

Virgin australia essay sample

[Transportation](#), [Airlines](#)



This report analyses Virgin Australia (ASX code VAH) and identifies its potential business and audit risks that will need to be addressed in the 2014 audit. It is presented to the Virgin Australia Audit Committee as part of the 2014 Audit planning process. The first part of this report provides a broad introduction into the business of Virgin Australian by examining its principal sources of revenue, its nature of operating, its competitors, the market share and the regulations affecting its operations. From this, it can be seen that Virgin Australia operates in a very competitive environment and generates revenue by the core business of passenger and cargo transport. The second part of this report analyses the external business environment which the civil aviation industry operates in and its specific impacts on VAH by using a PESTEL model consisting political, economic, socio-cultural, technological, environmental and legal which are macro environment factors affect strategic business planning.

Three major audit risks are identified and assessed in the third part of the report. These relate to revenue and income accounts, the PPE and intangible assets. The accuracy of revenue and income may be questionable due to of unearned passenger revenue obligations and future obligations in relation to credit voucher redemption rates. The PPE account is possibly overstated as it is hard to predict the next scheduled heavy maintenance especially for the new aircraft model and value of the leasehold properties are easily to be overstated. Finally the intangible asset account can be overstated, which is indicated by the the difficulty of the valuation of Sabre Sonic software and fair value of goodwill. 1. Information of Virgin Australia

1. 1 Sources of revenue

Virgin Australia Airlines is part of the Virgin Group which was established in 1970 by Sir Richard Branson. It is Australia's second-largest airline bases in Bowen Hills, Brisbane. Virgin Australia's principal activity is the operation of domestic and international airlines. It generates the majority of its income from the Domestic Airlines in Australia industry. In 2013 the company recognised revenue and other income of \$4, 020. 4 million for the financial year ended 30 June 2013. Revenue is measured at the fair value of the consideration received or receivable. Revenue is recognised for the major business activities as follows:

Airline passenger revenue- Airline passenger revenue comprises revenue from ticket sales. Other revenue- Other revenue comprises revenue earned from the provision of other airline related services (including freight revenue, on-board sales and other product revenue), unutilised carriage and redemption of credit vouchers. The Group defers revenue relating to the issuance of points to members in its loyalty program Velocity frequent flyer program. Cash received from third parties above the fair value of the redemption is recognised immediately in profit or loss. Government Grants- Government assistance received and confirmed no amounts will be refundable Aircraft Lease Income- Aircraft lease income relates to income generated from the leasing of owned aircraft. Net Foreign Exchange Gains - A net ineffective cash flow hedge and non-designated derivatives and foreign exchange gain of \$49. 1 million was recorded for the financial year 2013.

1. 2 Nature of VAH Production Operations

Australia was established in August 2000 with two aircraft operating on a single route, offering seven return flights a day between Brisbane and Sydney initially. It catapulted to the position of Australia's second airline after the collapse of Ansett Australia in September 2001. 1 The airline has grown to directly serve 29 cities in Australia from hubs in Brisbane, Melbourne and Sydney. 2 The company has more than 80 aircraft in operation, operates over 162, 000 flights a year and offers the following additional services: 3 Travel Extras - Holiday and hotel bookings, car hire, travel insurance, transfers, tours, event tickets, cruises and Currency Exchange. Airport Lounges - Virgin Australia provides airport lounges at Sydney, Melbourne, Brisbane, Canberra, Adelaide, Perth, Mackay and Gold Coast domestic airports. Designed for frequent travelers, entry is by membership only. Velocity Rewards - Virgin Australia's loyalty program that allows points to be used to purchase airline travel, hotel nights, car hire, online shopping and charitable donations. Freight - Virgin Australia offers domestic and international freight services to its customers, including same day and overnight express, perishable cargo, dangerous goods and animal transport services.

The diagram is company's every week flights, and we can observe it directly.

1. 3 Competition Analysis

Virgin Australia is facing competition from both international market and domestic market. The major competitor is Qantas Airways Limited which is the largest airline in Australia base on the number in fleet. Qantas has 244

aircrafts and Virgin Australia has 128 aircrafts according to Australian civil aircraft register search on ' Civil Aviation Safety Authority' on January 2014. Domestic market Virgin Australia, including Tiger Australia (Virgin owns 60% of Tiger now), occupies 35% of the domestic market share in Australia, and its major competitor Qantas, including its subsidiary Jetstar, accounts for a majority of 61% of the domestic market share in January 2014. Qantas (QF) has grown by 18% over 5 years (Jan 2008 vs. Jan 2014) while Virgin Australia (VA) has grown by 23% and Tiger Australia (TT) 136%. 4

International market Virgin Australia occupies 8% of the international market share in Australia, and its primary competitor is also Qantas which accounts for 24% of international market share in January 2014. Qantas international capacity is flat over 5 years while Virgin Australia increases the market share by 84%.

1. 4 Regulations affecting the company's operations

Environmental laws and regulations: The environment impact is a critical issue that VAH would consider in its operations. As the most significant environmental impact, Fuel emission is a great issue that VAH focuses on. There are significant monetary value fines and total number of nonmonetary sanctions for non-compliance with environmental laws and regulations. Therefore, to deduct fuel emissions, VAH supported Queensland Sustainable Aviation Fuel project and Mallee Jet Fuel project. Convention on International Civil Aviation, Civil Aviation Act 1988, Civil Aviation Safety Regulations 1998 (CASR 1998), Civil Aviation Regulations 1988 (CAR 1988), Civil Aviation Orders, Civil Aviation Advisory Publications rules under development manual

of standards, Australia's State Safety Program Virgin Australia maintain a strong safety culture and are committed to increasing awareness of safety in the business. It adopted Security Management System (SeMS) this year to maintain a safe and sustainable operation, and it is approved by the Department of Infrastructure and Transport (Office of Transport Security). Carbon Tax In order to cover carbon tax, Virgin Australia had to charge extra on domestic LCC passengers. (Jacob & Dale, 2013) International trade regulations and restrictions

Trade practice Act 1974 Virgin Australia's first priority is to ensure a safe, secure and healthy environment for our team members, contractors, customers and visitors. Competition regulation In order to operate the acquisition of local companies, VAH must get the permeation of Australia Competition and Consumer Commission (ACCC) and approved by Securities Industry. Australian financial reporting standards: the company is listed at the stock exchange and must produce financial reports in line with the. Breach of these regulations will lead to fines imposed by specific regulator, unlisted, or fall of market value as the result of investor confidence crisis.

2. PESTEL Analysis

PESTLE Analysis is an analytical tool for strategic business planning. PESTLE stands for Political, Economic, Social, Technological, and Environmental and Legal which are the macro-environment factors that affect strategic planning but are out of organisation's direct control. It is also a strategic framework for understanding external influences on a business. By understanding these

external environments, organisations can maximise the opportunities and minimise the threats to the organization.

PESTEL Factors

Overall Influences and Impacts on AAC

Political

Open Skies

Airlines are differs from many other industries, many airlines are wholly or partly government owned or subsidised. Therefore, protectionism is imposed. Open skies is an international policy concept that calls for the liberalisation of the rules and regulations of the international aviation industry, especially commercial aviation, in order to create a free-market environment for the airline industry. Signing up bilateral air transport agreements allows the airlines of two states or more than two states in multilateral air transport agreement to launch commercial flights that covers the transport of passengers and cargoes of countries in agreements. But each agreement takes a lot of negotiating, often between governments rather than between the airlines involved. Therefore, Australian government has a huge influence on how Virgin Australia expands their business, create new routes or increase the frequency of their existing flights. Management has to communicate and cooperate with aviation department closely.

Political Stability

Political stability contributes a great impact on travel industry. Australia is a political stable country which is beneficial to travel and airlines industries.

People around the world are fear of terrorism now and most travellers prefer to travel to safe countries. Also, airlines operate in a relatively political stable countries would have less security cost burden on their operating expenses; it helps the airlines to run the business.

Economic

Interest Rate

Due to have a full-year loss of \$98. 1 million in 2013. Virgin Australia's major shareholders Air New Zealand, Etihad Airways and Singapore Airlines, which collectively own 53. 4 per cent of the airline, have provided it with a \$90 million loan facility to ease any liquidity concerns. 6 Low interest rate definitely helps them to have a better operating environment. However, interest rate is uncontrollable and Virgin Australia realises the importance of hedging against volatility in interest rate. Therefore, they hold derivative financial instruments to hedge the interest rate risk exposures and other aspects such as foreign currency and fuel price. Also, majority of organisations have business loan and many families have mortgages. Low interest rate causes these organisations and families to have more spare money to spend on travelling either for business or leisure. It stimulates spending, economic activity and helps to increase the employment rate. Virgin Australia would be benefited from it definitely.

Economy

People living in a country with strong economy would travel more frequently in average. Therefore, Virgin Australia would have a direct impact on their business referring to the economy of the world. When the economy is in

recession, there is less demand of flights either for business or leisure. Virgin Australia has been engaged in a price war with its larger competitor Qantas. It faced a difficult economy and intense competition. The price war with Qantas had also made it more difficult to recover the \$47.9 million cost of the carbon tax. Virgin Australia had a full-year loss of \$98.1 million after tax in financial year 2013. Economic uncertainty continues to cloud its outlook. 8 But it has accessed new growth markets through the acquisition of Skywest Airlines with the launch of a new regional operation in May 2013 and re-entry into the budget market segment with the acquisition of 60% of Tiger Airways Australia in July 2013, These strategic investment provide Virgin Australia with a platform to be the lowest-cost aviation operation in all key market segments. It increases its ability to drive future revenue growth.

Socio-cultural

Change in perception

Air travel was earlier seen as an expensive cost for most people. However, with the development of technology in aviation industry and increasing number of low-cost airline companies, air travel has been made available to larger public. This promotes the aviation industry and VAH has benefited from it in the airline passenger revenue for its low-cost strategy

Increasing travel lifestyle

With the development of tourism industry, people now prefer to travel overseas on holidays. The overall income of the aviation industry in Australia in 2012 was around \$79.6 billion, which accounted for 6.1% of the GDP⁹. It

is believed that the increasing travel lifestyle helps VAH to get more revenue, especially in the international market¹⁰. Technological

New

technologies

Booking and check-in system that enable travellers to check in, booking and cancel flights is more customers friendly. In increasingly severe global competition environment, Australian civil aviation industry is upgrading their pilot cadet program and online reservation system to transit to the globally recognised reservation system to compete with competitors. It is believed that the selection of technologies can help airlines to be more effective and efficient. Nowadays smart mobile phones are widely used. Apart from the online booking and check-in system, more airline companies adopt mobile boarding and flight specials apps to provide convenience to customers and improve user experience. Mobile applications makes it easier for customers to order tickets or change their schedule. Nowadays companies have developed an extensive range of solutions to improve the passenger's journey, streamline and integrate airline and airport operations, track baggage and cargo, and ensure that the highest levels of maintenance and aircraft safety and security are effectively communicated The airline industry continues to deliver an integrated approach to fuel efficiency, waste reduction, sustainable aviation biofuel development and carbon offsetting to reduce emissions.

Technological Threat

The remote conference system is adopted by more business, especially

multinational companies and large - scale companies. After the international financial tsunami, more company decrease business travel and change to video chat meetings. For independent travellers, webcam software and social media may lead to less travel in general.

Environmental

Carbon emissions

The carbon emissions issue is drawing great attention of the public in recent years. In respond to this, Australia submitted its first Action Plan on managing Australia's aviation carbon emissions to ICAO in November 2012. The Action Plan is currently under review and Australia will submit an updated Action Plan to ICAO by June 2015, in accordance with ICAO's requirement. 11 Aviation industry, as one of the main sources of carbon emissions, has to manage its contribution to this issue. In order to decrease its carbon emissions, VAH has to introduce some newer, more fuel efficient aircrafts into their fleets, which means a huge expenditure in purchasing. The company may also need to change in its management to increase fuel use efficiency. It is a huge project for VAH, which is time- consuming and costly.

Noise control

Aircraft noise is an unavoidable consequence of aviation activity. Air services works with partners in the aviation industry to minimise the impacts of aircraft noise. It requires the airline companies to ensure that flight departures and arrivals are designed to minimise noise impacts on communities around airports. Under the monitor of air services, VAH has to

increase its expenditure on the technology and procedures that can reduce the aircraft noise. 12 Legal

Carbon tax

Australian government has imposed tax of 23 Australian dollar for every metric ton of carbon emitted which was put into action on July 2011(Flicking, 2013). Tax policies in response to major carbon polluters. The results in adding up to raw material, cost, acquisition costs, and operation coasts for the whole civil aviation industry.

Safety regulations

The industry must obey Civil Aviation Act 1988, CASR 1998, CAR 1988, and reforms and changes, and maintain a strong safety culture and are committed to increasing awareness of safety in the business.

3. Audit Risk

3. 1 Audit Risk 1

Account

Assertion

Revenue and Income

Accuracy

There is a risk that revenue may be overstated.

Revenue recognition from rendering of services as per AASB118; revenue is recognised by reference to the stage of completion of the transaction at

reporting date when the outcome of the transaction can be estimated reliably.

Revenue is recognised in profit or loss when carriage is performed. Airline passenger revenue received in advance is carried forward in the consolidated statement of financial position as unearned revenue based on expected future carriage.

Moreover, revenue from the redemption of credit vouchers is recognised in profit or loss as other revenue when carriage is complete, or when the credit voucher is no longer expected to be redeemed by the guest based on an analysis of historical non-redemption rates, or upon expiry.

Virgin Australia carries continuous assessment of unearned passenger revenue obligations and historical trends of non-attendance rates has resulted in an increase in revenue of \$11. 1 million for the year ended 30 June 2013 (2012: nil). As a result of a period of non-disrupted activity in the market and greater levels of program information, a review of the Velocity frequent flyer program occurred during the year ended 30 June 2013, resulting in an increase in program revenue of \$14. 6 million (2012: nil).

Also, there is a continuous a reassessment of future obligations in relation to credit voucher redemption rates resulting in an increase in revenue of \$8. 0 million for the year ended 30 June 2013 (2012: \$18. 9 million) as a consequence of continuing system improvements and a review of historical issued and expired credit vouchers.

However, what are these reassessments involved; what criteria does Virgin Australia use and who performs these reassessments would cause significant effect on the outcome. All these assessments should be carried by the party which is independent to Virgin Australia. Otherwise, the reassessments result may be too optimistic, historical non-redemption rate may not be realistic due to the weak economy and competitive operating environment. Then, revenue may be overstated.

In addition, the Group is a party to various alliance arrangements. Revenue under these arrangements is recognised in profit or loss when the Group performs the carriage or otherwise fulfils all relevant contractual commitments.

However, passengers always make changes near the original booked travel dates. The accounting system may not be able to catch all these amendments especially for the carriage performed by alliance partner airline. Then, revenue would be overstated if the passenger delays the travel date or cancels the booking and part of the ticket price needs to be refunded. In contrast, the revenue may be understated if the passenger changes the travel date to an earlier date.

3. 2 Audit Risk 2

Account

Assertion

Property, Plant and Equipment

Valuation and Allocation

There is a risk that the property, plant and equipment assets of VAH are misstated due to the fleet expansion and some other investments. In the annual report of VAH 2013, it is clearly seen that property, plant and equipment assets are valued at \$3005. 2 million on 30th June 2013, accounts for almost 86. 9% of the non-current assets, and nearly 67. 9% of the total assets. Hence this large proportion should attract great concern. Furthermore, there is an inherent risk that judgments of the managers would contribute to assets overvaluation.

Source from the annual report 2013

In 2013, VAH accessed new growth markets by the acquisition of Skywest Airlines and 60 percent of Tigerair Australia, which is completed in July. The company also launched new regional operation in May and invested in the Group's lounge facilities as well as the entertainment system in flight. Because of the fleet expansion, capital expenditure of maintenance obligations, investments in facilities and systems, property, plant and equipment assets increased by \$236. 2 million during this year, approximately 8. 53% higher than last year.

Because of the fleet expansion, large numbers of aircrafts and airports of Skywest Airlines and Tigerair Australia are getting into the possession of VAH. According to the annual report, VAH uses straight-line method in their depreciation calculation, and have different depreciation and amortization rates for different items. Therefore, including the assets of Skywest Airlines and Tigerair Australia into the system of VAH may result in the risk of misstatement of accumulated depreciation, and have impacts on the

valuation of these assets. In addition, it is a huge project to acquire some other company because large amount of information should be concluded into the financial system, which means there is a risk of miscalculation of the value of these assets.

There is also a risk of misevaluating investments in Group's lounge facilities and the entertainment system in flight. It is mainly because the tastes of customers and technology used in the system are changing very fast, therefore the value of these assets may decline accordingly, and some misstatements about valuation and allocation may happen.

3. 3 Audit Risk 3

Account

Assertion

Intangible Assets

Valuation & Allocation

There is a risk that the fair value of the intangible assets is misstated due to the difficulty of the valuation. From the consolidated statement of financial position, we can see the intangible assets have a big increase, such as from \$101. 0 million to \$329. 6 million. From the data, we observe that there is a big surge in the intangible assets, means the company experience some acquisitions and the revaluation of the intangible asset. Whether it is reasonable, we need to investigate it. Plus there is an inherent risk that judgments by management would result in asset overvaluation. The goodwill is the difference between the fair value and the purchase price. When the

excess is negative, a bargain purchase gain is recognized immediately in profit or loss. Then it can be belong to the total comprehensive income. Also from the financial statement, there is a big decrease in total comprehensive income, such as from \$22. 8 million in FY2012 to \$(98. 1) million in 2013, from here we can observe that there is a big problem in operating, so the management are likely to increase their profit, by increase the value of intangible assets may be a more easy way to do it.

Because when we use this way, we can give many reasons about it, and the reason is easy to get, so the management have a big incentive to use this way. The intangible assets have a big portion is goodwill. The goodwill acquired in business combination is not amortized. Instead goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired, and is carried at cost less accumulated impairment losses. To other intangible assets that are acquired by the Group and have finite useful lives are measured at cost less accumulated amortization and impairment losses. Amortization is calculated using the straight-line method to allocate the cost of intangible asset over the estimated useful lives. Amortization methods, useful lives and residual values are reviewed at each annual reporting date. When we use the above step to calculate the value of intangible assets, all the inputs we need to use is need us to estimate, such as recoverable value, useful lives and so on, also the choice of the amortization method. All about this need us to have a judgment, so there will be a problem in valuation & allocation.

Reference

<https://assignbuster.com/virgin-australia-essay-sample/>

Virgin Australia Official Website

<http://www.virginaustralia.com>

Auditing and Assurance Standards Board

<http://www.auasb.gov.au>

Institute of Chartered Accountants Australia

<http://www.charteredaccountants.com.au>

Civil Aviation Safety Authority

<http://www.casa.gov.au>

Official Airline Guide (OAG)

<http://www.oag.com>

Virgin Australia Preliminary Final Report for the 12 months ended 30 June
2013 Preliminary Final Report for the 12 months ended 30 June 2013 (PDF
256k)

zeeshanvali