

## FRAUD

## Airline Turbulence

*Running an airline is tough-going in the best of times, let alone in troubled times. But airlines are not only exposed to the vagaries of the economy; they are also vulnerable to fraud on many levels. Here are a dozen ills for which airline companies must constantly be on guard.*

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The airline industry was among the most exposed to the global economic crisis. Operational costs in the airline business are high and margins low. Fuel price volatility and exchange rate fluctuations can lead to ballooning debt or poor economic performance. Financial risks can also come from non-economic factors: air disasters, even when a company's own planes are not involved, can have a negative impact on the whole industry.

Fraud, too, is an ever-present danger. According to Kroll's recent *Global Fraud Report*, the problem is increasing in the transportation sector. (For a copy of the report, visit [kroll.com/about/library/fraud](http://kroll.com/about/library/fraud).) Moreover, economic challenges, such as those noted above, can make fraud cases more complex and harder to address. Airline companies need well-thought-out management strategies with up-to-date controls and continuous monitoring to prevent fraud. Here are some common situations and the related fraud risks that industry executives must consider.



**Information Technology:** IT supports numerous airline procedures, from aircraft navigation to ticketing to financial management. Information systems are therefore prime targets for fraudsters. An investigation for an airline headquartered in Latin America identified a US\$10 million fraud that used a fake register of suppliers in the Enterprise Resource Planning system. Well designed policies, controls, password protocols and accessibility rules for management software can minimize risks.

**Finance:** Although airlines tend to dedicate the bulk of their anti-fraud resources to protect against financial crime, this remains the biggest threat. Currency exchange rates are essential to airline activity, especially for international firms. As such, relationships with brokers require careful monitoring and companies should make sure that all activity fits strictly within the company's foreign exchange policy. Aircraft leasing contracts can also be a source of problems. Managers should therefore regularly review contract terms and service performance. Background checks usually uncover red flags that are often not raised by day-to-day monitoring systems.

**Cargo:** Cargo transportation has always been an important revenue source for airlines. Some, mainly small companies, however, do not have extensive cargo transportation departments and many airports lack proper storage facilities, making theft easier. Airway bills also require strict control. Incorrect weights or taxes on these bills can lead to losses. Moreover, false content declarations are illegal and can put the company at risk.

**Ticketing:** The rapid evolution of ticketing systems and related software has helped reduce fraud in this area. The ticketing process is still vulnerable to attack at numerous points, however, especially when payment is by credit card. Gangs specializing in card cloning use repeated ticket buying to obtain money. Corporate internal control systems should thus be synchronized with alerts issued by card companies. Moreover, credit approval systems

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must block suspicious transactions that are abnormal given the usual rate of regional card activity and the card holder's profile.

**Maintenance:** The acquisition of aircraft parts is crucial to an airline's success, often requiring precise logistical execution in the face of great urgency. Businesses in the sector live or die by their agility, and grounded aircraft mean lost income. For maintenance technicians, *aircraft on ground (AOG)* means a top priority situation. Urgency, however, must not lead to those responsible for procurement compromising on the quality of parts or suppliers. Fake parts are distributed by suppliers which very often have no certification from civil aviation regulatory agencies. Checking a supplier's documentation, as well as researching market prices, can reveal irregularities.

**Catering:** Although on-board food services have seen reduced menus in recent years to allow airlines to lower ticket prices, effective controls in this area can still help companies avoid fraud and other losses. One useful approach is to occasionally reconcile, by route and type of aircraft, the number of on-board meals with the number of passengers. This practice often raises red flags of potential fraud.

**Handling:** The implementation of contracts for the use of equipment such as boarding ladders, push backs, power plants and loaders for baggage handling must be thoroughly checked. Recording the time and equipment actually used provides useful data for certifying the fulfillment of contracted services. In a recent investigation, for example, it was discovered that, during the loading of an A319 aircraft, a luggage conveyor belt was not used, although the airline's service provider charged for its use nonetheless.

**Luggage:** The logistics involved in luggage handling must be as efficient as all the other processes relating to the arrival and departure of aircraft. Mistakes can happen and bags get diverted from the right destination. In some cases, however, we have found frauds varying from false content declarations to the issuing of refunds for supposedly lost luggage that was never checked. Moreover, despite automatic controls, repeated fraud related to excess baggage weight can cause considerable long-term losses.

**Marketing:** The results of marketing are often the most intangible of any purchased service, so they are the hardest to evaluate and control. Service measurement techniques should include microeconomic analysis and market studies previously agreed in the contract with the service provider. Without these, although a contract may be technically fulfilled, companies might well pay more than the activities are worth.

**Frequent Flyer Programs:** Although not the most common cause of fraud in the sector, the abuse of mileage programs has seen considerable growth. In a recent investigation, we documented the improper transfer of miles to friends and relatives, data manipulation to improperly credit miles to unqualified individuals, and the sending of malicious emails to obtain data illegally and misappropriate the points of program members.

This brief review underscores that airline companies need appropriate controls specific to each area of operation. They also need to align such controls with the creation of a compliance culture. Only through the commitment and support of every employee is it possible to reduce the levels of fraud within the airline companies.

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