Aero Africa Ltd (‘AA’) is an airline that listed on the Johannesburg Securities Exchange in June 2012.

AA is a decentralised company with the following divisions:

- Aero Africa;
- Aero Africa Mobilechefs (catering division);
- Aero Africa Technical (the technical division which provides aircraft maintenance services); and
- Aero Africa Travel Centres (Aero Africa’s own branded travel agencies).

United Auditors Inc., a firm of Registered Auditors, has been the external auditor of AA for the past ten years. United Auditors Inc., based in Johannesburg, is currently comprised of three audit partners and 30 trainees. Kingston Jacobs was the audit engagement partner for AA prior to his resignation from United Auditors Inc. in February 2012.

**Governance arrangements**

Prior to its listing, all the shares in AA were owned by Mr Marc Brooney, a highly successful South African businessman. Mr Brooney introduced a policy ten years ago whereby directors on AA’s Board were appointed for a three-year period only, in order to promote transformation. Since then the only person who has been reappointed was Ms Luhle Jacobs, who was the information technology director. To date, Ms Jacobs (wife of Mr Kingston Jacobs) has been a director for ten and a half consecutive years.

Prior to its listing, Mr Brooney consistently had to provide financial support to AA to enable it to continue as a going concern. Therefore to eliminate the need for on-going financial support of the airline, Mr Brooney proposed that –

- AA be listed at R50 per share;
- he would own 51% of the shares;
- all directors would receive share options on listing and annually thereafter;
- Mr Jacobs would be appointed as the chief executive officer (CEO); and
- Ms Jacobs would be appointed as the chief operating officer (COO).

Investors did not, however, accept Mr Brooney’s proposed listing price and shareholding. Rather, they believed that a market related price was R20 per share, and that Mr Brooney should own no more than 40% of the shares. Mr Brooney agreed to these conditions but added a condition of his own, namely that his shareholding would permit him to appoint the majority of the Board members. This was accepted and the Memorandum of Incorporation of AA was amended to reflect this.

Once listed and with the approval of Mr Brooney, Kingston and Luhle Jacobs nominated and appointed the following persons to the Board of Directors for a three-year period:

- Non-executive directors
  - Mr Ryan Abbott (22), a qualified aircraft technician;
  - Mr Nathan Barclay (70), a retired marketing manager who is now a director of various companies; and
  - Mr Tyler Callan (24), a travel agent.
• Executive director
  ♦ Ms Alexia Viljoen (41) CA (SA), as the chief financial officer (CFO).

There are no other directors. An audit committee and remuneration committee were established once the company had listed. In terms of a Board resolution the internal audit services have been outsourced to United Auditors Inc.

Within a few months of the listing, AA stated at a press conference that Ms Viljoen had ‘resigned with immediate effect to pursue personal interests’. In her letter of resignation to the Board of Directors of AA, Ms Viljoen stated the following:

The high director turnover rate at AA is a consequence of the three-year contract appointments made while it was a private company. This has resulted in the following practices, which are continuing even though the company is now a public company and listed:

• Upon their appointment, directors negotiate very large payments that would be payable to them if they were not reappointed after their three-year term.
• The rigging of tender processes is common practice – tenders are awarded to companies or individuals who secretly pay incentives to the executive directors.
• There is no focus on employee recruitment, remuneration or incentives, which has resulted in poorly skilled employees and a generally unhappy employee base.

When the CEO signed the engagement letter for the reappointment of United Auditors Inc. as the company’s registered auditor despite my reservations, and without the knowledge of the shareholders, I had no other option but to resign.

 Shortly thereafter the public shareholders of AA began raising concerns about the company’s commitment to compliance with the Companies Act, 2008 and its application of The Revised Code of and Report on Governance Principles for South Africa (King III).

AA and its flight operations

The core business of the airline is to move people and goods by air. AA operates in three distinct markets:

• Domestic: AA has the most extensive domestic schedule of all airlines operating in the South African domestic market;
• Regional: AA is one of the leading carriers and serves 20 destinations across the African continent apart from its South African destinations; and
• International: AA connects South Africa to all continents of the globe via ten direct routes.

AA is segmented on a geographic basis into South Africa, the rest of Africa, Asia, Australia, Europe, the Middle East, North America and South America. The CEO and COO of AA are currently reviewing the performance of each of these segments and want a detailed performance review of the South American segment, because this is one of the very few segments which is performing well.
South American segment

AA has landing rights for a daily flight from South Africa to the international airport at São Paolo, Brazil. As the agreement entails operating a single landing slot, the airline has one return flight per day on the Johannesburg to São Paolo (‘JNB-GRU’) route. This route has proved to be very popular among travellers as AA is the only African airline linking South America to South Africa. AA currently has no other landing slots in South America.

AA started using two new Airbus A330-200 aircraft for this route at the beginning of the financial year ending on 31 December 2012. These aircraft represent the latest technology on offer from Airbus in Europe, with one of their most important features being their fuel efficiency. The aircraft are financed by means of an operating lease entered into between AA and a European based aviation leasing company. The aircraft are configured with 36 business class seats and 186 economy class seats.

The financial results for the JNB-GRU route for the year ended 31 December 2012 are summarised below:

<table>
<thead>
<tr>
<th>Notes</th>
<th>Budget R</th>
<th>Actual R</th>
</tr>
</thead>
<tbody>
<tr>
<td>Passenger sales revenue</td>
<td>842 678 400</td>
<td>909 381 200</td>
</tr>
<tr>
<td>Cargo services revenue</td>
<td>19 600 000</td>
<td>19 800 000</td>
</tr>
<tr>
<td><strong>Total revenue</strong></td>
<td>862 278 400</td>
<td>929 181 200</td>
</tr>
<tr>
<td>Direct operating expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accommodation and refreshment costs</td>
<td>(14 625 360)</td>
<td>(15 331 680)</td>
</tr>
<tr>
<td>Catering</td>
<td>(21 491 520)</td>
<td>(23 354 240)</td>
</tr>
<tr>
<td>Jet fuel costs</td>
<td>(163 522 944)</td>
<td>(200 163 600)</td>
</tr>
<tr>
<td>Navigation, landing and parking fees</td>
<td>(18 666 000)</td>
<td>(19 091 800)</td>
</tr>
<tr>
<td><strong>Indirect operating expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aircraft lease costs</td>
<td>(474 018 000)</td>
<td>(490 931 000)</td>
</tr>
<tr>
<td>Electronic data costs</td>
<td>(16 278 000)</td>
<td>(16 456 000)</td>
</tr>
<tr>
<td>Other allocated overheads</td>
<td>(415 600 000)</td>
<td>(431 905 000)</td>
</tr>
<tr>
<td><strong>Operating profit for the period</strong></td>
<td>169 954 576</td>
<td>180 308 880</td>
</tr>
</tbody>
</table>

Notes

1. The budget was based on the following key assumptions:

   | Number of one-way flights | 732 |
   | Passenger numbers (average per one-way flight) | |
   | Business class | 24 |
   | Economy class | 148 |
   | Average one-way fare per passenger | |
   | Business class | R27 000 |
   | Economy class | R3 400 |
An evaluation of the actual results revealed the following:

- Two flights out of Johannesburg had to be cancelled – one for technical reasons and the other due to low passenger numbers. The passengers booked on these flights as well as those booked on the return flights from São Paolo, which had to be cancelled as well, were accommodated on AA flights on other days.
- A total number of 19 656 business class passengers had been carried on the route at an average one-way fare of R28 250, while 110 656 economy class passengers had been carried on the route at an average one-way fare of R3 200 per passenger.

It is AA’s policy to price a return ticket at double the one-way fare on this particular route.

2 AA had budgeted to transport a total of 14 000 tonnes of cargo on the JNB-GRU route for the year. Because AA has standing contracts with their customers in terms of which customers are charged for the volume of cargo transported, it considers this revenue to be fixed in nature. The actual quantity of cargo transported was 5% more than the budgeted quantity.

3 This represents the cost of the subsistence allowance paid to each crew member. A fixed number of cabin crew works on the Airbus A330-200 to São Paolo and the crew has a three-night stop-over in São Paolo. The budgeted and actual allowance was US $150 per crew member per day. The average budgeted exchange rate was US $1: R7,40 while the average actual exchange rate was US $1 : R7,80.

4 Each passenger is served two meals on each flight and it is airline policy not to carry any extra meals on a flight. The budgeted cost per business class meal was R180, while the actual cost per business class meal was R200. The budgeted and actual cost per economy class meal was R70.

5 The standard flying time to and from São Paolo is ten hours. AA budgeted for the aircraft to consume 4 800 litres of jet fuel per hour at a budgeted price per tonne of R4 654. The actual quantity of jet fuel used on the route was 33 360 600 litres and the actual average flying time was 9 hours and 45 minutes. Fuel is consumed evenly throughout the flight.

6 These costs are incurred per flight. The budget was based on an average cost per flight of R25 500.

7 This represents the annual operating lease costs of the two aircraft deployed to this segment. The operating lease payments amount to €4 300 000 for the year. The budget was based on an average exchange rate of €1 : R9,80.

8 This is the allocated portion of the information technology costs of AA. A review of the allocation indicates that the correct allocation rates have been used in respect of the budgeted and actual allocations.

9 This represents the portion of the overheads AA incurred at corporate level and apportioned to the different business segments and business units.
Performance assessment of the South American segment

AA makes use of variance analysis to evaluate the performance of its segments. The AA group does not prepare flexed budgets but instead compares actual results to original budgets.

At a recent meeting of the Board of Directors, the COO of AA was asked how critical business class passengers were to the profitability of the JNB-GRU route. The COO agreed to investigate the issue and report back at the next meeting.

Jet fuel

The CEO is particularly pleased with AA’s revenue performance in the 2012 financial year given that the actual results exceeded the budgeted results in tough economic times. However, he is concerned about jet fuel costs which were much higher than budgeted. AA did not hedge against jet fuel price increases and exchange rate fluctuations in the 2012 financial year. The cost of jet fuel has increased dramatically in recent months and the Board of Directors of AA has requested its executive management to investigate ways in which jet fuel prices could be hedged in future. Jet fuel prices are dependent on the prevailing Brent crude oil prices in US dollar.