

# Implementing an Effective Cost Control Strategy at Stations: Case Study of PIA

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## Abstract

*This case study describes the process of developing and implementing a strategy to control costs and reduce losses on account of frauds, accounting errors, wrong payments, etc., at the worldwide outstations of an airline where traditional oversight methods had fallen short of management expectations. By identifying the systemic weaknesses in various areas of station disbursement accounting arising out of lack of training, non-availability of important corporate policies and management directives and lack of standard procedures for preparing and dispatching disbursement reports to head office, a comprehensive Stations Disbursement Manual was developed to train and empower the managers at stations to control and release payments in a responsible manner.*

**Keywords:** *Airline Cost, Disbursement Accounting, Cost Control Strategy, PIA*

## INTRODUCTION

The Deputy Managing Director (Finance) of PIA was pacing to and fro in his office on the first floor of the head office. He was quite perplexed after his meeting with the CEO of the airline from which he had just returned. The CEO had called him to discuss a spate of financial scandals at various domestic and foreign stations, which were a cause of concern. He had told the DMD (Finance) that he was quite concerned about the increasing trend of frauds, leakages and wastage of precious funds taking place around the airlines' vast network. The CEO had not minced his words. He wanted visible action to stop further deterioration on a top priority basis. He directed the head of finance to take any measures thinking fit to control the situation and implement effective measures as soon as possible. "Let's meet again in four weeks and we can then go over your plans together and decide further steps required", the CEO had remarked.

The DMD (Finance) called a meeting of his top executives the same day. The meeting was attended by General Managers of Accounting, Revenue, Funds Management, Budgets as well as the Chief Internal Auditor of the airline (See Annexure for a partial Organization Chart). In the meeting, he declared, "Gentlemen, you are all aware of the recent high profile cases of frauds and wrong payments which have caused us losses of millions of rupees. I have just

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returned from a meeting with the CEO and he wants swift action to control this undesirable trend. Although we caught a few people, the damage was enormous. I know you have all been doing your best to minimize cases of frauds and collusion and some safeguards have already been deployed over the years. But it is quite obvious that the existing safeguards are not enough. I want you all to drop everything you are working on and immediately discuss this issue with your managers and come up with concrete ideas to improve the situation". The DMD (Finance) then went on to review the present status of recoveries, actions taken in individual cases and follow up of cases with other departments. As the other participants were leaving, he asked the General Manager Accounting to stay back. He asked him to convey his concerns to the Finance Managers abroad and within Pakistan and apprise them of the seriousness of the issue. "I want you to hold meetings with all your divisional corporate managers as well to review all the existing rules and procedures, identify any weaknesses and propose practical ideas for improvement. Top management will not tolerate any more frauds and scandals and I want you to move fast before another financial scandal erupts! Do I make myself clear?"

The next day, General Manager Accounting called a meeting of his corporate managers, attended by the Managers of Disbursement, Accounting and Payrolls and Taxes sections. It was a brainstorming session. Each one of the managers got a turn to speak. The steps already implemented were recounted and reviewed. All the progress made in accounting automation was recalled. The managers reviewed the existing training levels of staff and station finance heads. At the end of the session, General Manager Accounting summed up the proceedings as follows, "We already know what steps we have implemented in the past but they are obviously not enough. We need to come up with new ideas and tools to effectively control disbursements at outstations. You all have so much experience and also seasoned staff working in your sections. Use their knowledge, skills and experience to develop some strong and visible measures to prevent frauds and leakages. Top management is not going to tolerate cosmetic measures and reassurances any longer. We have very limited time to work out some tangible measures so that the financial assets of the corporation are adequately safeguarded. I hope and pray that you will come up with some innovative ideas within a couple of weeks".

Immediately after this meeting, Manager Disbursement returned to his office and called all his officers for a marathon brainstorming session. Among the officers working in the Disbursement Section were several who had prior experience of foreign stations. Some of them had worked in Saudi Arabia, the Middle East, the Far East, the United Kingdom as well as Canada and the U.S.A. All had interacted with internal auditors as well as external auditors. Manager Disbursement gave them a very simple guideline. He asked each one to make a list of the causes of frauds, errors and mistakes in accounting that they had observed while auditing station disbursement reports during the last five years. They were given only a week's time to comply.

One officer was given the task of compiling all the observations that were contributed by the officers of the Disbursement Section. In the next meeting, the compiled list of all possible reasons of frauds and irregular payments was shared with the staff of Disbursement Section. At that time, some insights were gained about the extent of the problem. For example, it was highlighted that despite the induction of so many business school graduates as well as qualified chartered accountants in the airline nobody had ever developed any material exclusively devoted to the subject of disbursement accounting at domestic and foreign stations as well as at various

finance sections attached with the departments at head office.

It was pointed out that although several documents had been developed in the past relating to specific areas of finance such as general accounting or automation, no specific document existed which could be used for guidance of outstation finance personnel regarding various questions related to disbursement accounting. The meeting stretched on for several hours as more and more officers shared their personal experiences and related cases of dealing with fraud and its unpleasant aftermath in the shape of enquiries, audits and, ultimately, dismissal of employees on disciplinary grounds. Everyone agreed that, indeed, there was a gap in the existing documents and an entirely new document will have to be developed from scratch that will address the following issues:

- Gathers all relevant administrative orders and circulars issued by the management from time to time in a single volume for ready reference by station finance managers as well as the station heads
- Must give a concise summary of all the management directives that were currently scattered in various old reports and manuals and were certainly not available at the newer outstations both within the country and abroad
- A standard procedure to control various types of payment must be developed and made a part of the proposed document, containing such fundamental information as the Schedule of Powers, limits of various functionaries and whom to approach for help if a station has any questions regarding a certain type of payment
- Contains comprehensive instructions arranged systematically to help the finance manager to release payments after meeting all the required regulations including audit requirements, tax aspects, foreign exchange regulations, IATA requirements, etc.
- It was also felt that as certain administrative orders and old financial circulars were very hard to trace, all old, as well as more recent orders and circulars, must be reproduced and attached as an integral part of the document

In other words, the document must be a complete resource for the station finance personnel as well as the station head who is already a joint signatory for each payment. The concept of developing such a comprehensive document by the Disbursement Section required formal approval of the management. Manager Disbursement and General Manager Accounting soon arranged a meeting with the DMD (Finance) where a presentation was made outlining significant areas to be covered by the proposed comprehensive document. “How long will you take to develop and issue such a document?” asked the DMD (Finance).

Manager Disbursement pondered over this question for a while before answering, “Sir, this is a new undertaking which has never been attempted before. We will know for certain how long the project will take once the initial work has started and we compile a complete list of requirements and contents which will be covered. Please give us a minimum of three months’ time to complete the project as anything less than this will be nothing but a miracle!” After some further discussion, the Director of Finance agreed to this limit and asked General Manager Accounting to provide all possible support to Manager Disbursement and his team for completing this project within the agreed time.

Pakistan International Airlines was established in 1955 through an Act of Parliament. Earlier the Ispahani family had established the Orient Airways as the first airline established by Muslim entrepreneurs which were shifted to Karachi in 1947 on the request of the Quaid-e-Azam, Muhammad Ali Jinnah. PIA made rapid progress in the early years after its establishment and provided an air link between the two wings of Pakistan. It soon spread its wings and expanded its international operations to the Middle East, Africa, the Far East and Europe. PIA became the first Asian airline to operate jet aircraft in 1960 when it introduced Boeing 707 flights to London and, soon thereafter, crossed the Atlantic and started flights to the USA. PIA pioneered the Silk Route to China and the Batik Route to the Far East and established several world records for long distance flights as well as speed records and won international accolades for its in-flight service. PIA was also a pioneer in Asia and helped in the setting up of over two dozen airlines and provided technical assistance to almost every airline in Asia as well as some African and European airlines.

By the mid-seventies, PIA was already a well-established airline with over two decades of operations and its network spanned four continents. It survived two wars with India and the breakup of Pakistan and successfully regrouped and resumed its operations after the cataclysmic events of 1971. PIA soon had to face the next big challenge in the form of the oil crisis of 1973 and the start of the era of high oil prices. Next challenge was to meet the huge demand of labour movement to the Middle East as a result of the construction boom in Saudi Arabia and the Gulf states. PIA opened several new offices in the Middle East and North Africa to cater to the increasing demand for air transportation. The number of employees started increasing exponentially as new pilots, aircrew, aircraft engineers and other personnel were hired in record numbers. At the same time, new facilities were set up including flight kitchens, wide-body aircraft hangar, a modern world-class training centre, and one of the first flight simulators in Asia where pilots were trained to fly wide-body aircraft such as the Boeing 747. This record growth propelled PIA into the top ranks of Asian airlines. However, PIA had no time to rest on its laurels as further challenges were in the offing.

PIA was asked by the United Arab Emirates to help set up a new airline in 1985 based in Dubai named Emirates. PIA leased out two of its own aircraft along with crews and ground personnel to assist the new startup. Soon Emirates was joined by Qatar Airways and other Middle Eastern carriers who challenged PIA's dominant position and gained access to the lucrative Pakistan market. Successive governments allowed greater and greater access to the Pakistan market in the nineties resulting in the gradual loss of market share to the newly established Middle Eastern carriers. At the same time, permission was granted to private airlines to start flights on the domestic sectors of Pakistan. These developments further weakened PIA's competitive position and resulted in turning it into a loss-making entity which continued to pile up record debts year after year, a state from which it has not recovered for over fifteen years.

### *A Conceptual Model for the Disbursement Accounting Manual*

After formal permission was granted by the top management to develop a disbursement accounting manual, Manager Disbursement held a series of meetings with his team members to come up with an innovative solution which would help to plug the rising cases of frauds, leakages, duplicate payments, wastage of resources, wrong accounting, incorrect capitalization of assets, unsettled audit observations, non-recovery of advances from employees and other

parties, etc. Unfortunately, these negative developments had increased in recent years and it was important to uncover the underlying reasons before a solution could be developed.

After a series of meetings and countless *impromptu* discussions, the following points emerged:

- Lack of knowledge of newly posted finance staff of the basic rules governing the airlines' disbursements
- Low staff morale at several important stations, due to years of neglect, resulting in taking shortcuts and not exercising due diligence before releasing payments
- Lack of availability of relevant administrative orders, office orders, financial circulars, audit observations, etc., in the finance sections at domestic and foreign stations.
- Non-availability of even the most essential rules, policies and procedures at stations, such as the Schedule of Powers
- Lack of proper training of the accounting personnel, especially at junior levels who were hired within the last five years or were inducted into finance department on a contract basis without a formal induction procedure
- Appointment of station heads who lacked formal education in finance and personnel management, e.g. individuals with non-airline backgrounds or former sportsmen
- Other specific reasons, which varied from country to country, e.g. lack knowledge of local tax laws or employment regulations or the non-appointment of local tax advisors or legal advisors or translation services due to financial constraints resulting in the imposition of heavy penalties by local authorities due to non-compliance of employment or tax regulations
- As airline disbursement activities are of a specialized nature and are highly rule-bound, it came as no surprise that even qualified chartered accountants, cost and management accountants and university graduates with business degrees were lacking the degree of expertise expected from them and needed further training in airline disbursement accounting

### *Challenges in developing a Disbursement Accounting Manual*

Once these main sources of negative performance were identified, it was decided to prioritize the work so that some tangible progress could be shown to the management. So in the first phase, the teams were tasked to locate and compile all the administrative orders, office orders and financial circulars and audit observations, which had been circulated over the last fifteen years. Of course, this was a huge task and some orders or circulars were not readily available in the administration department's files due to their old age and the constant shifting of records from one location to another. Further complications arose as the old circulars had been defaced or handwritten notes added which made them illegible. It was then decided to scan all the orders and circulars and edit them for clarity to remove any chances of misinterpretation. Even some overseas stations were approached for sending copies of important local tax rules and employment regulations, especially regarding staff salary deductions.

When this phase of collecting all the circulars and capturing them digitally through scanners was in the concluding phase, the question arose how best to organize them? Should they be simply in chronological sequence? Alternatively, should they be organized subject wise? After

a lot of debate, it was decided to have a multi-column layout wherein each expense account would be listed first, followed by the account description, the type of control to be exercised, and finally giving the reference of the annexure containing the specific administrative order or financial circular. This layout would ensure that no station finance manager would fail to locate the required control information easily.

Next, in order to ensure a complete reference guide, it was also decided to compile a summary of all the administrative orders issued during the past decade. This was done so that only current and valid rules are conveyed to the stations and they are not burdened with obsolete information. Again this was a painstaking task and was not fully visualized at the inception stage of the project. In the Summary of Administrative Orders section, all administrative orders were listed chronologically, followed by the subject. The new concept introduced was to list all the related administrative orders in the next column. The last column listed all related expense accounts which could be affected by a particular order. To give an example, medical treatment for dependent parents at other than the station of posting of employees in case of non-availability of facilities was covered by Administrative Order 29/89 dated 18 September 1989. Nevertheless, it was, later on, amended by the PIA Personnel Policies Manual, Volume 1, Chapter X, Rule 14 (b). Expense account codes 42140, 42160, 42170 and 42220 were affected by this A.O. Such comprehensive information integrating sources from the Finance and Administration departments had never been compiled before by the airline.

### *The Way Forward*

As this was one of the most important sections of this document, it would be worthwhile to describe a few of its features. Previously, wrong accounting was done at the station as no comprehensive resource was available either with the finance manager or with the station head who was traditionally appointed from either the marketing or customer services departments. But if such comprehensive information was made available at every location both within Pakistan as well as abroad, then the concerned person would be empowered to implement the management instructions in letter and spirit, ensure that all necessary safeguards are observed as well as bring uniformity in accounting. This point was repeatedly emphasized to the middle and the upper tiers of the management during various interactions to highlight the importance of providing the required resources at every station.

At the same time, it was emphasized that all future postings of finance managers and station heads should be made conditional on their completing a full course of the briefing at various head office departments where they would undergo customized training on the various features of the disbursement accounting manual. Further benefits were envisaged, as precious time would be saved in avoiding frequent queries from the head office about various types of expenditures that were being received from the outstations.

With the passage of time and growth of the airline network to more than forty countries in four continents, the management had taken various policy decisions regarding staff induction, training, emoluments, retirement benefits, medical treatment, educational facilities, hiring of accommodation, provision of transport facilities, payment of advance rent, retirement age of various categories of employees, introduction and discontinuation of specific trade-related allowances, e.g. officiating allowance, entertainment allowance, perquisites allowed to cabin crew, cockpit crew and management categories, etc. The summary of administrative orders

guided the station staff to correct entitlements and payment procedures in different situations and pre-empted questions. One of the frequent areas where questions were raised was the provision of hotel accommodation to cockpit and cabin crew and passengers laid-off from transit/ delayed/ cancelled flights. All required guidance was available in A.O. 48/90 dated 27 September 1990. This A.O. was later amended by A.O.s 18/91, 12/92 and 08/97 respectively. The related expense accounts were 43050, 43060 and 55040. So by going through the summary, a complete picture could be obtained of all categories of expenditures likely to be encountered at the stations. Furthermore, cases of wrong accounting could be minimized by a careful reading of the concerned Administrative Orders. (See attached Annexure for a list of Administrative Orders)

Now that the main issues had been identified and the required administrative orders, office orders, financial circulars and management directives had been meticulously assembled, scanned, organized and summarized, it was time for the last and final stage. It was now time to write out important instructions for the finance managers to follow before and after releasing payments. Using the collective wisdom of the old and experienced hands who were available in the Disbursement Section, detailed notes were written for preparation of pay vouchers, signature verification, depending only on the original documents, serial ordering of pay vouchers, safe retention of all pre-numbered stationery, specially addressed envelopes were developed and sent in bulk to the stations to avoid cases of lost and wrongly addressed envelopes. Instructions regarding budgetary control were also included in this section.

Approximately five hundred volumes of the new Stations Disbursement Manual would be required to be printed and distributed all over the network in a very short time. PIA Training Centre would be involved in order to arrange formal training sessions for finance managers and station heads. Arrangements for printing and procurement of necessary material would have to be coordinated with the PIA Printing Press. Again, teams were formed and duties were distributed to achieve all the targets within the given time frame. Word had already spread about the new Manual and the stations were looking forward to receiving their copies soon. When the DMD (Finance) met the CEO a few weeks later, he presented him with a copy of the new Stations Disbursement Manual.

The CEO was more than happy with the collective efforts of Manager Disbursement and his team. A formal ceremony was held to launch the new manual and soon copies were dispatched to all the domestic and overseas offices of PIA. It was made an official document and a part of each station's permanent record. An amazing level of improvement soon became noticeable as the quality of the disbursement reports started showing marked improvements after the very first month of its implementation. The station disbursement reports were now complete and came with all the required supporting documents thus reducing the need for raising unnecessary queries and follow up. Positive feedback was also received from Internal Audit teams who were deputed on station audits. Managers of Payrolls section, as well as the other head office Finance Divisions, were full of praise for the improved quality of financial reporting from the stations.

Perhaps the best accolade came from one of the directors who returned from a tour of the European stations. "At each station I visited, both the station head as well as the finance head made it a point to praise the way in which their productivity had increased after the issuance

of the Stations Disbursement Manual (PIA Stations Disbursement Manual-2001, 2001). Previously they were overburdened with correspondence with the Head Office to resolve all sorts of queries, recoveries of wrong payments, making corrections of wrong accounts coding, sending additional supporting documents and so on. But now they are self-sufficient and feel empowered to release payments and account for them with complete confidence”.

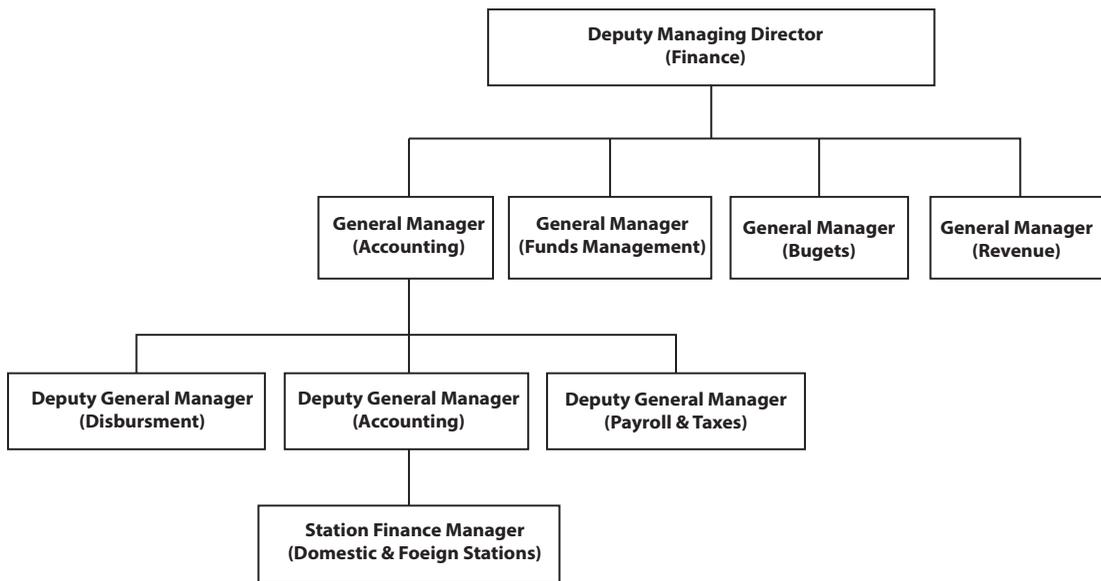
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### *Annexure*

#### *A-Partial Organization Chart – Finance Department- PIA*



#### *B-Year- wise Number of Administrative Orders issued (1989-2001)*

1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
40	61	56	40	33	29	10	11	22	12	45	19	48