



WORKING PAPER

TENTH SESSION OF THE STATISTICS DIVISION

Montréal, 23 to 27 November 2009

Agenda Item 3: Air carrier financial data

**IMPACT OF REPORTING OF AIR CARRIER FINANCIAL
DATA ON TRAFFIC FORECASTS — OTHER ISSUES**

(Presented by the Secretariat)

SUMMARY

The manner in which Frequent Flyer Programmes (FFP) and exchange rate differences are accounted for when reporting air carrier financial data may have an impact on the analytical and forecasting activities of ICAO by biasing the price elasticity of air travel demand. This paper also points out the lack of quantifiable data to ascertaining their true impact on these activities, by ICAO and other organizations. Hence the Fourteenth Meeting of the Statistics Panel (STAP/14) agreed to invite ICAO and IATA to assess the impact of frequent flyer programmes and exchange rate differences in the analytical and forecasting activities of the various civil aviation stakeholders through a survey to be sent to a sample of IATA members.

Action by the division is in paragraph 6.

1. INTRODUCTION

1.1 This paper deals with the non-standardized reporting rules of financial items in the income statement of the air carriers and the impact it may have on the analysis activities of ICAO. In particular, the paper looks at the impact of unrealized revenues due to marketing promotions and to the translation differences linked to currencies exchange rates.

**2. ACCOUNTING TREATMENT OF LOYALTY AND
PROMOTIONAL PROGRAMMES**

2.1 It is a common practice in the industry to have sales campaigns related to loyalty programmes such as frequent flyer programmes (FFP), or to promotional activities proposing, for instance, two tickets per ticket purchased.

2.2 Because of the volume and complexity of transactions involved in frequent flyer programmes¹. A one-to-one matching of flight coupons (both own coupon or interline one) against the loyalty or promotional ticket is not viable. This is the reason why air carriers are using two different accounting methods for treating the loyalty programmes, which are the incremental costs and the deferred revenue accounting method².

2.3 Differences between the two accounting methods

2.3.1 *Incremental costs accounting*: Incremental costs usually include fuel cost, passenger amenities, sales and ticketing costs. Under this method, the carrier records a liability for the incremental costs associated with passengers expected to redeem their frequent flyer points. The loss of revenue on the passenger ticket uplifted is not deferred in this accounting method, as the carriers consider that they do not need to defer revenues, since the redemption of an FFP does not take the place of a revenue-paying passenger but simply uses the excess capacity of the aircraft.

2.3.2 *Deferred revenue accounting*: Under this method, the loss of revenue attributed to the fair value of any mileage credit is deferred till the time the mileage credit is utilized.

2.3.3 For both methods, as carriers are not able to track each mileage point from its inception to its redemption, statistical models are used to calculate the redemption utilization trends and the deferred revenue liability. This may result in potential variances between deferral of revenues and redemptions. There could be several factors that account for this result as follows:

- a) changes in the popularity of programmes: the old redemption history is no longer valid;
- b) airline bankruptcy or merger;
- c) customers who rarely redeem or who built up points for larger redemptions;
- d) redemption pattern changing for services other than air travel;
- e) minimum point requirements may mean passengers are unable to redeem or do not become members of the air carrier loyalty programme; and
- f) expiration or purge period will result in write-backs of deferred revenues.

2.3.4 As a result, the revenues written back from the deferrals would not match the passenger uplifts, and these differences between deferrals of revenue and redemptions will translate into variances in passenger revenues and yields and therefore will bias any underlying analysis.

2.3.5 By adopting appropriate accounting guidelines, air carriers present a true and fair account of their financial situation to their owners, although their practices may not necessarily match the reporting requirements of entities such as ICAO, and IATA or others.

¹ 14 trillion frequent flyer miles as of January 2005 corresponding to 700 billion dollars – Source The Economist 16th January 2005.

² The deferred revenue liability method of accounting stems as defined in International Financial Reporting Instructions Committee (IFRIC) guidance, under Interpretation No 13, *Customer Loyalty Programmes*.

3. REVENUE PASSENGER AND PASSENGER REVENUES REPORTING INSTRUCTIONS

3.1 In order to reflect current air carrier marketing practices, in the ICAO reporting instructions for air carrier traffic (Form A), the definition of a revenue passenger includes, *inter alia*, the following category: *a) passengers travelling under publicly available promotional offers (for example, “two-for-one”) or loyalty programmes (for example, redemption of frequent-flyer points)”*.

3.2 Hence, the numbers for passengers carried and passenger-kilometres performed reported in Form A include passengers travelling under promotional offers or under the air carrier loyalty programme.

3.3 With regard to the treatment of passenger revenues for these promotional programmes, the reporting instructions in Form EF state that passenger revenues *“include all revenues earned from the transportation of passengers on scheduled flights, after the deduction of applicable discounts and rebates and interline prorated through-tariffs. In the case of promotional offers (i.e “two-for-one”), the gross passenger revenue for both tickets is to be charged with the applicable discount so as to reflect the net revenue of the value of one ticket. For passengers travelling on tickets issued in exchange for frequent-flyer points, nil revenue is to be entered”*.

3.4 Therefore, ICAO reporting instructions related to passenger revenues do not take into account the different methods adopted by each air carrier for its FFP accounting treatment. In Form EF, the definition of passenger revenues requires that no revenues be recognized for a FFP passenger which is not the case under the deferred revenue accounting method. Also, in form A (Traffic-commercial air carriers), the FFP passenger is considered a revenue passenger, in line with the deferred revenue liability accounting scenario, but in contrast with the incremental cost accounting method.

3.5 There is no specific authoritative accounting standard that an airline could adopt in accounting its FFPs, and this lack of uniformity in FFPs accounting practices is reflected in the way air carriers report their financial data to ICAO, and the extent to which such practices could lead to biased analysis when comparing yields across carriers has to be further explored.

4. TRANSLATION DIFFERENCES

4.1 International accounting standards require that ticket sales made under foreign currencies be translated into home currencies at the exchange rates prevailing at the time of the sale, and therefore be reported as traffic revenues in the home currency. Most international air carriers have significant exposure (more than 50% of their sales) to currencies other than their home currencies.

4.2 In Form EF, air carriers submit their financial data in their home currency. The internal ICAO process is to then convert them into U.S. dollars by using year-end exchange rates. The table below shows the U.S. dollar variances against the currencies of some major world economies.

Currency	2007_2002 % cumulated var	2007_2006 % var
Canadian dollar	-37.2	-14.9
Euro	-28.8	-10.5
Australian dollar	18.2	-0.9
Yen	-4.9	-4.2
Indian rupee	-17.9	-10.9

4.3 This difference between the exchange rate used for accounting and for reporting to ICAO makes international carriers significantly exposed to foreign exchange variances. Indeed, their income statements could be quite different from their traffic revenue reported, without having the variances clearly identified and reported separately.

4.4 ICAO's reporting Form EF and the results of the questionnaire on costs and revenues (sent each year to the States) are notably used to provide passenger yields in US currency for the purpose of ICAO forecasting and analysis activities. These yields are generated from U.S. dollar traffic revenues.

4.5 Any fluctuation in the value of the U.S. dollar against major world currencies has the potential of increasing or dampening passenger yields when they are translated into U.S. currency. Hence, for air carriers whose home currency is not the U.S. dollar, the currency conversion into the U.S. dollar could impact their yields. It is estimated by ICAO that in 2007, the passenger revenues generated by air carriers not registered in the United States amounted to US \$260 billion.

4.6 If appropriate steps are not taken since the beginning to isolate and remove these variances in foreign currency rates, they will translate into variances in yields which are essentially *noise* carried across a time series that could impact the traffic forecasts results.

5. ABSENCE OF QUANTIFIABLE DATA

5.1 Common to the above mentioned items is that no study has been conducted to attempt to quantify the exact impact that the differences between the accounting rules and the reporting processes may have on the real value of an air carrier's revenues. In the absence of quantifiable data, it is difficult to subjectively ascertain their impacts on analysis and on the price elasticity component of forecasts.

5.2 *Conclusions of the Fourteenth Meeting of the Statistics Panel (STAP/14)*. The panel agreed to invite ICAO and IATA to assess the impact of frequent flyer programmes and exchange rate differences in the analytical and forecasting activities of the various civil aviation stakeholders through a survey that could be submitted to a sample of IATA members.

5.3 Since the panel meeting, ICAO has forwarded to IATA a list of questions to be submitted to their members in an effort to clarify the issues raised in this paper. For its part, an IATA Committee is currently reviewing ICAO's questions prior to going ahead with the survey.

6. ACTION BY THE DIVISION

6.1 The division is invited to recommend that ICAO and IATA continue in their effort to assess the impact of frequent flyer programmes and exchange rate differences in the analytical and forecasting activities of the various civil aviation stakeholders through a survey that could be submitted to a sample of IATA members.

— END —