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Alaska Airlines

FAA-02-13918-5

December 28, 2000

Passenger Facility Charge Branch (APP-530)
Joseph Hebert
Airports Financial Assistance Division, Room 619
Federal Aviation Administration
800 Independence Avenue, S.W.
Washington, DC 20591

02 DEC 29 11 46 AM '00
FEDERAL AVIATION ADMINISTRATION

Dear Mr. Hebert,

It is our intention to submit information pertaining to the costs Alaska Airlines incurs in collecting, handling, and remitting Passenger Facility Charge revenues. However, it is not possible to meet the December 31, 2000, deadline. I anticipate forwarding the information to you by January 9, 2001.

I hope this short delay will not seriously inconvenience you.

Sincerely,



Sally Walcott
Manager, Revenue Accounting
Alaska Airlines, Inc.

Alaska Airlines

January 4, 2001

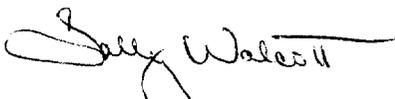
Passenger Facility Charge Branch (APP-530)
Joseph Hebert
Airports Financial Assistance Division, Room 619
Federal Aviation Administration
800 Independence Avenue, S.W.
Washington, DC 20591

Dear Mr. Hebert,

You will find enclosed the submission of Cost Incurred in Collecting, Handling, and Remitting Passenger Facility Charge Revenues. Note that this submission covers both Alaska Airlines, Inc. and our sister airline, Horizon Air Industries, Inc. As required, the 1999 data has been reviewed by our independent accountants and their report is attached.

If you should have any questions related to the submission, please refer them to me.

Sincerely,



Sally Walcott
Manager, Revenue Accounting
Alaska Airlines, Inc.

(206) 988-9352

Alaska Airlines, Inc. and Horizon Air Industries, Inc. Confidential

1999 Actual Costs, 2000-2002 Forecast Costs Incurred for PFC's

	Actual Costs 1999 ¹	1999 Pro-Forma ²	Implementation Costs ³	2000* Costs	Full Year Costs 2000 (9A+3F) ^{4,5}	Forecast 2001 ^{5,6}	Forecast 2002 ^{5,7}
Credit Card Fees / Bad Debt Expense	846,555 70%	1,269,833 78%		667,021 67%	889,361	1,187,075 (C)	1,610,423 (C)
Audit Fees (External)	3,000 0%	3,000 0%	7,000 20%	3,099 0%	3,099	3,173 (B)	3,250 (B)
Disclosure Costs	52,162 4%	52,162 3%		51,413 5%	68,551	70,196 (B)	71,881 (B)
Reservations (RSSRs) (fully allocated)	U/Q	U/Q		U/Q	U/Q	U/Q	U/Q
Passenger Services (CSRs)	U/Q	U/Q		U/Q	U/Q	U/Q	U/Q
Data Entry:							
Internal	- 0%	0 0%		- 0%			
ARC	- 0%	0 0%		- 0%			
BSP	- 0%	0 0%		- 0%			
Revenue Accounting	4,546 0%	4,546 0%	6,875 20%	4,707 0%	6,276	7,054 (C)	7,576 (C)
Tax Department	2,120 0%	2,120 0%		2,231 0%	2,975	3,344 (C)	3,591 (C)
Accounts Payable	1,254 0%	1,254 0%		1,403 0%	1,871	1,916 (B)	1,962 (B)
Corporate Property Dept	6,326 1%	6,326 0%		7,407 1%	9,876	10,113 (B)	10,356 (B)
Training:							
RSSRs	4,598 0%	4,598 0%		3,587 0%	4,783	5,376 (C)	5,774 (C)
Data Entry	0 0%	0 0%		- 0%		0	0
Passenger Service (CSRs)	63,586 5%	63,586 4%		54,346 5%	72,461	81,447 (C)	87,474 (C)
Internal On-Going IT	44,378 4%	44,378 3%		36,523 4%	48,697	54,736 (C)	58,786 (C)
CRS On-Going fees	172,962 14%	172,962 11%		162,796 16%	177,595	199,617 (C)	214,388 (C)
ATPCO	573 0%	573 0%		573 0%	573	587 (B)	601 (B)
ARC + BSP	2,120 0%	2,120 0%	2,869 8%	3,934 0%	5,245	5,896 (C)	6,332 (C)
Internal One-Time IT update			17,549 51%				
CRS One-Time update			U/Q				
Interest Revenue (Net)	(189,601) n/a	(284,402) n/a		(153,178) n/a	(204,237)	(266,785) (A)	(353,841) (A)
TOTAL COSTS	1,204,180 100%	1,627,458 100%	34,293 100%	999,040 100%	1,291,363	1,630,528	2,082,393
TOTAL COSTS LESS INTEREST	1,014,579	1,343,056		845,862	1,087,126	1,363,743	1,728,552
Number of PFCs Remitted	13,249,958	13,249,958	13,833,543	10,375,157	13,833,543	15,216,897 (A)	15,977,742 (A)
Number of PFCs Collected	14,391,535	14,391,535	15,132,936	11,349,702	15,132,936	16,646,230 (A)	17,478,541 (A)
Cost / PFC Remitted	\$0.0766	\$0.1014	\$0.0025	\$0.0815	\$0.0786	\$0.0896	\$0.1082
YOY Change				6.5%	2.6%	14.0%	20.7%
Cost / PFC Collected	\$0.0705	\$0.0933	\$0.0023	\$0.0745	\$0.0718	\$0.0819	\$0.0989
YOY Change				5.7%	1.9%	14.0%	20.7%

ASM growth rate 0.0% 10.0% 5.0%
 CPI - Urban from WEFA ⁸ 3.3% 2.4% 2.4%

Notes:

- 1 - Actual costs incurred. Costs have been audited by independent auditor.
- 2 - Assumes the same volume as 1999, but with 100% of PFCs Collected at \$4.50 per PFC -- this only impacts Credit Card Fees and Interest Revenue.
- 3 - For any costs associated with the implementation of the new maximum \$4.50 PFC rate. This column is not year specific.
- 4 - [9] months of 2000 are actual with [3] months of forecast
- 5 - Does not include any Implementation Costs
- 6 - Assumes 3 months with 100% of PFCs Collected at \$3. Assumes 9 months with 50% at \$3 and 50% at \$4.50.
- 7 - Assumes 12 months with 100% of PFCs at \$4.50.
- 8 - WEFA US Economic Outlook 2000-05 - US Cycle Monitor, September 2000, page 201, All Items - Urban Wage Earners

U/Q: Unable to quantify. Intuitively know that costs exist.

(A): Affected by ASM (volume) growth only.

(B): Affected by CPI (rate) growth only.

(C): Affected by both ASM and CPI growth.



ARTHUR ANDERSEN

Independent Public Accountants' Report on Applying Agreed-Upon Procedures

To Alaska Airlines and
the Federal Aviation Administration:

We have performed the procedures enumerated in Attachment I, except as noted, thereto, which were agreed to by Alaska Airlines (the "Company") and the Federal Aviation Administration ("FAA"), solely to assist you in evaluating the accompanying schedule of incremental costs directly associated with Passenger Facility Charges ("PFC") collection, handling, remittance, reporting, recordkeeping and auditing for the year ended December 31, 1999. This engagement to apply agreed-upon procedures was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of the FAA and the Company. Consequently, we make no representation regarding the sufficiency of the procedures described in Attachment I, either for the purpose for which this report has been requested or for any other purpose.

See Attachment I for the procedures performed on this engagement and the related results.

We were not engaged to, and did not, perform an audit, the objective of which would be the expression of an opinion on the accompanying schedules. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you. Further, with respect to the calculations described in Attachment I, we express no assurance as to the propriety of the methodologies employed in determining the amounts expressed in the accompanying schedule of incremental costs, or on the assumptions and estimates used in the specific calculations.

This report is intended solely for the information and use of the Board of Directors and management of the Company and the FAA, and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of the procedures for their purposes. However, this restriction is not intended to limit the distribution of this report, which is a matter of public record.

Arthur Andersen LLP

Seattle, Washington
December 28, 2000

Attachment I

As determined by Alaska Airlines and the FAA, we have performed the following procedures:

1. We obtained a summary schedule from Alaska Airlines of all costs attributed to the collection and administration of passenger facility charges ("PFC"), by expense caption, for the year ended December 31, 1999.
2. We obtained a schedule from Alaska Airlines of the total dollar amount of PFC's collected, refunded, and remitted for the year ended December 31, 1999 and agreed the total to an Alaska Airlines system generated report. We calculated the number of PFC's collected for the year by dividing the total dollar amount of PFC's collected by \$3.
3. We obtained a schedule from Alaska Airlines of the total dollar amount of interest income earned by the company on PFC funds it held between the time of collection from passengers and the time of remittance to and receipt by the airport(s) (or the refund of the PFC funds to passengers) for the year ended December 31, 1999.
4. We tested the summation of the total 1999 costs, as reported on the summary schedule, for clerical accuracy.
5. We performed the following procedures related to each expense caption, as listed on the summary schedule, and the interest earned amount as reported on the schedule obtained in Step 3., for the year ended December 31, 1999:

Cost Caption

Procedures

a. Credit Card Fees

- i. We have obtained from Alaska Airlines, a schedule containing the breakout of total sales by month, for the year ended December 31, 1999, separated between cash sales and credit card sales, and agreed two months of sales to the general ledger.
- ii. We have recalculated, based on the schedule obtained in Step 5.a.i., the percentage of credit card sales as a portion of total sales for the year.
- iii. We have recalculated "PFC dollars collected via credit card sales" for the year ended December 31, 1999 by multiplying total PFC dollars collected less PFC dollars refunded, from the schedule obtained in Step 2., by the percentage calculated in Step 5.a.ii.
- iv. We have recalculated the "credit card discount expense" related to PFC's for 1999 by multiplying the PFC dollars

collected via credit card sales, as calculated in Step 5.a.iii., by the average credit card discount percentage, as determined by Alaska Airlines.

- v. We have recalculated "bad debt expense" related to PFC's for 1999 by multiplying the PFC dollars collected via credit card sales, as calculated in Step 5.a.iii., by the bad debt rate, as determined by Alaska Airlines and included this amount with bad debt expense for PFC dollars associated with NSF checks.
- vi. We have summed the credit card discount expense, calculated in Step 5.a.iv., and the bad debt expense, calculated in Step 5.a.v., for 1999 and agreed the total to the respective amount reported on the summary schedule .

b. Audit Fees

- i. We have agreed the fees, reported on summary schedule, to Arthur Andersen LLP bills (or schedule of fees) for the audit, agreed-upon procedures and/or any additional charges related to PFC's for 1999.

c. PFC Disclosure

- i. We have obtained from Alaska Airlines, a summary of all disclosure cost components related to PFC's for 1999.
- ii. We have agreed the total costs from the schedule obtained in Step 5.c.i. to the respective amount reported on the summary schedule.
- iii. We have recalculated disclosure costs for 1999, using Alaska Airlines's methodology and assumptions, which considers number of media units containing PFC information, cost per media unit and portion of ad space attributed to PFC language.

d. Reservations

- i. Alaska Airlines was unable to quantify the reservations cost components related to PFC's for 1999. Consequently, this amount was not included in the cost summary.

e. Passenger Service

- i. Alaska Airlines was unable to quantify the passenger service cost components related to PFC's for 1999. Consequently, this amount was not included in the cost summary.

f. Revenue Accounting,
Data Entry, Accounts

Data Entry

- i. We have obtained from Alaska Airlines, a summary of all

Payable and Tax

data entry cost components related to PFC's for 1999.

- ii. We have agreed the total costs from the schedule obtained in Step 5.f.i. to the respective amount reported on the summary schedule.
- iii. We have recalculated the data entry costs for 1999, based on Alaska Airlines's methodology and assumptions, which incorporate estimates of managerial, staff, and clerical employee time spent related to PFC's, entering data and supplies costs.

Revenue Accounting

- iv. We have obtained from Alaska Airlines, a summary of all revenue accounting cost components related to PFC's for 1999.
- v. We have agreed the total costs from the schedule obtained in Step 5.f.iv. to the respective amount reported on the summary schedule.
- vi. We have recalculated the revenue accounting costs for 1999, based on Alaska Airlines's methodology and assumptions, which incorporate estimates of managerial, staff and clerical employee time spent related to PFC's and supplies costs.

Accounts Payable

- vii. We have obtained from Alaska Airlines, a summary of all accounts payable cost components related to PFC's for 1999.
- viii. We have agreed the total costs from the schedule obtained in Step 5.f.vii. to the respective amount reported on the summary schedule.
- ix. We have recalculated the accounts payable costs for 1999, based on Alaska Airlines's methodology and assumptions, which incorporate estimates of new vendor costs, data input time, monthly and quarterly mailing, and other costs related to PFC administration.

Tax

- x. We have obtained from Alaska Airlines, a summary of all tax department cost components related to PFC's for 1999.
- xi. We have agreed the total costs from the schedule obtained in Step 5.f.x. to the respective amount reported on the summary schedule.

- xii. We have recalculated the tax costs for 1999, based on Alaska Airlines's methodology and assumptions, which incorporate estimates of managerial and staff employee time spent related to PFCs and supplies costs.
- g. Corporate Property
 - i. We have obtained from Alaska Airlines, a summary of all corporate property cost components related to PFC's for 1999.
 - ii. We have agreed the total costs from the schedule obtained in Step 5.g.i. to the respective amount reported on the summary schedule.
 - iii. We have recalculated the costs for 1999, based on Alaska Airlines's methodology and assumptions, which incorporates estimates of employee time spent meeting with airports regarding PFCs and travel expenses.
- h. Training – Reservations, Ticket Agents and Other Departments
 - i. We have obtained from Alaska Airlines, a summary of all departmental training costs allocated to PFC's for 1999.
 - ii. We have agreed the total costs from the schedule obtained in Step 5.h.i. to the respective amount reported on the summary schedule.
 - iii. We have recalculated the costs for 1999, based on Alaska Airlines's methodology and assumptions, which consider agent population, agent turnover, and average hour of training and labor rates.
- i. Carrier Ongoing Information Systems
 - i. We have obtained from Alaska Airlines, a summary of all carrier ongoing information systems costs allocated to PFC's for 1999.
 - ii. We have agreed the total estimated costs from the schedule obtained in Step 5.i.i. to the respective amount reported on the summary schedule.
 - iii. We have reviewed the estimated costs for 1999, based on Alaska Airlines's methodology and assumptions, which considers ongoing costs related to the maintenance of systems, data storage, resource materials, and the additional run time to price and print tickets. We were unable to recalculate the schedule based on the judgmental nature of the estimate.

- j. CRS Ongoing Costs

 - i. We have obtained from Alaska Airlines, a schedule of all costs related to ongoing maintenance of PFC data for 1999.
 - ii. We have agreed the total costs from the schedule obtained in Step 5.j.i. to the respective amount reported on the summary schedule.
 - iii. We have agreed the cost components to client analyses provided by Alaska Airlines.

- k. PFC Absorption

 - i. We have inquired of Alaska Airlines, as to which airports it absorbed PFC costs during 1999, noting that the Company does not absorb such costs. Consequently, this amount was not included in the cost summary.

- l. Airline Tariff Publishing Company (ATPCO)

 - i. We have obtained from Alaska Airlines, a schedule of all ATPCO costs incurred in 1999.
 - ii. We have agreed the total costs from the schedule obtained in Step 5.l.i. to the respective amount reported on the summary schedule.
 - iii. We have selected the total industry charges for 1999 and multiplied the charges by the Company's usage percentage to recalculate the estimated costs incurred.

- m. Airline Reporting Corporation (ARC)

 - i. We have obtained from Alaska Airlines, a schedule of all ARC and BSP costs incurred in 1999.
 - ii. We have agreed the total costs from the schedule obtained in Step 5.m.i. to the respective amount reported on the summary schedule.
 - iii. We have recalculated the total charges for 1999 and agreed the charges to the respective ARC and BSP invoices (or other document supporting such costs).

- n. Interest Income

 - i. We have obtained from Alaska Airlines, a schedule containing the breakout of the total dollar amount of interest earned on PFC funds held by the company by month, for the year ended December 31, 1999.
 - ii. We have obtained from Alaska Airlines a schedule showing the average number of days that a PFC collected in each month was held between time of receipt by the airline and time of receipt by the airport(s); or (in the case of refunded tickets) time of refund to the passenger.

- iii. We have obtained from Alaska Airlines a schedule of the average interest rates earned for each month in 1999 on its short-term investment portfolio.
 - iv. We have recalculated two months of "Interest earned on PFC dollars collected from sales" for the year ended December 31, 1999, by multiplying monthly PFC dollars collected from the schedule obtained in Step 2 by days held (both for remitted PFC's and PFC's refunded to passengers), as a proportion of a 360 day year obtained in Step 5.n.ii, and then by the appropriate monthly interest rate percentages obtained in Step 5.n.iii.
 - v. We have agreed the total income for each month, as calculated in Step 5.n.iv., to the respective amount reported on the schedule obtained in Step 3.
6. We have calculated the average cost per PFC for the year ended December 31, 1999 by dividing the total costs for the year, as reported on the summary schedule, less the interest earned on collected PFC's, as reported in Step 3, by the number of PFC's collected and the number of PFC's remitted, as determined in Step 2.

**Alaska Airlines, Inc. and Horizon Air Industries
Confidential**

1999 Actual Costs Incurred for PFC's

	Actual Costs 1999 ¹	
Credit Card Fees / Bad Debt Expense	846,555	70%
Audit Fees (External)	3,000	0%
Disclosure Costs	52,162	4%
Reservations (RSSRs) (fully allocated)	U/Q	
Passenger Services (CSRs)	U/Q	
Data Entry:		
Internal	-	0%
ARC	-	0%
BSP	-	0%
Revenue Accounting	4,546	0%
Tax Department	2,120	0%
Accounts Payable	1,254	0%
Corporate Property Dept	6,326	1%
Training:		
RSSRs	4,598	0%
Data Entry	0	0%
Passenger Service (CSRs)	63,586	5%
Internal On-Going IT	44,378	4%
CRS On-Going fees	172,962	14%
ATPCO	573	0%
ARC + BSP (plus one-time change)	2,120	0%
Interest Revenue (Net)	(189,601)	n/a
TOTAL COSTS	1,204,180	100%
TOTAL COSTS LESS INTEREST	1,014,579	
Number of PFCs Remitted	13,249,958	
Number of PFCs Collected	14,391,535	

Cost / PFC Remitted	\$0.0909
YOY Change	

Cost / PFC Collected	\$0.0837
YOY Change	

Notes:

1 - Actual costs incurred.

U/Q: Unable to quantify. Intuitively know that costs exist.