020, IAWG has recently issued three Accounting Guides to ensure comparability of financial statements: (1) IFRS 9 Financial Instruments; (2) IFRS 15 Revenue from Contracts with Customers; and (3) IFRS 16 Leases (IATA, 2020c, 2020d, 2020e).

The objective of former and current guidelines was to try to minimize the diversity and improve uniformity of accounting and financial reporting in the airline industry. However, it should be noted that these guidelines are based on accounting policies, and accounting policies are subsections of financial reporting frameworks like US GAAP and IFRS.

Therefore, the aim of this chapter is to take an overall picture of the financial reporting framework adopted by airlines in the global context considering past and present before moving on to further research.

3. DATA AND RESEARCH METHODOLOGY

3.1 Data

The sample of this research is made up of listed and non-listed airlines whose financial statements are available on their websites without language barrier regardless of whether they are member of IATA. Within the framework of these parameters, a sample of 79 airlines from 44 countries was established using the regional classification of IATA (Table 1). This sample consists of around 6% of

Table 1. Geographical Distribution of the Sample of Airlines.

	Number of Airlines
Americas	22
Europe	22
Africa – Middle East	9
Asia - Pacific	20
China – Northern Asia	6

1,303 commercial airlines whose financial statements are publicly available in the market as of 2018 (ATAG, 2018).

3.2 Accounting Period for the Data

The sample focuses on annual reports of airlines for the accounting period ended on December 31, 2018, to analyze current financial reporting practice in the airline industry. However, the end of accounting periods, sometimes vary from one country to another. In such cases, annual accounting periods ended on January 1, 2019, March 31, 2019, May 31, 2019, June 30, 2019, and September 30, 2019, were equivalent to the annual accounting period ended on December 31, 2018.

In addition, the sample uses the most recently available historical annual reports for analyzing historical financial reporting practice in the airline industry before the IFRS adoption regardless of the end of accounting period.

3.3. Constraint of the Research

A limited number of airlines (Air Malta, Ethiopian Airlines, Oman Air, Precision Air, PNG Air, Qazaq Air, and South African Airways) whose 2018 annual reports were not available were excluded from the sample considering 2018 as the common denominator of the annual accounting period.

3.4 Research Methodology

This research collects data and assesses those data using the frequency of distribution method regarding the financial reporting framework adopted by airlines considering past and present.

4. FINDINGS AND DISCUSSION

4.1 Financial Reporting Framework in the Airline Industry in the Past

Regarding the history of financial reporting framework in airlines, this research detected historical annual reports of 28 airlines (Table 2). By analyzing available historical annual reports of airlines, this research points out the following 4 issues:

1. The majority of airlines prepared their financial statements in accordance with generally accepted accounting principles or national accounting standards of

Table 2. Former Regulation of Financial Reporting in the Airline Industry.

Region	Country	Former GAAP/Standards
Americas		
GOL Linhas Aereas	Brazil (BR)	BR GAAP – US GAAP
Air Transat	Canada	Canadian GAAP
WestJet	Canada	Canadian GAAP
Air Canada	Canada	Canadian GAAP
Cargojet Airways	Canada	Canadian GAAP
Aeromexico	Mexico	Mexican Financial Reporting Standards
Copa Airlines	Panama	US GAAP
China and Northern Asia		
Cathay Pacific Airlines	Hong Kong (HK)	HK GAAP
China Airlines	Chinese Taipei	Chinese GAAP
Europe: EU, EAA, and Others		
Air France – KLM Group	France	French GAAP
Lufthansa	Germany	German GAAP
SAS Group	Sweden	Swedish Accounting Standards
Air Partner	UK	UK GAAP
Easy Jet	UK	UK GAAP
British Airways	UK	UK GAAP
Fast Jet	UK	UK GAAP
Aer Lingus	Ireland	Ireland GAAP
Norwegian Air	Norway	Norwegian GAAP
Turkish Airlines	Turkey	Turkish GAAP
Africa & Middle East		
Comair	South Africa (SA)	SA GAAP
Emirates	UAE	IFRS
Asia – Pacific		
Regional Express	Australia	Australian GAAP
Qantas	Australia	Australian GAAP
Virgin Australia	Australia	Australian GAAP
Korean Air	Korea	Korean GAAP
Asiana Airlines	Korea	Korean GAAP
Air New Zealand	New Zealand (NZ)	NZ GAAP
Singapore Airlines	Singapore	Singapore Accounting Standards

their country of incorporation leading to diversity in measurement and disclosure from one country to another unless countries with similar cultures, environments, and external factors such as similar background features like laws and company structures have similar accounting systems and thus similar accounting practices (Nobes, 1992, 1998).

2. Copa Airlines whose country of incorporation is Panama prepared its financial statements in accordance with US GAAP due to being listed in New York Stock Exchange (NYSE).
3. GOL Linhas Aereas whose country of incorporation is Brazil had dual reporting in accordance with BR GAAP and US GAAP.
4. Emirates prepared its annual reports in accordance with IFRS since 1994. It looks like that it is the oldest airline reporting under IFRS. This quite early adoption of IFRS at this airline compared to other airlines may be explained by coercive, normative, and mimetic pressures over the United Arab Emirates