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Independent Accountants' Report on Applying Agreed-Upon Procedures

The Board of Directors and Management
Southwest Airlines Co.

and

The Federal Aviation Administration

We have performed the procedures enumerated below, which were agreed to by Southwest Airlines Co. (Southwest Airlines or 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. These incremental costs are included in the Schedule of Southwest Airlines Co. Summary Table (Summary Table) under the caption "1999 Actual Costs," included as Exhibit I. Our procedures do not extend to other information (except as noted in step six below) included in the Summary Table and the information included in the "PFC Incremental Cost Definitions" included at Exhibit II. 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 below either for the purpose for which this report has been requested or for any other purpose.

The schedules and/or analyses provided to us by the Company calculated incremental costs directly associated with PFCs, and such analysis and/or schedules are, by their nature based on assumptions and/or studies performed by the Company. Accordingly, we make no comments as to the reasonableness of the assumptions or as to the methodologies underlying the studies, including those noted on Exhibit II.

The following procedures were performed without any exceptions noted:

1. We obtained the Summary Table (Exhibit I) from Southwest Airlines of all costs attributed to the collection and administration of PFCs, by expense caption, for the year ended December 31, 1999.
2. We obtained a schedule from Southwest Airlines of the total dollar amount of PFCs collected, refunded, and remitted for the year ended December 31, 1999, and agreed the total to a Southwest Airlines system-generated report. We recalculated the number of PFCs collected for the year by dividing the total dollar amount of PFCs collected by \$3.

3. We obtained a schedule from Southwest Airlines of the total dollar amount of interest income earned by the Company on PFC funds it held from the time of collection from passengers to the time of remittance to the airports (or the refund of the PFC funds to passengers) for the year ended December 31, 1999.
4. We recalculated the summation of the "Total costs" under the caption "1999 Actual Costs", as reported on the Summary Table obtained in step 1., for clerical accuracy.
5. We performed the following procedures related to each expense caption, as listed on the Summary Table obtained in step 1., and the interest earned amount as reported on the schedule obtained in step 3., for the year ended December 31, 1999:

<u>Cost Caption</u>	<u>Procedures</u>
a. Credit Card Fees	<ol style="list-style-type: none">i. We obtained from Southwest 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 (February 1999 and October 1999, which were judgmentally selected) to the general ledger.ii. We 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 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 recalculated the "credit card discount expense" related to PFCs 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 Southwest Airlines, and agreed the total to the respective amount reported on the Summary Table obtained in step 1.
b. Audit Fees (External)	<ol style="list-style-type: none">i. We agreed the audit fees, reported on the Summary Table obtained in step 1, to the Ernst & Young schedule of fees for the audit and agreed-upon procedures for 1999.

Cost Caption

Procedures

- c. PFC Disclosure
- i. We obtained from Southwest Airlines a summary of all disclosure cost components related to PFCs for 1999.
 - ii. We agreed the total costs from the schedule obtained in step 5.c.i. to the respective amount reported in the Summary Table obtained in step 1.
 - iii. We recalculated disclosure costs for 1999, using Southwest Airlines' methodology and assumptions, which considered, among other things, the number of media units containing PFC information, cost per media unit, and portion of ad space attributed to PFC language.
- d. Reservations
- i. We obtained from Southwest Airlines a summary of all reservation cost components related to PFCs for 1999.
 - ii. We agreed the total costs from the schedule obtained in step 5.d.i. to the respective amount reported, in the Summary Table obtained in step 1.
 - iii. We recalculated reservations expense for 1999, using Southwest Airlines' methodology and assumptions, which considered, among other things, total reservation calls handled, "PFC" calls handled, seconds per normal call, difficult calls handled, seconds per difficult calls, total seconds per call, call hours and average wage rate per hour.
- e. Passenger Service
- i. We obtained from Southwest Airlines a summary of all passenger service cost components related to PFCs for 1999.
 - ii. We agreed the total costs from the schedule obtained in step 5.e.i. to the respective amount reported in the Summary Table obtained in step 1.
 - iii. We recalculated passenger service expense for 1999, using Southwest Airlines' methodology and assumptions, which considered, among other things, Customer Service Agents (CSA) hours worked, percentage of time spent on PFC explanation, hours worked on PFC fees, CSA average hourly wage rate and CSA benefits.
- f. Revenue Accounting Accounts Payable
- Revenue Accounting*
- i. We obtained from Southwest Airlines a summary of all revenue accounting cost components, including data entry, related to PFCs for 1999.
 - ii. We agreed the total costs from the schedule obtained in step 5.f.i. to the respective amount reported in the Summary Table obtained in step 1.

Cost Caption

Procedures

- iii. We recalculated the revenue accounting costs for 1999, based on Southwest Airlines' methodology and assumptions, which incorporated, among other things, estimates of managerial, staff, and clerical employee time spent related to PFCs and supplies costs.

Accounts Payable

- iv. We obtained from Southwest Airlines a summary of all accounts payable cost components, including data entry, related to PFCs for 1999.
 - v. We agreed the total costs from the schedule obtained in step 5.f.iv. to the respective amount reported in the Summary Table obtained in step 1.
 - vi. Southwest Airlines' methodology and assumptions, which incorporated, among other things, estimates of new vendor costs, data input time, monthly and quarterly mailings, and other costs related to PFC administration.
- g. Corporate Property Department
- i. We obtained from Southwest Airlines a summary of all corporate property cost components related to PFCs for 1999.
 - ii. We agreed the total costs from the schedule obtained in step 5.g.i. to the respective amount reported in the Summary Table obtained in step 1.
 - iii. We recalculated the costs for 1999, based on Southwest Airlines' methodology and assumptions, which incorporated, among other things, estimates of employee time spent meeting with airports regarding PFCs and travel expenses.
- h. Training: Reservations and Passenger Service Departments
- i. We obtained from Southwest Airlines a summary of all departmental training costs allocated to PFCs for 1999.
 - ii. We agreed the total costs from the schedule obtained in step 5.h.i. to the respective amount reported in the Summary Table obtained in step 1.
 - iii. We recalculated the costs for 1999, based on Southwest Airlines' methodology and assumptions, which considered, among other things, agent population, agent turnover, average hours of training, and labor rates.
- i. Carrier Ongoing Information Systems
- i. We obtained from Southwest Airlines a summary of all carrier ongoing information systems costs allocated to PFCs for 1999.

Cost Caption

Procedures

- ii. We agreed the total costs from the schedule obtained in step 5.i.i. to the respective amount reported in the Summary Table obtained in step 1.
 - iii. We recalculated the costs for 1999, based on Southwest Airlines' methodology and assumptions, which considered, among other things, ongoing costs related to the maintenance of systems, data storage, resource materials, and the additional run time to price and print tickets.
 - j. Interest Income
 - i. We obtained from Southwest 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 obtained from Southwest Airlines a schedule showing the average number of days that a PFC collected in each month was held from time of receipt by the airline to the time of remittance to the airports or, in the case of refunded tickets, time of refund to the passenger.
 - iii. We obtained from Southwest Airlines a schedule of the average interest rates earned for each month in 1999 on its short-term investment portfolio.
 - iv. We recalculated two months (January 1999 and February 1999, which were judgmentally selected) 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 PFCs and PFCs refunded to passengers), as a proportion of a 365-day year obtained in step 5.j.ii., and then by the appropriate monthly interest rate percentages obtained in step 5.j.iii.
 - v. We agreed the total income for each month, as calculated in step 5.j.iv., to the respective amount reported in the schedule obtained in step 3.
- 6. We recalculated the "Cost Less Interest / PFC Remitted" and the "Cost Less Interest / PFC Collected" included on the Summary Table under the caption "1999 Actual Costs", by dividing the "Total costs", as reported on the Summary Table under the caption "1999 Actual Costs" obtained in step 1., less the interest earned on collected PFCs, as reported in step 3, by the number of PFCs collected and the number of PFCs remitted, as recalculated in step 2.

Southwest Airlines Co.
and
The Federal Aviation Administration

Page 6

We were not engaged to, and did not, perform an audit, the objective of which would be the expression of an opinion on the incremental costs included under the caption "1999 Actual Costs" included in the Summary Table. 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.

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.

Ernst & Young LLP

December 8, 2000

Southwest Airlines Confidential
(1999 Actual, 2000-2002 Forecast)

Exhibit I

	1999 Actual Costs ¹		1999 Pro-Forma ²	Implementation Costs ³	2000 Full Year Costs (10A+2F) ^{4,5}	2001 Forecast ^{5,6}	2002 Forecast ^{5,7}
Credit card fees	2,874,322	31%	4,311,483	-	3,447,690	4,345,995	5,650,701
Audit fees (external)	25,000	0%	25,000	19,500	25,000	25,000	25,000
Disclosure costs	5,638,596	61%	5,638,596	-	6,229,218	6,927,469	7,273,842
Reservations	964,004	10%	964,004	-	952,066	945,516	968,208
Passenger services (CSAs)	602,321	6%	602,321	-	705,419	866,292	931,437
Revenue accounting	10,800	0%	10,800	-	11,340	12,193	13,110
Data entry:							
Internal	-	0%	-	-	-	-	-
ARC	-	0%	-	-	-	-	-
BSP	-	0%	-	-	-	-	-
Accounts payable	750	0%	750	-	788	847	910
Tax department	-	0%	-	-	-	-	-
Legal department	-	0%	-	-	-	-	-
Corporate property department	51,313	1%	51,313	-	55,853	46,935	48,062
Training:							
Reservations	686	0%	686	-	661	694	746
Data entry	-	0%	-	-	-	-	-
Passenger service (CSAs)	68,230	1%	68,230	-	70,154	71,937	77,347
Carrier One-Time IT update	-	0%	-	108,296	-	-	-
Carrier On-Going IT	45,939	0%	45,939	-	51,371	57,446	64,239
CRS One-Time update	-	0%	-	-	-	-	-
CRS On-Going fees	-	0%	-	-	-	-	-
ATPCO	-	0%	-	-	-	-	-
Interest income (Net)	(1,004,374)	-11%	(1,506,561)	-	(1,416,174)	(1,486,983)	(2,341,997)
TOTAL COSTS	9,277,587	100%	10,212,561	127,796	10,133,386	11,813,341	12,711,606
Number of PFCs Remitted	51,430,430		51,430,430	51,430,430	59,563,882	62,542,076	65,669,180
Number of PFCs Collected	64,489,195		64,489,195	64,489,195	74,123,953	77,830,151	81,721,658
Cost Less Interest / PFC Remitted	\$0.1804		\$0.1986	\$0.0025	\$0.1701	\$0.1889	\$0.1936
YOY Change					-5.7%	11.0%	2.5%
Cost Less Interest / PFC Collected	\$0.1439		\$0.1584	\$0.0020	\$0.1367	\$0.1518	\$0.1555
YOY Change					-5.0%	11.0%	2.5%

"CPI - Urban" from WEFA ⁸

2.4%

2.4%

Notes:

- 1 - Actual costs incurred. Costs have been subjected to the attached agreed upon procedures performed by independent accountant.
- 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 Income.
- 3 - For any costs associated with the implementation of the new maximum \$4.50 PFC rate. This column is not year specific.
- 4 - 10 months of 2000 are actual with 2 months of forecast.
- 5 - Does not include any implementation costs.
- 6 - Assumes 100% of PFCs collected at \$3.
- 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

PFC INCREMENTAL COST DEFINITIONS

Cost Definition	Notes
<p>a. Credit Card Fees: A fee associated with and paid with the processing of each PFC transaction inherent in a ticket with a credit card form of payment.</p>	<p>This equals PFC dollars collected less PFC dollars refunded multiplied by the credit card sales percentage and average discount rate for the year.</p>
<p>b. Audit Fees: Fees associated with the annual audits of the PFC process by the independent auditors as required by CFR 158.69 (b) (1), including additional fees relating to the PFC Agreed Upon Procedures recommended by the FAA. In addition, this includes costs related to the internal preparatory work for the audits.</p>	<p>This is based on the audit fee agreement with Ernst & Young LLP.</p>
<p>c. PFC Disclosure: Based on the FAA requirement to provide notice that PFC fees may be applicable to the passenger, the airline must pay for all disclosure to include this communication.</p>	<p>This equals average PFC costs per broadcast or print advertisement multiplied by the number of spots/jobs for the year multiplied by the portion of spots/jobs attributed to PFC's.</p>
<p>d. Reservations: Cost of increased telephone "talk time" with airline customers explaining PFC's and their applicability to their journey when the reservation is made by telephone.</p>	<p>This equals the number of calls requiring explanation multiplied by the average number of seconds for explanation multiplied by the average reservation agent labor rate per second (including benefits) for the year.</p>
<p>e. Passenger Service: Cost of increased face-to-face time with airline customers explaining PFC's and their applicability to their journey and the issuance of their ticket when the reservation is made or when a ticket is purchased at a ticket office. Time and material associated with the issuance of documents (including Special Service Tickets, Miscellaneous Charge Orders, Prepaid Ticket Authority, Refund and Exchange Documents) specifically for collection of PFC's.</p>	<p>This equals average passenger service hours worked multiplied by the percentage of time spent on PFC explanations multiplied by the average hourly passenger service agent labor rate (including benefits) for the year.</p>
<p>f. Revenue Accounting, Data Entry, Accounts Payable, Tax, and Legal: PFC-specific costs for personnel assigned to tasks related to the calculation of PFC distribution amounts, including assurance of proper acknowledgement of PFC approved airports, calculation of amounts due, generation and distribution of payments and reports to PFC approved airports. This line item includes any PFC-specific carrier cost for manual data entry of the PFC (additional keystrokes), Refund Staff, and Bad Debt (cash). In addition, these costs may include attorneys' fees spent considering this issue.</p>	<p>This equals the number of hours spent by Revenue Accounting on the calculation of PFC distribution amounts and related reportwork multiplied by the average hourly labor rate (including benefits) for that group, plus the number of hours spent by Accounts Payable on generation of the PFC payments multiplied by the average hourly salary (including benefits) for that group.</p>

<p>g. Corporate Property Dept: Costs for related expenses for personnel assigned to tasks related to the notification and approval process, including salary and travel expenses for property and facility managers/directors to meet with airports regarding PFC applications.</p>	<p>This equals salaries and travel expenses for the property managers multiplied by the percentage of time spent on PFCs.</p>
<p>h. Training Reservations, Ticket Agents, and Other Departments: The costs reflects the costs associated with training material development and distribution, as well as training personnel.</p>	<p>This equals the average salaries for trainers and agents per minute (including benefits) multiplied by the number of minutes spent on PFC training, plus the cost of training materials.</p>
<p>i. Carrier Ongoing Information Systems: Costs incurred in the maintenance of systems (i.e. programming, testing, etc.), data storage, resource materials costs and the additional run-time to price and print tickets are included in this line item.</p>	<p>This equals the number of hours spent by IT for the year on PFC projects multiplied by the average hourly IT salary (including benefits).</p>
<p>j. CRS On-Going: On-going costs related to expenditures incurred by the CRS and charged to the carriers in the form of booking fees, etc.</p>	<p>As these amounts were not significant to our PFC costs, we did not include them in our calculation.</p>
<p>k. PFC Absorption: Some airlines report that they must "absorb" from other revenues the PFC charge in some markets because the markets are too price sensitive to pass on the PFC to consumers. In this case, the carriers wish to treat such absorbed costs as administrative expenses.</p>	<p>Not applicable.</p>
<p>l. Airline Tariff Publishing Company (ATPCO): ATPCO costs for maintaining and distributing PFC data to the industry that are passed to carriers through various fees. Fees associated with one-time AIR-21 changes should be included as implementation costs (see below).</p>	<p>As these amounts were not significant to our PFC costs, we did not include them in our calculation.</p>
<p>m. Airline Reporting Corporation (ARC): Ongoing costs for maintaining and distributing PFC data to industry passed to the carriers through various fees. Costs associated with planning, programming, and testing systems to accommodate AIR-21 changes passed to carriers through various fees should be included as implementation costs (see below).</p>	<p>As these amounts were not significant to our PFC costs, we did not include them in our calculation.</p>

<p>n. Interest Income: Interest earned on PFC funds collected and held by the airline prior to the PFC funds being transmitted to and received by the airport(s) for which they were collected. Under sec. 158.53 of 14 CFR Part 158, "PFC revenue recorded in the accounting system of the carrier...shall be remitted to the public agency no later than the last day of the following calendar month (or if that date falls on a weekend or holiday, the first business day thereafter).</p>	<p>This equals PFC dollars collected less PFC dollars refunded multiplied by the average number of float days for PFC's collected/refunded multiplied by the average interest rate earned on the funds for the year.</p>
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IMPLEMENTATION COSTS

<p>Carrier One-Time Information Systems: Costs associated with planning, programming, and testing systems to accommodate the PFC increase and other changes authorized by AIR-21, including the addition two or more decimal places in the PFC calculation and total.</p>	<p>This equals the number of hours spent by IT for planning, programming, and testing related to the PFC increase multiplied by the average hourly IT salary (including benefits).</p>
<p>One-Time CRS Costs: One time CRS and related third party (if applicable) cost of programming PFC logic for AIR 21 changes that are charged to the air carrier.</p>	<p>As these amounts were not significant to our PFC costs, we did not include them in our calculation.</p>