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KPMG’s Market Presence

KPMG member firms work extensively with:

- Passenger airlines;
- Freight airlines;
- Tour and charter operators;
- Regional and start-up airlines;
- Airports;
- Aviation services providers;
- Aviation authorities;
- Air navigation and civil aviation authorities.

Our aviation network spans every continent, with centres of excellence in:

- UK;
- Australia;
- USA;
- Hong Kong.

We are passionate about the industry. Our global network of aviation specialists meet regularly to share best practice and industry developments for the benefit of our clients.

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Alternatively, refer to Page 26 for your local KPMG contact.
The aviation industry continues to experience enormously testing times. The driving factor is the weakened global economy. The uncertain outlook makes predicting passenger and cargo demand increasingly difficult.

The industry is continually having to adapt to a variety of demographic, political and regulatory changes. These range from a growing demand for air transport in Asia, to new taxes, surcharges, and environmental and security requirements set by Governments.

**Introduction**

For all airlines and airport operators, adapting is part of survival.

- Many airlines have developed innovative alliance and joint-venture structures to work around route right rules and foreign ownership restrictions. Given the cost structure of the airline industry, the trend to consolidation is likely to continue.
- As oil prices remain high, airlines must ensure cost efficiency elsewhere. To be competitive, airlines must keep their supply chains and operations lean. They must ensure cash is managed effectively. As aviation taxes increase in many countries, it is important to keep operations tax efficient where possible.
- Many airlines around the world are restructuring to match changing circumstances. This is being achieved through a variety of options or combination of options. These include operational restructuring, a restructuring of the funding structure or undergoing a Chapter 11 procedure.
- Airlines continue to develop new ways to make their aircraft leases cost and tax-effective. The impact of IASB proposals to move operating leases onto the balance sheet would have a major impact on airlines’ accounts.
- Many Governments worldwide continue to tentatively liberalise aviation markets to lower fares and/or increase quality of the services provided. Airlines should be poised to seize opportunities to enter new markets. They must also make sure they are fully aware of local regulatory and tax arrangements.
- In the 21st century, IT security and infrastructure are critical for airlines. This is particularly the case for more established airlines with aging IT infrastructure. Protecting customer data is essential. If managed appropriately, it can enhance the customer experience. If managed inappropriately, it presents a major reputational and legal risk.
- Airports are being privatized or changing ownership more regularly. This presents an opportunity for international airport owners to expand. For example, airport regulators in Asia are looking for foreign or domestic partners. These partners are needed to provide the funding and expertise to meet the unprecedented regional demand for new and larger airports.

These are challenging times for the industry. This document presents a selection of KPMG member firms’ work in helping clients navigate their way through this complexity.
British Airways Plc integration of British Midland Airways Limited

Context
International Airlines Group (IAG), the parent company of British Airways Plc (BA) completed its £172.5m acquisition of British Midland Airways Limited (bmi) from Germany’s Lufthansa Group in April 2012. The decision to fully integrate bmi mainline into BA, the flag carrier airline of the United Kingdom, was made early on in the planning process.

IAG originally intended to acquire the bmi mainline business without the bmi Baby and bmi Regional businesses. However, as a buyer was not found, IAG acquired these businesses upon completion of the transaction, with a view to sell/wind-down as soon as possible.

The integration of bmi mainline into BA was driven by aggressive timelines to reduce the ongoing losses that bmi was incurring. This meant that targets were set to fully integrate the bmi business operationally within six months of acquisition. Key activities included the transfer or release of all staff, conversion of all passenger bookings to BA, extraction of bmi from the Star Alliance, and the transfer of all international stations to BA control and all aircraft under BA’s operating certification. The bmi legal entity was then to be reduced to a shell company within nine months of the acquisition date.

There were a number of significant challenges from the outset that required careful navigation, in particular:

- the complete restriction on interaction with bmi staff up to the point of takeover due to regulatory process;
- a heavily unionized employee base and the requirement for full consultation of multiple staff groups;
- managing the separation/sale of bmi Regional and wind-down of bmi Baby while simultaneously integrating bmi mainline;
- the need to take control of all bmi passenger bookings as quickly as possible to enable control of revenue flow and effective utilization of BA’s network and sales body;
- needing to close unprofitable international routes; and
- transfer of aircraft to BA certified operation balanced against the training flow-through of 1,400 bmi engineering and operations staff, cabin crew and pilots.

BA was also in the midst of a challenging airline industry environment with pressure from the market to deliver the integration efficiently, without undue financial burden and with minimal adverse customer impact.
KPMG’s role

KPMG in the UK was engaged from the pre-deal phase though to integration completion.

During the pre-deal phase KPMG provided strategic guidance to BA in structuring its integration programme. This included the overall approach, governance structure and establishing the project management office. KPMG also led and coordinated the multiple cross functional work-streams.

On contract signing, KPMG provided further detailed integration planning by preparing, coordinating and critiquing long-term delivery plans. The team also provided delivery coordination in key functional areas, particularly airport operations, customer services, cargo, and HR.

KPMG supported the BA HR team with the integration of bmi staff by using a KPMG cultural diagnostic to identify key points of variation. We developed forward action plans to support bmi staff in integrating with BA culture.

KPMG also assisted BA by preparing a comprehensive communication plan for external customers, suppliers and stakeholders. This included the communication plan with trade unions, BA staff and bmi employees.

Throughout the integration process, KPMG provided advice, challenge, and support to the Integration Committee.

Outcome

The integration program delivered its objectives on time, achieved cost synergies and began delivering revenue benefits ahead of plan.
Asian Airline: Tax Advisory

Context
The client, a fast growing Asian airline, had previously been flying domestically and decided to commence international operations. It required tax advice to ensure it was aware of and compliant with tax structures and regulations in five new operating jurisdictions.

KPMG’s role
KPMG’s member firm was engaged as tax advisors to the airline in 2006, and since then have been providing direct and indirect tax advisory services within the airline’s domestic operations.

The work has included advice on leasing, MRO and transaction structuring. KPMG’s member firm assisted the client to evaluate the tax and regulatory environment for its proposed international operations. This was done by combining KPMG’s member firm’s knowledge of the client’s operations and the aviation industry with expertise gained through KPMG’s global aviation network.

Advice was given on the following tax and regulatory issues:

• The appropriate and tax efficient entity set-up in each jurisdiction. For example, branch office or project office;
• Tax and local law registration (e.g. company law, labor law) requirements for a foreign airline company in each jurisdiction;
• Taxability of profits generated in the international jurisdictions. KPMG’s member firm brought to bear it’s knowledge of the double tax agreements entered between the airline’s home country and the foreign jurisdiction; and
• Indirect-tax implications on airline operations.

Outcome
The airline was able to define a consistent approach to tax strategy in each jurisdiction. The results of the work provided the airline with a deeper understanding of the tax and regulatory implications on their current and proposed transactions. It assisted the airline’s management in tax planning to maximise the tax efficiency of their operations.
Aircraft Leasing Company: Acquisition, Restructuring, and Disposal of South African Airline

Context
The aviation industry has seen considerable change since the global economy sank into recession and bank liquidity contracted. Many airlines and leasing companies faced financial distress. However, those companies with strong financial resources were well placed to engage in transactions with real value potential. The client, an aircraft leasing company, identified such an opportunity in 2008 for the acquisition of a South African airline. The client required an advisor with deep knowledge of the airline and airline leasing markets to advise on the acquisition, restructuring and ultimately the future disposal of the airline.

KPMG’s global Aviation Finance and Leasing Practice were therefore heavily involved. The Practice, a network of specialists, based in Dublin, has significant experience in aircraft leasing. KPMG is the only professional services firm to be included in the Airfinance Power 30 list, a list of companies voted on by the industry that make an essential contribution to aviation finance.

KPMG’s role
The client engaged KPMG firms in Ireland and South Africa to work on the acquisition and restructuring. Through their knowledge of both countries’ taxation and regulatory structure, they provided insight to help ensure the client’s acquisition and restructuring was successful and tax efficient.

The restructuring included a migration of the aircraft portfolio to Ireland, with the aircraft then leased back to the airline. After holding the investment for less than two years, the client realized its value on the disposal of the airline. KPMG in Ireland and South Africa advised on the disposal.

In addition to the due diligence work, KPMG in Ireland and South Africa advised on the following:

- Optimizing the tax efficiency of the acquisition, restructuring and disposal;
- The foreign transfer tax implications of migrating a portfolio of aircraft;
- The foreign withholding tax implications of leasing the aircraft;
- Optimizing the financing structure;
- Review of the overall structure from a transfer pricing perspective;
- Maximizing the tax basis of the aircraft and availability of tax losses;
- The tax efficient repatriation of profits;
- Detailed accounting implications; and
- The tax provisions in the legal agreements.

Outcome
Three major transactions were completed by the client within a two year period with the assistance of KPMG firms at every stage in the process.
Showcased Offering: Restructuring Services

Since the onset of the global economic downturn, airlines across the industry have been hit by decreasing profits and tightening cash flow.

Many airlines have sought to improve their cash and profit position through various forms of restructuring. A wide range of options are available, from deep seated financial and operational changes, through refinancing, to a formal bankruptcy protection procedure.

In recent years, KPMG member firms have worked with a number of full service, low fare, and leisure carriers on restructuring projects. We help them to implement these successfully and in a way that is supported by shareholders and lenders - often providing executive as well as advisory support.

KPMG member firms provide our airline clients with a variety of skills and expertise that is necessary for such wide-ranging projects. These have included:

- Provision of executive assistance, including to Chairmen, CEOs and CFOs;
- Accelerated strategic planning supported by extensive benchmarking;
- Redesign and management of annual budgeting processes;
- Short-term and long-term cash forecasting;
- Assessment of business and network plans and their impact on cash and liquidity;
- Analysis of financing facilities and advice on refinancing options;
- Review of aircraft lease and ownership arrangements;
- Providing negotiating tools for use with shareholders, lenders and national regulators;
- Contingency planning should existing management plans fail to deliver;
- Operational and financial improvements;
- Stress testing of liquidity position – checking the airline’s ability to withstand risks;
- Improvement of cash and financial management process;
- Project management of airline-wide turnaround plans; and
- Tax and accounting advice under Chapter 11 procedures.

Member firms use our professionals’ airline industry knowledge and expertise, combined with a wide range of technical skills, to help airlines achieve the best possible outcome.
European Airline: Enterprise Risk Management Implementation

Context
Around the world, the importance of strong corporate governance and risk management has become increasingly acknowledged. Our client, a major European airline with global operations, was required by the law of the country where it is based, to issue an annual corporate governance report reflecting its corporate governance structure and practices, including risk management information.

KPMG’s role
To ensure that the airline complied with these requirements, KPMG’s member firm worked with the airline to develop a risk management system. The system was based on leading practice principles adopted from the KPMG member firm’s risk management experience across a number of sectors. This was combined with industry expertise to provide bespoke technical assistance in the design and implementation of a formal risk management system for the airline, including the:

- Validation of the internally developed risk map;
- Preparation of an action plan to improve or implement controls to keep risks at a desired level; and
- Development of the risk management policy and detailed risk management procedures.

KPMG’s member firm worked with the airline to embed the risk management system and helped to keep it updated with developments in leading practice. This was done by providing ongoing assistance to the airline, updating the risk map and preparing the risk management disclosures in the Annual Corporate Governance Report.

Outcome
With KPMG’s member firm’s help, the airline was able to establish a leading practice risk management system integrated into the corporate governance structure that met its needs and helped it to manage risk more effectively.
European Airline: Post Acquisition Accounting

Context
A KPMG member firm’s client was acquired by another airline. As a result, the client had to fulfill the new parent company’s group reporting requirements.

The client required support on the preparation of their year-end reporting under IFRS while observing a very tight deadline and achieving the required reporting quality.

KPMG’s Accounting Advisory Services (AAS) were asked to provide support.

KPMG’s role
Accounting advisory specialists from member firms from multiple countries worked with the client’s staff to help ensure a successful and timely completion of all group reporting requirements before the closing deadlines. They helped to create reporting capabilities by providing coaching and on-the-job training to the client’s staff.

Key activities included:
- Support during preparation of the year-end IFRS reporting;
- Set-up of a hard-close approach in which the period 11 financial information was rolled forward to period 12 through various estimation approaches as agreed with the parent company and the external auditors;
- Documentation of IFRS and Purchase Price Allocation adjustments;
- Coaching of client personnel in fast and effective workarounds;
- Quality control of reported information to prevent any material errors;
- Identification of issues in the financial close process (which would be remediated in a second phase); and
- Identification of internal control weaknesses and implementation of a “monitored internal control system”.

Outcome
The tight reporting deadline was achieved and the submitted information was in line with the new parent company’s quality expectations.

The IFRS adjustments were analysed and documented to enable the client to work with the adjustments independently in the future.

A variety of financial close process findings were noted and recommendations identified. Phase two, to remediate these issues, was commenced in conjunction with the client.
Navi Mumbai Airport: Transaction Advisory

**Context**
Chhatrapati Shivaji International Airport (CSIA), Mumbai handles 30 million passengers per annum (mppa) today, and its peak capacity is 40 mppa. Due to the high growth rate in Indian air traffic, Mumbai will need a second airport by 2015-16.

The provincial government of the Indian state of Maharashtra is developing a second airport at a cost of around US$ 2bn to alleviate capacity constraints, Navi Mumbai International Airport (NMIA). This is proposed to be developed in four phases under a Public Private Partnership (PPP) framework.

**KPMG’s role**
KPMG in India was appointed in September 2011 to provide transaction advisory services for the development of NMIA. NMIA is a project of the City & Industrial Development Corporation of Maharashtra Ltd (CIDCO) and the Government of Maharashtra. It is the largest greenfield airport project in India.

KPMG in India is providing advice gained through significant experience and expertise in the airport sector. The role includes:

- Advising the Government on PPP structuring, using the international KPMG network to gain understanding of leading practice and innovative structures from around the world;
- Financial modeling, to provide the client with an understanding of the financial impact of their options;
- Regulatory advice;
- Bid process management, to ensure that the bidding process for this highly complex PPP is managed efficiently and generates the best possible bids for the client; and
- Negotiation support with the winning bidder, using KPMG in India’s knowledge of airport PPPs from both buy and sell side mandates to help ensure the right deal is achieved for the client.

Through this, KPMG in India will manage a number of complex challenges, including:

- This airport will be developed through a new regulatory framework. KPMG in India is modeling the effects of this on profitability to enable the client to be aware of the impact;
- Mumbai’s air traffic will be shared by two privately run airports once NMIA is operational. KPMG in India is working with the client to assess and evaluate possible risk mitigation options to arrive at a viable project structure for NMIA;
- The client requires an innovative project structure to maximize returns to stakeholders.

**Outcome**
This project is ongoing.

Given an in-depth understanding of the risks associated with development of greenfield airports in India, KPMG in India is currently advising on greenfield airport developments in a number of other cities in India.
Asian Airline: Due Diligence Services

**Context**
The client is a major Asian airline with global operations. The airline’s owning group had increased its borrowing funds to support a major acquisition.

As a result, it faced liquidity constraints, and undertook a group restructuring project.

As part of the group restructuring, the airline, carried out a debt restructuring process by agreement with its major creditor banks.

**KPMG’s role**
KPMG’s member firm provided due diligence services for the restructuring. KPMG’s member firm worked closely with the airline to fully understand the motivations and requirements of the airline for the debt restructuring process. KPMG’s member firm deployed a team with knowledge of the financial structure and operations of airlines. This enabled the team to provide customized advice which would take into account the client’s specific circumstances.

The work included estimation of the airline’s future cash-flows and assessment of the going concern and liquidation values. Through this, potential financial risks were identified and highlighted to the client. These included provisions in event of default relating to the airline lease contracts and early repayment claims relating to the issuance of exchangeable bonds. This information was then used by the airline to develop their restructuring strategy.

Finally, KPMG’s member firm reviewed the airline’s plans for issuance of asset backed securities to improve liquidity and evaluated the airline’s wider restructuring plan. This included their plans for disposal of investment securities and fixed assets. KPMG’s member firm made a series of recommendations around the debt and equity structure of the airline to help ensure it would obtain the best possible outcome from the restructuring. These recommendations included the extension of the debt maturity date, conversion of excessive debt to equity and increase in paid-in capital.

**Outcome**
Following KPMG’s member firm’s due diligence work, the airline was able to commence, with confidence, its debt restructuring process. As a result of KPMG’s member firm’s recommendations on the restructuring plan, the debt maturity date was extended. This provided the owning group with additional time to improve its liquidity position.
Asia-Pacific Airline: Goods and Services Tax (GST) Systems and Process Review

Context
The client is an airline based in the Asia-Pacific region. GST (a consumption tax similar to VAT) is applied to the majority of the airline’s domestic revenues and expenses. The airline’s annual GST bill represents a significant proportion of the tax paid by the airline. The capturing, recording and remitting of GST at the airline is administered by a number of stand alone sub systems.

In 2011 the airline sought an external review of their GST systems and processes. This was in order to support their tax risk rating from the Government.

KPMG’s role
KPMG’s member firm, the airline’s auditor, was engaged to perform an independent review of the systems, processes and controls that govern the GST payable and receivable transactions for the airline and its subsidiaries. KPMG’s member firm leveraged the extensive knowledge of the audit team and conducted the review concurrently with the 2011 financial statement audit in order to limit the impact on the day to day business of the airline. Given the focus on systems and processes, the audit team led the review, with tax specialists providing specific tax technical input.

The output of the engagement was a detailed report on the individual GST payable and receivable processes, specifically covering the following for each process:

- Mapping the entire GST process - from transaction initiation through to inclusion in the general ledger and remittance to the tax authority;
- Identification and testing of key GST controls;
- Data mining and testing of journal entries posted to GST general ledger accounts (performed by KPMG forensic specialists);
- Review of client’s tax compliance documentation; and
- Identifying potential performance improvements in the GST processes.

Outcome
The in-depth knowledge of the airline’s operations enabled KPMG’s member firm to efficiently provide an overall view on the effectiveness of the airline’s GST systems, processes and controls, which the airline has shared with the local tax authority.

KPMG’s member firm’s detailed process review identified several improvement opportunities that the airline implemented to enhance the GST control environment. In addition, KPMG’s member firm assisted management in identifying a number of one off instances where the airline had overpaid GST and received cash refunds.
Brazilian Airline: Identity and Access Management

Context
The client is a Brazilian airline. In 2007, following internal audit reviews, the airline decided to develop and implement a new Identity and Access Management Strategy. It sought advice to ensure that the new strategy was leading practice, and was implemented successfully. Alongside this, the airline wished to migrate from the Legacy Global Distribution System (GDS) and Flight Management platform to a new, leading practice platform. This was conducted as part of the airline’s efforts to join an international airline alliance.

KPMG’s role
KPMG in Brazil was appointed to assist the client to implement its Identity and Access Management program and support the system migration.

The main services provided to the client included:

- Diagnosis of the current state of identity and access management, and assistance on the implementation of the new processes, including access requests, revocations, evaluation and approval. KPMG in Brazil worked to enable integration with other areas such as human resources and third party management;
- Definition of segregation of duty matrices, monitoring potential conflicts of interest in the systems and making adjustments to the access rights in order to eliminate or mitigate risks related to the segregation of duties;
- Definition of user access controls and procedures to monitor the adequate execution of these controls;
- Assistance on the development of policies and procedures related to information security, based on the ISO 27002 standard;
- Provision of resources to support the client’s project to migrate to the new system. KPMG in Brazil was responsible for conversion and migration of over 60,000 users and 1,000 types of user rights; and
- Support to the client on the system migration, supporting the migration activities and establishing a framework to avoid conflicts of interest in the ERP, while ensuring the client’s migration timescales were met.

Outcome
The implementation of the new identity and access management strategy was completed, and the airline successfully joined a global alliance.
British Airways: IT Security Assessments and Third Party Reviews

Context
Over the past several years, KPMG in the UK has been an important provider of external information security services to British Airways. The range of services provided has increased since KPMG initially started providing independent assurance services to British Airways’ Business Controls function in 2004. A strong working relationship has since developed between KPMG’s information protection team and British Airways via the provision of high quality deliverables and frequent communication between the two teams.

The security services provided require in-depth technical skills, as well as industry knowledge and experience, and address a wide variety of systems and technologies.

KPMG’s role and Outcome
The main services KPMG provide to British Airways include:

• Platform security assurance review: This is an intense annual technical assessment of British Airways’ key operating platforms and systems. The work is performed to strict timescales to avoid disruption to the airline’s live operations, and to meet deadlines set by external audit. KPMG works with British Airways each year to minimize the impact of the audit upon the business and, where possible, to streamline the audit program.

• Internet security: KPMG provides assurance services over British Airways’ external facing network systems by providing both web application and network service level testing of systems and public facing applications. Web application testing consists of “Ethical Hacking” of British Airways’ systems, in order to establish areas of potential weakness, through the use of a number of tools and techniques available both commercially and developed in-house. KPMG has also been engaged to test the robustness of the network perimeter devices, such as Internet facing servers and intrusion detection systems.

• Third party assessments: KPMG has been commissioned to provide assurance regarding security over a number of third party organizations. The work has included assessments of the controls in place at the organizations, and the provision of processes and procedure recommendations in order for the organizations to remediate control deficiencies.
**Saudi Arabian Airlines: IT Transformation**

**Context**

Saudi Arabian Airlines is one of the largest Middle Eastern flag carriers carrying over 16 million passengers annually. Saudi Arabian Airlines is a complex entity that serves the Kingdom of Saudi Arabia with both commercial and public service obligations, having to cater for Royal/VIP demands and religious travel (Hajj and Ummrah) while operating commercially on a global network spanning approximately 90 destinations.

In the early 2000s Saudi Arabian Airlines was selected for privatization by the Government. In order to support the break-up of the airline into specific lines of business, Saudi Arabian Airlines chose to transform its information technology systems from their then current in-house portfolio of legacy based applications and infrastructure to 'Best of Breed' OTS products to support and serve their current and future requirements.

**KPMG’s role**

KPMG in Saudi Arabia was engaged in early 2008 until 2013 to set up, run and manage an IT Program Management Office with responsibility for driving and controlling the delivery of the IT Master Plan program. This program consisted of over 25 new technology solutions into nine specific lines of business across the enterprise.

Our multidisciplinary team worked across a number of work streams which included:

- Program Risk, Issue and Scope Management;
- Program Interdependency Management;
- Program Financial Control and Vendor/Contract Management;
- Business Blueprint Quality Assurance; and
- Program Communications.

**Outcome**

Our in-depth understanding of the airline industry, IT systems, project and program management enabled KPMG to assist Saudi Arabian Airlines to install a relevant and working methodology to manage the overall implementation of a complex and highly interdependent portfolio of applications and supporting infrastructure in alignment with new business processes.
Jet Airways: Co-sourced Internal Audit

Context
Jet Airways is one of India’s largest private airlines.

To establish and improve their internal control system over reporting, and to monitor and assess the business processes and control activities, Jet Airways engaged KPMG in India.

KPMG’s role
KPMG provided co-sourced internal audit services to Jet Airways for five years. Our role involved providing an independent assessment of the internal control design and operating effectiveness of business processes/areas selected from the Internal Audit Plan approved by the Board of Jet Airways. The various areas reviewed comprised:

- Inventory management (technical and non-technical);
- Fuel procurement;
- Treasury management;
- Revenue management;
- Contract compliance;
- Debtors and creditors review;
- High value procurement;
- Landing and parking charges;
- SAP authorization controls;
- Statutory compliance; and
- Freight inward charges.

Outcome
With our recommendations, Jet Airways improved and strengthened its internal controls across business processes. The results of our review provided independent assurance to the Board and management of Jet Airways on the adequacy of internal controls and compliance to company policies.
Qantas: Proposed Loyalty Program Initial Public Offering

**Context**
In 2008 Qantas considered the separation of Qantas Frequent Flyer (QFF) from Qantas Limited, including the listing of Qantas Frequent Flyer on the Australian Stock Exchange through an Initial Public Offering (IPO).

**KPMG’s role**
KPMG in Australia was engaged as Investigating Accountant to the IPO and provided advice to QFF on their business processes in operating as a stand-alone business. Our multidisciplinary team of 25 staff worked across a number of work streams which included:

- Carve out and audit of the historical results of the QFF business;
- Review of the forecast financial information to be included in the prospectus;
- Model integrity review of the financial model supporting the forecasts;
- Taxation advice on the separation of QFF from Qantas Limited;
- Accounting advice on the treatment of points ‘breakage’;
- Review of external actuarial advice on points ‘breakage’, and
- End-to-end business process review focusing on key risks and associated control measures.

Concurrent with the transaction process, the QFF business was implementing a number of strategic initiatives to establish the loyalty scheme as a premium loyalty offering in the market. These initiatives included:

- Any seat any time redemption options;
- Introduction of the QFF store, which is comparable with credit card loyalty stores; and
- A move from an indirect earn model to direct earn for credit cards.

These business-transforming initiatives added significant complexity to our review of the forecast financial information.

**Outcome**
Our in depth understanding of the operation of loyalty programs and the QFF business model, enabled KPMG to overcome these complexities and deliver across multiple work streams within the tight timescales required of the transaction.

Qantas deferred the IPO of Frequent Flyer and later made the strategic decision to retain 100 percent of the business.
Major US Airline: Internal Control Review

**Context**
KPMG in the US was engaged to undertake work on the effectiveness of the Airline’s internal controls over financial reporting.

**KPMG’s role**
KPMG evaluated management’s risk assessment process by:
- Identifying significant activities within the Airline (e.g. Aircraft Leasing, Frequent Flyer Accounting and Inventory Accounting);
- Performing process walkthroughs of significant activities within the Airline;
- Identifying critical process-level controls that mitigate identified process-level risks;
- Identifying critical entity-level controls that mitigate identified entity-level risks;
- Testing the design of identified controls; and
- Testing the operating effectiveness of identified controls.

**Outcome**
KPMG was able to provide valuable feedback to management on the effectiveness of the internal control environment over financial reporting.
Major European Airline: Carbon Risk Management and Fuel Hedging

Context
The client is one of the leading airlines in the European aviation market.

All airlines with destinations in the European Union (EU) have to participate in the EU Emission Trading Scheme (ETS). As part of this obligation, airlines had to submit their carbon monitoring concepts to the supervisory authorities by the end of 2009. The challenge was to set up a proper system for the measurement of carbon emissions, as well a process and methodology to start carbon trading and hedging.

Hedging of carbon emissions is closely related to the hedging of an airlines’ jet fuel exposure. For this task, a diverse set of hedging strategies exists. Although most airlines have defined a hedging strategy, it remains a challenge to measure the actual risk of their plain exposure as well as of the hedged portfolio. However, risk measurement is a key element in identifying potential hedging strategy improvements with respect to risks taken versus insurance costs.

KPMG’s role
The airline asked KPMG to validate its monitoring and ton kilometer concepts for the ETS. Additionally, KPMG was asked to provide a way of measuring the actual risk of the jet fuel exposure and the corresponding hedges and to enable the client to examine the risk as well as the cost of alternative hedging strategies in different market situations.

With respect to validating the concept for Carbon Measurement, KPMG:
- Reviewed the internal solutions to measure carbon emissions under EU-regulations. Data such as fuel density, fuel upload and flight distance had to be collected and aggregated; and
- Validated the internal controls and risk management processes, as several departments and IT tools were involved.

With respect to enabling the airline to optimize its hedging strategy, KPMG developed a comprehensive tool based on Microsoft Access. The key features of the tool were:
- Calculation of the earnings at risk of the exposure as well as of the hedge portfolio;
- Calculation of the cost of these strategies with respect to spreads as well as option premiums paid;
- Support of the hedge accounting process especially with respect to prospective as well as retrospective regression testing and the calculation of the hedge effectiveness; and
- Incorporation of all major instruments observed in the jet fuel arena as well as all major underlying pricing indices.

Outcome
A working paper including the key findings of verifying the ETS scheme concepts was elaborated. Furthermore, the key challenges of implementing the solutions described in the concepts were displayed and discussed with the airline. Subsequently, the airline received approval by the supervisory authority.

With respect to its hedging strategy the airline is now able to compare the risk and the cost of “simple” hedging strategies with more complex strategies that are based on other underlying factors than jet fuel and include e.g. complex option structures as instruments. With this ability, the airline has a key tool to further optimize its hedging strategy.
Asian Airline: Enterprise Risk Management Framework

Context
The airline commenced its Enterprise Risk Management (ERM) project in 2007 and gradually established the ERM framework. The Airline had completed the phase of risk identification and assessment, planned to further improve the efficiency and effectiveness of the ERM system for corporate risk management, and incorporate clear accountability to support risk management objectives.

Considering that the process of improving its existing ERM system is a long term project, the company had selected Investment Risk, which was one of the planned pilot risk areas as its starting point, to initiate the project.

KPMG’s role
KPMG’s member firm worked with the airline to compare its current risk management practices against industry peers’ and to analyze the business risks threatening the achievement of the business objectives. We first considered the existing risk management practices and position of the organisation on the Risk Management Maturity Framework. KPMG’s member firm then helped the airline to determine where the organization planned to proceed for its business growth.

KPMG’s member firm worked with the airline to establish a plan to achieve their risk management goals by identifying gaps between the current and expected risk management practices as measured against KPMG’s Risk Maturity Framework. We worked with the airline to help them understand the benefits of closing identified gaps and to develop an action plan to achieve the expected outcome.

Outcome
With our recommendations, the airline developed a balanced ERM framework that can assist the airline to align with their business strategy and embed the framework in their business processes with better focus on their most critical risks.

We assisted the airline with implementing a risk management program to help embed risk management within the organisation.

We also advised the airline on implementing an ongoing monitoring program to continuously improve and reinforce risk management practices within the organisation.
Asian Airline: Payment Card Industry Data Security Standard Compliance

Context
With acquiring banks increasingly putting pressure on their merchant clients to conform with Payment Card Industry Data Security Standard (PCI DSS) requirements, a major global Airline found itself being subjected to a series of fines for non compliance. As a result of these fines the Airline recognized the challenges that the transport sector face in developing efficient systems and processes that comply with industry standards for the handling of credit card receivables. Ultimately every business unit was affected with the heads of finance, operations, technology, treasury, tax and sales all being involved in the related issues.

KPMG’s role
KPMG worked closely with the Airline to understand how credit card information flowed through the organisation from point of sale to acquiring bank. After gaining a deep understanding of their processes, recommendations from an efficiency and PCI DSS compliance perspective were provided and a future state operating process and systems architecture for the handling of credit card receivables developed.

During the project, KPMG advised the Airline on:
• Cash and treasury management issues relating to global transaction banking. The project revealed practices that were not in line with industry standards leading to increased cost, limitations to management intelligence, technology constraints resulting in manual processes and inefficient tax planning;
• Vendor selection and management in relation to the implementation of new core systems;
• Business requirements for the implementation of new core systems including an impact analysis on processes and their compliance with PCI DSS;
• Appropriate policies and procedures for the handling of credit card receivables in line with PCI DSS;
• Identified and provided recommendations on process inefficiencies leading to revenue leakage in excess of US$10m; and
• Profits and income tax planning as processes and systems for the handling of credit card receivables were restructured. With more and more transactions being processed through internet based portals and differing geographical locations the airline wanted to have a clear view of its profits and income tax liabilities and sought insight into how this could be managed efficiently.

Outcome
A future state operating process and systems architecture was developed for the handling of credit card receivables. The Airline was able to streamline and standardise its processes around credit card receivables achieving significant cost savings with improved management intelligence whilst following a risk based approach to PCI DSS compliance.
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