ARE PUBLICLY LISTED AIRLINES CHEATING INVESTORS ON E261?

News / Airlines

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Over €5bn in compensations are not disclosed on major European airlines' financial reports over the last three years. With up to 90% of passengers being aware of their rights on claim compensations for disrupted flights and compensation obligations remaining valid for up to 10 years (depending on the country), it is of utmost importance that auditors initiate improved financial reporting standards forairlines. Otherwise, shareholders and investors might witness more collapses of airlines in 2019.

Every year, when the end of the financial year approaches, airlines, just like all business, consolidate their financial reports. They are very eager to report their operational profits, however, those numbers aren't always telling the complete truth. Since the airlines can get away with leaving compensation payouts out of sight and off their report - they have been doing it. Auditors should be the first authority to control and ensure airlines disclose and reflect dragging compensations on their balance sheet yet are not currently taking these considerations into account when signing off on financial reports.

Data by claim compensation companies, like Skycop, shows approximately 1 percent of flights fall under EU directive E621 with average amount per compensation at €351. More than 10 million EU passengers were eligible for reimbursement in 2017 and more than 11 million in 2018 – and impressive piles of money of €3.66 billion and €3.66 billion respectively.

Outstanding claims should be added to the liability side of the balance sheet and assigned as accruals when it comes to reporting. However, financial reports do not reflect that. These claims can have a great impact on net profits if such accruals are created insufficiently to cover carrier obligation to pay compensation in the event of flight disruption. In this way, investors are put at serious risk; this ambiguous financial information does not paint the whole picture, and thus it makes it harder to make an accurate judgement of the company's financial situation.

Whether it is intentional or simply done out of negligence, the fact remains that publicly listed airlines **are not reporting on E261 properly**. As it stands these same airlines may be more than half of the market accruals on E261. Since these same airlines do not create adequate reserves for passenger compensations and resultantly show excessive profits in the balance sheet, the value of the company shares are wrong. When the auditors are forced to make reserves and reflect the true financial situation of the airline, company value can fall sharply.

Take for example the famous low-coster Ryanair - the cumulative amount of passenger claims over three years from 2015 to 2017 should have reached impressive €1 billion, while the company has reported €180 million for 2015, €149.3 million for 2016, and €138.2 million for 2017 under Provisions clause on their balance sheet.

Based on the experience of Skycop and other claim agencies, up to 90% of passengers today know their rights and claim compensation. In response, reserves are formed by management judgment rather than historical data which leads to insufficient reserves. As a result, airlines do not pay compensation and contest claims with claim companies that represent passengers. The net profit declared without enough reserves is not real profit because the indemnity owed to pay for claims may last up to 10 years (depending on the country). The actions taken by claims companies could lead to the situation where airlines will be forced to pay all accrued claims in one financial year. Audit firms are already aware of the problem – as well as Skycop and other companies - and are working hard to make auditors aware of the scale of the problem. With the mounting pressure it is probable that financial market supervisors will finally address the reserves issue and request stock listed airlines to account for claims in a more responsible way.

The aggregate of compensations has a significant meaning to whole financial reporting and must be revealed separately, as accruals. It is a special time that airlines need to start paying attention to disrupted flight claims, since this impacts their sustainability. Flight compensations are already affecting the bottom lines of carriers, therefore auditors should initiate improved financial reporting standards and requirements for airlines accounts. Investors and shareholders have the right to be informed about the actual financial status of the carrier, otherwise more collapses will be coming in 2019.

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