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MASSACHUSETTS BAY TRANSPORTATION AUTHORITY

(A Component Unit of the Commonwealth of Massachusetts)

Financial Statements and Required Supplementary Information

June 30, 2005 and 2004

(With Independent Auditors’ Report Thereon)

MASSACHUSETTS BAY TRANSPORTATION AUTHORITY

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Independent Auditors' Report

The Board of Directors of the
Massachusetts Bay Transportation Authority:

We have audited the accompanying statements of net assets of the Massachusetts Bay Transportation Authority (the Authority or MBTA), a component unit of the Commonwealth of Massachusetts, as of June 30, 2005 and 2004, and the related statements of revenue, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 10 and the historical pension information on pages 45 and 46 are not required parts of the financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 24, 2005 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

KPMG LLP

October 24, 2005

The management of the Massachusetts Bay Transportation Authority offers readers of our financial statements the following narrative overview and analysis of our financial activities for the years ended June 30, 2005 and 2004.

Financial Statements

Our financial statements are prepared using proprietary fund (enterprise fund) accounting that uses the same basis of accounting as private-sector business enterprises. The Authority is operated under one enterprise fund. Under this method of accounting, an economic resources measurement focus and an accrual basis of accounting is used.

Revenue is recorded when earned and expenses are recorded when incurred. The financial statements include statements of net assets, statements of revenues, expenses and changes in net assets, and statements of cash flows. These are followed by notes to the financial statements. In addition to the financial statements, this report also contains required supplementary information pertaining to the retirement plans of the Authority.

> The statements of net assets present information on the Authority's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Authority is improving or deteriorating.
>
> The statements of revenue, expenses and changes in net assets report the operating revenues and expenses and nonoperating revenues and expenses of the Authority for each fiscal year with the difference – the increase in net assets – being combined with any capital grants to determine the net change in assets for the fiscal year. That change combined with the net assets from the end of the previous year equals the net assets at the end of the fiscal year.
>
> The statements of cash flows report cash and cash equivalent activities for each fiscal year resulting from operating activities, capital and related financing activities, noncapital and related financing activities and investing activities. The net result of these activities added to the beginning of the year balance of cash and cash equivalents total to the cash and cash equivalent balance at the end of the fiscal year.

MASSACHUSETTS BAY TRANSPORTATION AUTHORITY

(A Component Unit of the Commonwealth of Massachusetts)

Management's Discussion and Analysis

June 30, 2005 and 2004

(Dollars in thousands)

Condensed Financial Information

Condensed financial information as of and for the years ended June 30, 2005, 2004 and 2003 are as follows:

		June 30		
		2005	**2004**	**2003**
Current and other assets	$	1,313,123	1,344,105	1,291,872
Capital assets, net		7,392,655	7,115,024	6,700,124
Total assets		8,705,778	8,459,129	7,991,996
Current liabilities		528,902	443,871	405,711
Long-term liabilities		4,977,628	4,821,691	4,498,611
Total liabilities		5,506,530	5,265,562	4,904,322
Net assets:				
Invested in capital assets, net of related debt		3,130,920	3,081,213	2,956,140
Restricted		36,092	31,651	20,848
Unrestricted		32,236	80,703	110,686
Total net assets	$	3,199,248	3,193,567	3,087,674
Operating revenue:				
Revenue from transportation	$	319,271	295,496	274,206
Other		52,282	49,440	43,361
Total operating revenues		371,553	344,936	317,567
Operating expenses:				
Transportation services		506,503	481,635	421,286
Other operating expenses		416,552	406,678	387,795
Total operating expenses, excluding depreciation		923,055	888,313	809,081
Depreciation and amortization		269,814	249,087	233,061
Total operating expenses, including depreciation		1,192,869	1,137,400	1,042,142
Operating loss		(821,316)	(792,464)	(724,575)
Net nonoperating revenue		644,615	665,739	642,253
Loss before capital grants		(176,701)	(126,725)	(82,322)
Capital grants and contributions		182,382	232,618	125,471
Increase in net assets		5,681	105,893	43,149
Beginning of year net assets		3,193,567	3,087,674	3,044,525
End of year net assets	$	3,199,248	3,193,567	3,087,674

(Continued)

The information contained in the condensed financial information table is used as the basis for the following discussion regarding the Authority's financial activities for the fiscal years ended June 30, 2005, 2004 and 2003.

Financial Highlights for the years ended June 30, 2005 and June 30, 2004

- The Authority ended the years June 30, 2005 and 2004 with a net asset balance of $3,199,248 and $3,193,567 of which $3,130,920 and $3,081,213 represented the amount invested in capital assets, net of related debt, and $32,236 and $80,703 was unrestricted, respectively. The net asset balance increased $5,681 and $105,893 in the years ended 2005 and 2004, respectively. The increase in net assets is attributable to increased transportation revenues and increased dedicated sales tax revenue.
- Despite the increase in net assets, the Authority incurred an expected operating loss for the years ended June 30, 2005 and 2004 of $821,316 and $792,464, respectively. The operating losses were offset in accordance with the Commonwealth of Massachusetts Forward Funding Legislation (Chapter 127 of the Acts of 1999 of the Commonwealth or Enabling Act). The legislation allows the Authority to receive a dedicated revenue stream consisting of the assessments on the communities in the Authority's service area and a Dedicated Sales Tax. For years ended June 30, 2005 and 2004 the Authority recognized $704,809 and $684,280 of sales tax revenues from the Commonwealth of Massachusetts. This amount was the guaranteed full year Base Revenue Amount. Local assessments on cities and towns within the Authority's service area accounted for $137,732 and $139,437 in nonoperating revenue in 2005 and 2004, respectively. Adding to the operating loss was interest expense, net of investment and other income of $197,926 and $157,978, respectively, in 2005 and 2004.
- The Authority has taken steps to minimize interest expense by reducing the amount of high interest rate debt by refunding outstanding bonds and paying off debt as funds become available.
- The Authority ended the years June 30, 2005 and 2004 with cash and investments of $1,096,313 and $1,151,338, respectively. However, only $99,994 and $146,423 of this amount at June 30, 2005 and 2004, respectively, is available for operations as the bulk of these assets are restricted for specific purposes and unavailable for the Authority's general use.
- The statements of cash flows identify the sources and uses of cash for each fiscal year. Cash and cash equivalents decreased by $50,022 in fiscal 2005 and increased by $61,886 in fiscal 2004. The decrease in fiscal year 2005 is due to the increased cash requirements for operations and increased utilization of cash for capital improvements. The decrease was offset by an increase from sales tax and local assessments. The increase in fiscal 2004 resulted primarily from the receipt of sales taxes and local assessments of $826,842. This increase was offset by $523,972 of cash used for operations and the cash used for financing of $270,144.

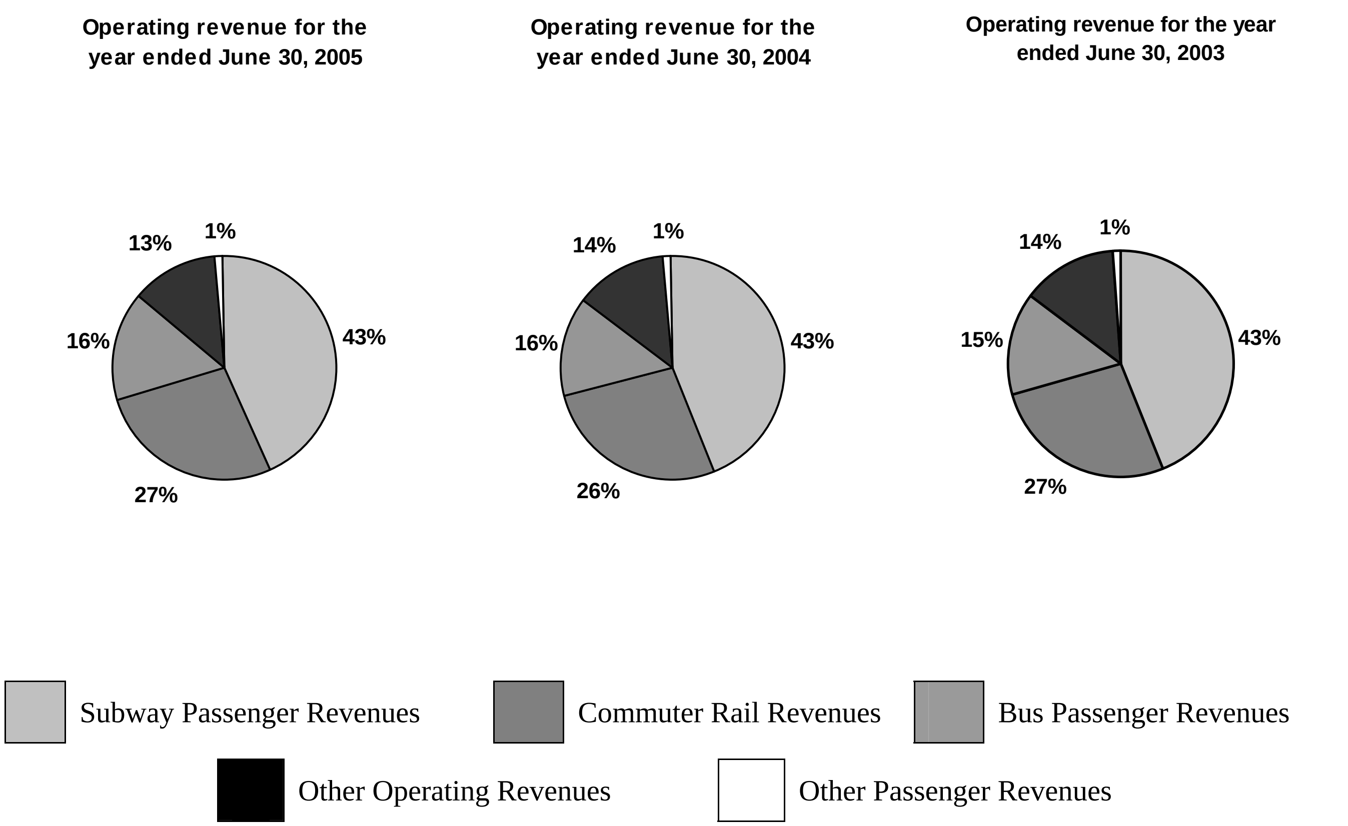
Financial Highlights for the years ended June 30, 2004 and June 30, 2003

- The Authority ended the years June 30, 2004 and 2003 with a net asset balance of $3,193,567 and $3,087,674 of which $3,062,161 and $2,939,502 represented the amount invested in capital assets, net of related debt, and $99,755 and $127,324 was unrestricted, respectively. The net asset balance increased $105,893 and $43,149 in the years ended 2004 and 2003, respectively. The increase in net assets is attributable to increased transportation revenues and significant capital grants received by the Authority in fiscal 2004 and 2003.

- Despite the increase in net assets, the Authority incurred an expected operating loss for the years ended June 30, 2004 and 2003 of $792,464 and $724,575, respectively. The operating losses were offset in accordance with the Commonwealth of Massachusetts Forward Funding Legislation (Chapter 127 of the Acts of 1999 of the Commonwealth or Enabling Act). The legislation allows the Authority to receive a dedicated revenue stream consisting of the assessments on the communities in the Authority's service area and a Dedicated Sales Tax. For both years ended June 30, 2004 and 2003 the Authority recognized $684,280 of sales tax revenues from the Commonwealth of Massachusetts. This amount was the guaranteed full year Base Revenue Amount. Local assessments on cities and towns within the Authority's service area accounted for $139,437 and $141,143 in nonoperating revenue in 2004 and 2003, respectively. Adding to the operating loss was interest expense, net of investment and other income of $157,978 and $183,170, respectively, in 2004 and 2003.
- The Authority has taken steps to minimize interest expense by reducing the amount of high interest rate debt by refunding outstanding bonds and paying off debt as funds become available.
- The Authority ended the years June 30, 2004 and 2003 with cash and investments of approximately $1,151,000 and $1,089,000, respectively. However, only $146,423 and $161,630 of this amount at June 30, 2004 and 2003, respectively, is available for operations as the bulk of these assets are restricted for specific purposes and unavailable for the Authority's general use.
- The statements of cash flows identify the sources and uses of cash for each fiscal year. For fiscal 2004 and 2003, cash and cash equivalents increased by $61,886 and $162,037, respectively. This increase resulted primarily from the receipt of sales taxes and local assessments of $826,842 and $818,475 for the years ended June 30, 2004 and 2003, respectively. These increases were offset by $523,972 and $493,740 of cash used for operations and the cash used for financing of $270,144 and $180,027 for the years ended June 30, 2004 and 2003, respectively.

Revenue

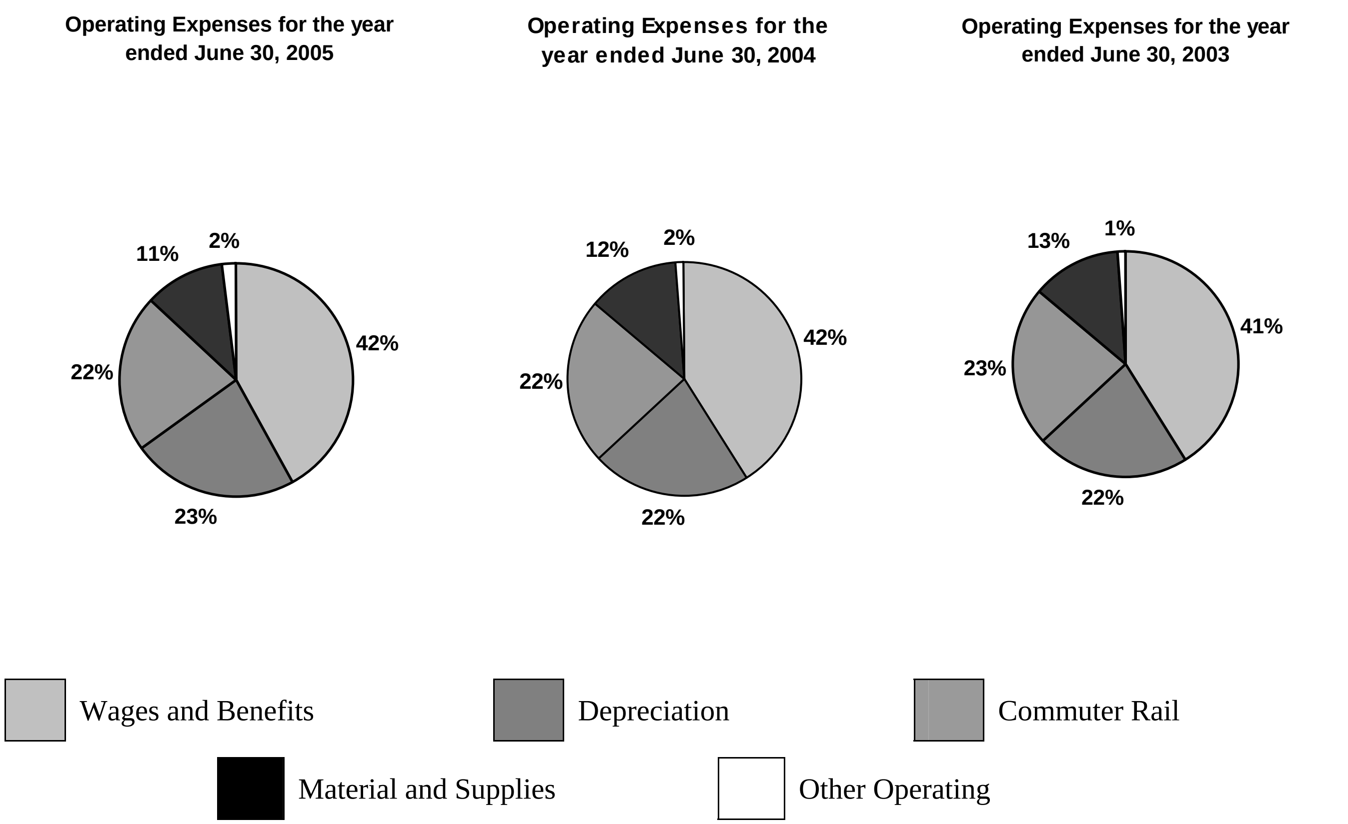
The following charts show the major sources of operating revenue for the years ended June 30, 2005, 2004, and 2003:



As in previous years, the passenger revenues make up over 85% of the total operating revenues. The Authority continues to work on increasing ridership through new equipment purchases, station upgrades and system expansion and will continue to pursue its policy of maximizing nonfare revenue opportunities.

Expenses

The following charts show the major sources of operating expenses for the years ended June 30, 2005, 2004, and 2003:



As in previous years, wages and benefits make up the largest portion of operating expenses. This is common in the public transportation industry as the provision of service is extremely labor intensive. Due to the significant investments the Authority has in capital assets, depreciation continues to be a large operating expense. Unlike the other expenses listed, depreciation is not a cash expense. The Authority has and continues to pursue ways to reduce costs without impacting service. The Authority has taken such measures as bidding and contracting with a new commuter rail provider and utility companies to obtain competitive pricing.

Capital Assets

The Authority's capital assets as of June 30, 2005, 2004, and 2003 amounted to $7,392,655, $7,115,024, and $6,700,124 (net of accumulated depreciation) respectively. This investment in capital assets includes land, construction work in progress, ways and structures and buildings and equipment.

(Dollars in thousands)

Net capital asset additions (reductions) included the following for the years ended June 30:

		2005	2004	2003
Land	$	13,264	37,222	24
Construction work in progress		(413,686)	243,503	149,193
Ways and structures		738,946	185,133	197,590
Buildings and equipment		181,257	180,972	70,013
	$	519,781	646,830	416,820

The Authority primarily acquires its assets with the proceeds from federal capital grants and revenue bonds. Station improvements, new equipment purchases and system expansion are all part of the Authority's capital investment program. Commitments on approved capital asset construction projects were $319,199, $368,466, and $407,895 for the years ended June 30, 2005, 2004 and 2003, respectively. Commitments to purchase new transportation equipment were $390,927, $452,422, and $662,319 as of June 30, 2005, 2004 and 2003, respectively.

Debt

Bonds and notes outstanding for the following years:

		2005	2004	2003
General Transportation System bonds	$	1,770,835	2,278,390	2,833,745
Revenue bonds		2,665,505	2,200,865	1,327,675
Boston Metropolitan District bonds		21,000	23,250	25,510
Grant Anticipation notes		81,665	—	—
Bond Anticipation notes		92,800	—	—
	$	4,631,805	4,502,505	4,186,930

The total amount for these categories of debt increased by $129,300, $315,575, and $311,759 for the years ended June 30, 2005, 2004, and 2003, respectively.

(Continued)

The Authority issued $1,100,665 in bonds during the 2005 fiscal year. Of the bonds issued, $1,029,625 were used to refund higher interest rate debt. The remainder is being used to finance vehicle replacements and pay off outstanding commercial paper. The Authority issued $1,195,725 in bonds during the 2004 fiscal year. Of the bonds issued, $791,510 were used to refund higher-rate debt, and the remaining $404,215 is being used to finance systemwide improvements, vehicle replacements and a commuter rail expansion project. The Authority issued $727,675 in bonds during the 2003 fiscal year. Of the bonds issued, $303,595 were used to refund higher rate debt with the remainder financing system wide improvements and a Vehicle Replacement Program. There was no new debt issued during the year ended June 30, 2002. In fiscal 2002, $135,300 represents debt defeased with available cash funds of the Authority and $115,804 was paid down in accordance with debt service requirements. The Authority has also entered into various agreements to help hedge against interest rate changes on certain outstanding debt. These agreements help the Authority better manage the total cost of borrowing and allow for better budgeting of future cash flows. The Authority’s Assessment Bonds have a rating of AAA by Standard & Poor’s and Aa1 by Moody’s Investor Services. The Authority’s Sales Tax Bonds have a rating of AAA by Standard & Poor’s and Aa2 by Moody’s Investor Services.

Requests for Information

This financial report is intended to provide an overview of the finances of the Authority for those with an interest in this organization. Questions concerning any information within this report may be directed to the Deputy General Manager and Chief Financial Officer of the Authority.

MASSACHUSETTS BAY TRANSPORTATION AUTHORITY

(A Component Unit of the Commonwealth of Massachusetts)

Statements of Net Assets

June 30, 2005 and 2004

(Dollars in thousands)

Assets	**2005**	**2004**
Current assets:		
Unrestricted cash and temporary cash investments (note 3)	$ 99,994	146,423
Restricted cash and temporary cash investments (note 3):		
Bond construction accounts	11,422	11,892
Lease accounts	361,434	372,043
Stabilization accounts	16,852	12,408
Other accounts	79,663	76,621
Accounts receivable:		
Commonwealth of Massachusetts	97,930	98,168
Federal grants	19,240	19,243
Other trade, net	29,812	17,771
Materials and supplies	42,726	33,768
Prepaid expenses	3,681	4,765
Total current assets	762,754	793,102
Restricted and other special accounts (notes 2(j) and 3):		
Bond construction accounts	65,300	159,055
Lease accounts	182,242	166,055
Bond reserve accounts	279,406	206,841
Total restricted and other special accounts	526,948	531,951
Capital assets, at cost (notes 2(c), 8, 9, and 11):		
Transportation property, being depreciated	9,509,474	8,589,271
Transportation property, not being depreciated	1,168,442	1,568,864
Less accumulated depreciation	(3,285,261)	(3,043,111)
Capital assets, net	7,392,655	7,115,024
Other assets:		
Deferred bond issue costs	23,421	19,052
Total other assets	23,421	19,052
Total assets	$ 8,705,778	8,459,129

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MASSACHUSETTS BAY TRANSPORTATION AUTHORITY

(A Component Unit of the Commonwealth of Massachusetts)

Statements of Net Assets

June 30, 2005 and 2004

(Dollars in thousands)

Liabilities	**2005**	**2004**
Current liabilities:		
Current maturities of bonds and notes payable (note 5)	$ 162,695	106,735
Current capital lease and other current obligations (note 8)	15,490	12,009
Accounts payable	135,284	134,377
Accrued liabilities:		
Payroll and vacation	27,318	21,525
Interest	92,187	80,119
Injuries and damage claims, worker's compensation claims, and other (note 10)	95,928	89,106
Total current liabilities	528,902	443,871
Long-term liabilities, less current maturities:		
Bonds payable, net (note 5)	4,415,847	4,260,083
Other noncurrent obligations (note 5)	—	1,135
Obligations under capital leases (note 8)	533,093	527,231
Pension liability (note 7)	9,252	12,867
Deferred revenue (note 6)	19,436	20,375
Total long-term liabilities	4,977,628	4,821,691
Total liabilities	5,506,530	5,265,562
Net Assets		
Invested in capital assets, net of related debt	3,130,920	3,081,213
Restricted	36,092	31,651
Unrestricted	32,236	80,703
Commitments and contingencies (notes 10 and 11)		
Total net assets	$ 3,199,248	3,193,567

See accompanying notes to financial statements.

MASSACHUSETTS BAY TRANSPORTATION AUTHORITY

(A Component Unit of the Commonwealth of Massachusetts)

Statements of Revenue, Expenses, and Changes in Net Assets

Years ended June 30, 2005 and 2004

(Dollars in thousands)

		2005	2004
Operating revenue, not including local and federal assistance:			
Revenue from transportation	$	319,271	295,496
Other		52,282	49,440
		371,553	344,936
Operating expenses:			
Wages and related employee benefits:			
Wages		339,760	321,386
Medical and dental insurance		94,035	89,363
Pensions		38,743	38,645
Social security taxes		30,335	28,076
Worker's compensation		20,971	19,305
Other		2,112	2,877
Capitalized costs		(19,453)	(18,017)
		506,503	481,635
Other operating expenses:			
Depreciation and amortization		269,814	249,087
Materials, supplies, and services		136,897	136,045
Injuries and damages		14,673	19,613
Commuter railroad and local subsidy expenses (note 4)		260,448	250,194
Other		4,534	826
		686,366	655,765
Total operating expenses		1,192,869	1,137,400
Operating loss		(821,316)	(792,464)
Nonoperating revenue (expense):			
Dedicated sales tax revenue		704,809	684,280
Dedicated local assessments		137,732	139,437
Other income		11,888	11,917
Interest income		5,999	7,208
Interest expense		(215,813)	(177,103)
Nonoperating revenue, net		644,615	665,739
Loss before capital grants		(176,701)	(126,725)
Capital grants and contributions (note 2(f))		182,382	232,618
Increase in net assets		5,681	105,893
Beginning of year net assets		3,193,567	3,087,674
End of year net assets	$	3,199,248	3,193,567

See accompanying notes to financial statements.

MASSACHUSETTS BAY TRANSPORTATION AUTHORITY

(A Component Unit of the Commonwealth of Massachusetts)

Statements of Cash Flows

Years ended June 30, 2005 and 2004

(Dollars in thousands)

		2005	2004
Cash flows from operating activities:			
Receipts from transit customers	$	318,980	295,496
Receipts from other operations		49,330	49,440
Payments to suppliers and vendors		(535,440)	(510,718)
Payments to employees		(378,938)	(358,190)
Net cash used from operating activities		(546,068)	(523,972)
Cash flows from capital and related financing activities:			
Cash (used for) provided by:			
Additions to transportation property		(512,694)	(620,654)
Interest paid		(235,733)	(181,029)
Decrease in deferred credits/charges		(2,482)	(2,378)
Payments on long-term debt		(1,145,830)	(880,150)
Proceeds from bond and note issuances		1,275,130	1,195,725
Proceeds from bond premiums		66,981	—
Capital leases		(13,661)	(14,722)
Capital grants		182,385	226,074
Other		8,978	6,990
Net cash used for capital and related financing activities		(376,926)	(270,144)
Cash flows from noncapital and related financing activities:			
Sales tax and local assessment		842,779	826,842
Reimbursable payments		15,921	10,035
Other		(3,615)	—
Net cash provided by noncapital and related financing activities		855,085	836,877
Cash flows from investing activities:			
Interest and other income		17,887	19,125
Net cash provided from investing activities		17,887	19,125
Change in cash, temporary cash investments, restricted, and other special accounts		(50,022)	61,886
Cash, restricted cash and temporary cash investments, beginning of year		619,387	557,501
Cash, restricted cash and temporary cash investments, end of year	$	569,365	619,387
Reconciliation of operating (loss) to net cash (used) by operating activities:			
Operating loss	$	(821,316)	(792,464)
Charges to cost of service not requiring current expenditure of cash:			
Depreciation and amortization		269,814	249,087
Changes in all other working capital accounts except cash, temporary cash investments, and short-term debt		5,434	19,405
Net cash used from operating activities	$	(546,068)	(523,972)

See accompanying notes to financial statements.

(1) The Reporting Entity

The Massachusetts Bay Transportation Authority (the Authority) was originally created in 1964 and is body politic and corporate and a political subdivision of the Commonwealth of Massachusetts (the Commonwealth).

The Authority is managed by a board of nine directors. The Secretary of the Executive Office of Transportation of the Commonwealth is the Chairman. The other eight directors are appointed by the Governor of the Commonwealth. All appointments to the Board became effective July 1, 2000. Since this time, six have been reappointed with two new appointments. The Board has the power to appoint and employ a General Manager and other officers. The Advisory Board, consisting of a representative from each of the cities and towns paying Assessments, has the power to approve the Authority's long-term capital program and annual operating budget.

In accordance with the requirements of Statement No. 14, *The Financial Reporting Entity, of the Governmental Accounting Standards Board* (GASB), the financial statements must present the Authority (the primary government) and its component units. Pursuant to this criterion, no component units were identified for inclusion in the accompanying financial statements. Additionally, the accompanying financial statements are incorporated into the financial statements of the Commonwealth as the Authority is a component unit of the Commonwealth.

(2) Summary of Significant Accounting Policies

(a) Funding of Operation

Until June 30, 2000, the Authority was subsidized by the Commonwealth for its annual "Net Cost of Service" and certain debt costs as defined in Chapter 161A of Massachusetts General Law in effect prior to July 1, 2000. As part of the Commonwealth's Forward Funding Legislation (Chapter 127 of the Acts of 1999 of the Commonwealth or Enabling Act), the Commonwealth's funding mechanism was repealed and restated. Effective July 1, 2000, the new legislation allows the Authority to receive a dedicated revenue stream consisting of the assessments on the communities in the Authority's service area (the Assessments) and certain Dedicated Sales Tax. Additionally, the Authority's service territory expanded from 78 to 175 cities and towns. The Authority also funds operations through charges for providing transportation services.

(b) Financial Reporting

The Authority follows the provisions of the Governmental Accounting Standards Board Statement. The accompanying financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting and reflect transactions on behalf of the Authority, the reporting entity. The Authority accounts for its operations as an enterprise fund. Operating revenues and expenses result from providing transportation services to member communities. All other revenues and expenses are reported as nonoperating revenues and expenses.

(Dollars in thousands)

Under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Government Entities that Use Proprietary Fund Accounting*, the Authority has adopted the option to apply only those Financial Accounting Standards Board (FASB) statements and interpretations issued before November 30, 1989, that do not conflict with or contradict GASB pronouncements. Only GASB pronouncements issued after this date will be followed.

(c) Capital Assets

Capital assets are stated at historical cost. These costs include the Authority's labor costs for employees working on capital projects, related fringe benefits, and an allocated share of general and administrative costs.

Depreciation is provided on the straight-line method at rates that are designed to amortize the original cost of the property over its estimated useful life. The major categories of transportation property in service and their estimated useful lives are as follows at June 30, 2005:

	Estimated useful life
Ways and structures	10-60 years
Building and equipment	3-25 years

(d) Construction in Progress

During 2005 and 2004, major construction projects aggregating \$930,715 and \$395,780, respectively, were completed and transferred to the appropriate transportation property accounts. Major projects included transit service extensions, right of way improvements and purchases of new rolling stock and other equipment.

Interest on debt used to finance construction that is capitalized as part of the Authority's capital assets is calculated by offsetting interest expense incurred from the date of the borrowing until completion of the project, with interest earned on invested proceeds over the same period. In fiscal years 2005 and 2004, the net interest cost eligible for capitalization was approximately \$32,099 and \$25,295, (\$33,541 and \$26,850 of interest cost offset by \$1,442 and \$1,555 of interest income), respectively.

Additionally, the Authority, under various interagency agreements, performs construction work on behalf of those agencies. Such construction costs are reimbursed upon completion of the work. Costs incurred during 2005 and 2004 were approximately \$16,208 and \$13,894, respectively. Amounts owed to the Authority for these costs and prior years costs as of June 30, 2005 and 2004 were approximately \$4,711 and \$2,983, respectively, and are presented in accounts receivable in the accompanying statements of net assets.

(e) Self Insurance

The Authority is fully self-insured for various risks including worker's compensation, injuries and damages and employee health claims. The Authority also self-insures a portion of casualty and liability claims.

(f) Capital Grants and Contributions

The Authority receives capital grants from certain governmental agencies to be used for various purposes connected with the planning, modernization, and expansion of transportation facilities and equipment. Capital grants of the Authority are reported as revenue rather than contributed capital as required by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*.

(g) Statements of Cash Flows

For purposes of the statements of cash flows, the Authority considers all highly liquid investments purchased with a maturity of six months or less to be temporary cash investments.

(h) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

(i) Compensated Absences

The Authority accrues for vested vacation pay when it is earned by employees. The amount of vested vacation pay accrued as of June 30, 2005 and 2004 was approximately $15,994 and $14,363, respectively.

(j) Restricted and Other Special Accounts

Certain cash and investments are segregated from operating cash due to certain internal or external restrictions. The following are included in restricted and other special accounts:

- Bond Construction Accounts – represents unexpended bond proceeds.
- Lease Accounts – represents cash held by trustees to be used to pay lease payments on the Authority's defeased capital leases.
- Bond Reserve Accounts – represents cash funds required to be maintained by bond indentures.
- Stabilization Account – represents funds held in accordance with statutory requirements to be used when annual revenues are projected to be less than annual expenses, or if the Authority has insufficient funds on hand to pay current expenses.

- Other Accounts – represents funds held in accordance with the Authority's Trust Agreements for capital maintenance, debt service, and other expenses.

(k) Materials and Supplies

Materials and supplies are stated at average cost and include items to support the Authority's operations.

(l) Reclassification

Certain reclassifications were made to the 2004 statements to conform to the current year presentation.

(3) Deposits and Investments

The Authority adopted the Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures* for fiscal year 2005. The standard requires that entities disclose essential risk information about deposit and investment requirements addressing common risks of investments. Comparative information for fiscal 2004 has been provided to the extent that information is available.

The Authority does not have a formal investment policy. Presently, only investments named in the respective trust agreements are purchased.

The Authority is authorized by its board of directors to make deposits into checking and savings accounts and to invest in direct obligations of the U.S. Treasury, its agencies and instrumentalities, brokers' acceptances, investment agreements, municipal bonds, repurchase agreements secured by U.S. government and agency obligations, and certain other investments permitted under the trust indentures.

Obligations of any agency or instrumentality of the United States of America, including, but not limited to the following, may be acceptable as collateral to secure certificates of deposit or other instruments:

(A) Federal Home Loan Banks
(B) Federal Land Banks
(C) Federal Intermediate Credit Banks
(D) Bank for Cooperatives
(E) Federal National Mortgage Association
(F) Federal Farm Credit Banks

The Authority may invest in prime commercial paper of corporate issuers with a minimum quality rating of P-1 by Moody's or A-1 by Standard and Poor's. These instruments can vary in maturity; however, no more than ten (10) percent of the investment funds shall be invested in the commercial paper of a single corporation.

Additionally, the Authority is authorized to invest in The Massachusetts Municipal Depository Trust (MMDT) established under General Laws, Chapter 29, Section 38 A.

(Dollars in thousands)

Restricted investments are recorded at fair value. Other investments are recorded at amortized cost, which approximates market, and earn interest and dividends at prevailing rates.

Deposits and investments consisted of the following amounts presented in the accompanying statements of net assets at June 30, 2005 and 2004:

		2005	2004
Construction accounts	$	76,722	170,947
Other accounts		375,921	295,870
Lease accounts		543,676	538,098
Cash and temporary cash investments		99,994	146,423
	$	1,096,313	1,151,338

(a) Custodial Credit Risk – Deposits

The custodial credit risk for deposits is the risk that in the event of a bank failure, the Authority's deposits may not be recovered. The deposits in the bank in excess of the insured amount are uninsured and uncollateralized. The carrying amount of the Authority's deposits at June 30, 2005 and 2004 was $473,025 and $534,343, respectively. The bank balance at June 30, 2005 and 2004 was $473,162 and $539,130, respectively. Of this amount, $337,860 and $386,739, respectively, was exposed to custodial credit risk as uninsured and uncollateralized.

(b) Interest Rate Risk – Investments

Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Authority follows the guidelines in the Authority's trust agreements, and does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

The Authority's fixed-income investments at June 30, 2005 are presented below. All investments are presented by investment type and maturity.

Fixed-Income Investments by Maturity
June 30, 2005
(Expressed in thousands)

		Investment maturities (in years)			
Investment type	**Fair value**	**Less than 1 year**	**1-3**	**4-8**	**More than 9**
MMDT	$ 16,928	16,928	—	—	—
Guaranteed investment contracts	103,788	1,076	65,300	8,288	29,124
Forward delivery agreements	241,995	—	—	—	241,995
Treasury strips	182,769	527	8,719	58,824	114,699
Auction rate securities	33,225	33,225	—	—	—
Investments	$ 578,705	51,756	74,019	67,112	385,818

The Authority has unrestricted deposits of $59,841 as of June 30, 2005. Restricted deposits held within the Authority's bond construction, lease, stabilization, capital maintenance, compensating and deficiency accounts aggregated $413,184 as of June 30, 2005.

(c) Credit Ratings

The Authority holds guaranteed investment contracts and forward delivery agreements with a fair value of $345,783 at June 30, 2005. These investments are not rated.

The Authority holds Auction Rate Securities that are invested in short-term investments that mature every 28 or 32 days. The balance held in these Auction Rate Securities was $33,225 as of June 30, 2005. All of these investments have a rating of AAA by Standard & Poor's.

Investments in Treasury Strips are a United States government obligation. The Authority had $182,769 invested in Treasury Strips as of June 30, 2005.

The Authority also has $16,928 invested in MMDT, a state investment pool managed by Fidelity Investments as agent for the Commonwealth of Massachusetts and shareholders of the MMDT Trust. MMDT is unrated.

(d) Concentration of Credit Risk – Investments

Concentration of credit risk is the risk of loss attributable to the magnitude of a government's investment in a single issuer. The issuers where securities at year-end exceeded 5% of the total investments are as follows (in thousands):

			% of portfolio
Providers of guaranteed investment contracts and forward delivery agreements:			
AIG Matched Funding Corp.	$	99,925	17.3%
Bank of America		78,588	13.6
Wachovia Bank		61,100	10.6
FSA Capital Management		47,015	8.1
	$	286,628	

(e) Foreign Currency Risk

The Authority has a foreign currency holding in Swedish Krona as a result of a cross-border lease transaction. There is a guaranteed exchange rate during the term of the cross-border lease. At June 30, 2005, the foreign currency was $44,583.

(4) Commuter Railroad and Local Subsidy

Under General Laws, Chapter 161A, Section 3(f) of the Commonwealth of Massachusetts, the Authority may enter into agreements with private transportation companies, railroads, and other concerns providing for joint or cooperative operation of any mass transportation facility and for operation and use of any mass transportation facility and equipment for the account of the Authority.

On September 1, 1995, the Authority entered into an operating agreement with the National Railroad Passenger Corporation (AMTRAK) to provide commuter railroad service over the Authority's rail lines. The Authority agreed to pay AMTRAK a fixed price per year for the services specified in the agreement and its amendments. This agreement was terminated on June 30, 2003 and a new agreement was entered into with Massachusetts Bay Commuter Railroad Company (MBCRC) beginning July 1, 2003 for a period of five years. The Authority will pay MBCRC a total fixed base contract amount of $1,050,081 over this five-year period. Residual amounts due to or from AMTRAK under the old contract are not considered material to the Authority's financial statements.

(5) Long-Term Debt

(a) Bonds Payable

The Enabling Act authorizes the Authority to issue general obligation debt, revenue, or other debt secured by a pledge or conveyance of all or a portion of revenues, receipts or other assets or funds of the Authority beginning July 1, 2000.

Debt issued by the Authority and outstanding at June 30, 2000 (prior obligations) is backed by the full faith and credit of the Commonwealth until the debt is paid off. Principal and interest payments on that debt were also subsidized by the Commonwealth prior to June 30, 2000.

Debt issued by the Authority after June 30, 2000 (new debt) will not be supported by the Commonwealth's guarantee. Additionally, the Authority is not expected to receive any principal or interest subsidies from the Commonwealth for the repayment of the prior obligations or new debt of the Authority, unless authorized by special legislation.

In fiscal 2004, the Authority issued three series of Sales Tax Bonds: 2003 Series C for $255,095, 2004 Series A for $16,630 and the 2004 Series B for $519,785. Principal is payable July 1, 2004 through July 1, 2023 on the 2003 Series C, from July 1, 2004 through July 1, 2016 on the Series 2004 A and from July 1, 2004 through July 1, 2030 on the 2004 Series B Bonds. Interest is payable semiannually on July 1st and January 1st on all three series. All three series were used to refinance higher interest rate debt, which is more fully described in footnote 5(b).

The Authority entered into an interest rate swap with Morgan Stanley Capital Services, Inc. for a notional amount of $25,005, which is equal to the par amount of the 2003 Series C Bonds that matures on July 1, 2020. The swap requires the Authority pay a fixed rate of 4.13% on the notional amount of $25,005, while Morgan Stanley will pay the MBTA a floating rate based on CPI (Consumer Price Index) plus 79 basis points. The swap agreement is not a Qualified Hedge Agreement under the Sales Tax Bond Trust Agreement, so payments resulting from the swap agreement are made to Morgan Stanley from the General Fund and payments received by the Authority are deposited into the Pledged Revenue Fund.

Also in fiscal 2004, the Authority issued Assessment Bonds Series 2004 A for $404,215. Principal is payable on July 1, 2005 through July 1, 2034. Interest is payable semiannually on July 1st and January 1st. The first interest payment on these bonds is January 1, 2005. The 2004 Series A Assessment bonds were issued to refund $188,000 in Bond Anticipation Notes (BANs) and use the remaining proceeds to finance systemwide improvements, vehicle replacements and a commuter rail expansion project.

In fiscal 2005, the Authority issued two series of Sales Tax Bonds: 2004 Series C for $323,275 and the 2005 Series A for $777,390. Principal is payable July 1, 2013 through July 1, 2024 on the 2004 Series C and from July 1, 2019 through July 1, 2035 on the 2005 Series A. Interest is payable semiannually on July 1st and January 1st on both series. Both series were used to refinance higher interest rate debt, which is more fully described in footnote 5(b).

Also in fiscal 2005, the Authority issued its first Grant Anticipation Note in the amount of $81,665. The debt service on the 2004 Series A GANS is entirely funded by Section 5307 "FTA Formula Funds". These notes were issued to fund 175 low floor emission control diesel buses and for improvements to the Fairmount Corridor Commuter Rail line. Principal is payable on March 1, 2006 through March 11, 2011. Interest is paid semiannually on March 1st and September 1st.

In June 2005, the Authority entered into two forward starting swaps with UBS AG in the amount of $248,485 and $47,055, respectively, equal to the approximate par amount of Assessment Bonds needed to current refund portions of the Authority's General Transportation System Bonds, 1997 Series B and C maturing on and after March 1, 2008 and portions of the Series 2000 Assessment Bonds maturing on and after July 1, 2011. The swap on the 1997 Series B and Series C General Transportation System Bonds is effective commencing December 2, 2006. Under this swap agreement, the Authority will receive a variable rate equal to the BMA index and pay a fixed rate of 3.783%. The swap on the 2000 Series A Assessment Bonds is effective April 3, 2010 whereby the MBTA will receive a variable rate equal to the BMA index and pay a fixed rate of 4.132%. Neither swap agreement is a Qualified Hedge under the Assessment Bond Trust Agreement, so payments under each swap agreement are made under the Assessment Bond Trust Agreement from the General Fund, and payments received by the Authority are deposited in the Pledged Revenue Fund.

General Transportation System (GTS) Bonds, all issued prior to July 1, 2000, are payable in annual installments on March 1st; interest is payable semiannually on March 1st and September 1st. The GTS bonds were issued to provide funds for the financing of the Authority's transportation property.

Boston Metropolitan District Bonds (BMD) were issued for transit purposes prior to the formation of the Authority in 1964.

The Authority had $92,800 in outstanding commercial paper as of June 30, 2005. Interest rates on the commercial paper range from a low of 2.2% to a high of 2.7%. In order to take advantage of the low interest rate short-term capital market, the Authority issues commercial paper to raise funds in order to pay its capital costs. The Authority has a $200 million commercial paper program. $100 million is administered by Bear Stearns and $100 million by Lehman Brothers. Authority commercial paper is rated P-1 by Moody's Investor Services and A-1+ by Standard and Poor's.

(Dollars in thousands)

The bonds outstanding are as follows at June 30, 2005:

	Year of maturity	Interest rates	Outstanding principal June 30, 2005	Due in fiscal 2006
General transportation system bonds:				
1974 Series A Bonds dated June 1, 1974	2014	5.0 – 6.6%	$ 12,075	—
1991 Series A Bonds dated November 15, 1991	2021	7.00%	75,000	—
1992 Series B Refunding Bonds dated December 1, 1992	2021	6.20%	125,200	—
1992 Series C Bonds dated November 15, 1992	2023	6.10%	15,575	—
1993 Series A Refunding Bonds dated June 1, 1993	2022	5.25% – 5.5%	198,110	28,170
1994 Series A Refunding Bonds dated June 1, 1994	2019	6.25% – 7.0%	155,725	—
1995 Series A Bonds dated April 1, 1995	2025	5.5% – 5.825%	106,240	—
1997 Series B Bonds dated August 1, 1997	2014	4.8 – 5.0%	6,760	615
1997 Series C Bonds dated August 1, 1997	2024	5.0 – 6.0%	234,170	1,805
1998 Series A Bonds dated February 15, 1998	2026	4.3% – 5.5%	298,705	7,040
1998 Series C Bonds dated November 1, 1998	2022	5.25% – 5.75	220,245	12,040
1999 Variable Interest Rate Bond dated June 29, 1999	2014	Variable	48,970	4,085
1999 Series A Bond dated December 1, 1999	2021	5.75% – 6.0%	86,060	—
2000 Variable Interest Rate Bond dated March 10, 2000	2030	Variable	188,000	—
			1,770,835	53,755

(Dollars in thousands)

	Year of maturity	Interest rates	Outstanding principal June 30, 2005	Due in fiscal 2006
Boston metropolitan district bonds:				
1994 Series A dated September 1, 1994	2005	5.3% – 5.5%	$ 1,520	1,520
1998 Series A dated November 1, 1998	2008	4.0% – 4.1%	1,965	435
2002 Series A dated December 1, 2002	2014	5.125% – 5.25%	17,515	—
			21,000	1,955
Revenue bonds:				
2000 Series A Assessment Bond dated August 1, 2000	2030	4.9%-5.75%	81,035	—
2000 Series A Senior Sales Tax Bond dated August 1, 2000	2030	4.7%-4.8%	28,620	—
2002 Series A Senior Sales Tax Bond dated November 1, 2002	2032	3.0%-5.0%	158,525	1,935
2003 Series A Senior Sales Tax Bond dated January 29, 2003	2021	2.25%-5.25%	228,065	9,380
2003 Series B Senior Sales Tax Bond dated February 26, 2003	2023	Auction Rate	93,375	—
2003 Series C Senior Sales Tax Bond dated February 3, 2004	2023	2.20%-6.0%	253,455	—
2004 Series A Senior Sales Tax Bond dated February 3, 2004	2016	2.20%-5.25%	16,535	40
2004 Series B Senior Sales Tax Bond dated March 9, 2004	2030	2.0%-5.25%	513,205	1,830
2004 Series A Assessment Bond dated June 10, 2004	2034	3.0%-5.25%	192,025	1,000
2004 Series C Sale Tax Bond dated December 22, 2004	2024	3.5%-5.5%	323,275	—
2005 Series A Sale Tax Bond dated March 24, 2005	2035	5.00%	777,390	—
			2,665,505	14,185

(Continued)

(Dollars in thousands)

	Year of maturity	Interest rates	Outstanding principal June 30, 2005	Due in fiscal 2006
Grant Anticipation Notes (GANS):				
2004 Series A Grant Anticipation Notes dated August 5, 2004	2011	2.0%-5.0%	$ 81,665	—
Bond Anticipation Notes (BANs)	2006	2.2%-2.7%	92,800	92,800
Total bond and notes payable			4,631,805	$ 162,695
Less current maturities			162,695	
Total long-term bonds payable			4,469,110	
Plus – unamortized bond premiums			237,964	
Less – unamortized bond discounts/ losses on bond refundings, net			(291,227)	
Total long-term bonds payable			$ 4,415,847	

The annual maturities of bonds and notes payable as of June 30, 2005 are as follows:

	Principal	Interest
Fiscal years:		
2006	$ 162,695	226,636
2007	146,355	235,254
2008	146,480	229,114
2009	168,605	220,527
2010	184,180	211,251
2011 – 2015	976,255	902,528
2016 – 2020	944,040	630,939
2021 – 2025	928,545	377,856
2026 – 2030	662,680	168,838
2031 – 2035	295,970	34,368
2036	16,000	400
Total	$ 4,631,805	3,237,711

(Dollars in thousands)

A summary rollforward of bonds for 2005 and 2004 is as follows:

	Balance 2004	Additions	Payments	Balance 2005
General Transportation	$ 2,278,390	—	507,555	1,770,835
Boston Metropolitan District	23,250	—	2,250	21,000
Revenue	2,200,865	1,100,665	636,025	2,665,505
Grant Anticipation Notes	—	81,665	—	81,665
Bond Anticipation Notes	—	92,800	—	92,800
	$ 4,502,505	1,275,130	1,145,830	4,631,805

	Balance 2003	Additions	Payments	Balance 2004
General Transportation	$ 2,833,745	—	555,355	2,278,390
Boston Metropolitan District	25,510	—	2,260	23,250
Revenue	1,327,675	1,195,725	322,535	2,200,865
	$ 4,186,930	1,195,725	880,150	4,502,505

The following funds included in restricted assets at June 30, 2005 and 2004 are in connection with the Authority's revenue bond trust agreements:

	2005			2004	
	Assessment bonds	Sales tax bonds	GANs	Assessment bonds	Sales tax bonds
Debt service	$ 11,756	82,499	—	12,097	68,070
Debt service reserve	73,102	103,761	8,288	75,023	51,651
	$ 84,858	186,260	8,288	87,120	119,721

The minimum required balances in the debt service reserve funds at June 30, 2005 and 2004 were $23,754 and $73,526 for the assessment bonds and $96,526 and $51,217 for the sales tax bonds, respectively. The minimum required balance in the debt service reserve funds at June 30, 2005 for Grant Anticipation Notes is $8,167. In addition, for the year ended 2005 and 2004, the Authority collected $842,779 and $826,842 in pledged revenue ($704,621 and $686,977 in dedicated sales tax receipts and $138,158 and $139,865 in local assessments), respectively. The Authority believes it has complied with its other material financial bond covenants.

(b) Debt Refundings

In current and prior years, the Authority defeased in-substance several General Transportation System Bonds by placing the proceeds of new bonds in an irrevocable trust fund to provide for future debt service payments on the old debt. Accordingly, the trust account asset and the liability for the defeased bonds are not included in the accompanying financial statements. On June 30, 2005 and 2004, $1,940,460 and $1,214,675 of these bonds, considered defeased in-substance, are still outstanding, respectively.

During fiscal 2005, the Authority refunded $222,215 in General Transportation System Bonds, $14,900 of 2000 Series A Sales Tax Bonds, $7,145 of 2002 Sales Tax Bonds and $41,985 of 2004 Series A Assessment Bonds with the issuance of the 2004 Series C Senior Sales Tax Bonds. The 2004 Series C Sales Tax Bonds also funded $20,649 of the $23,575 in swap termination payments while the Authority funded the balance of $2,926. The refunding qualified as an "in-substance defeasance." The difference in cash flows between the prior debt service and new debt service is approximately $21,476. The net present value or economic gain on the refunding is $3,117. The accounting loss of $19,842 has been presented as a reduction in the amount of outstanding debt and will be amortized over the life of the refunded bonds.

Additionally, the Authority refunded $197,015 in General Transportation System Bonds, $246,715 of 2000 Series A Assessment Bonds, $16,155 of 2000 Series A Sales Tax Bonds, $113,290 of 2002 Sales Tax Bonds and $170,205 of 2004 Series A Assessment Bonds with the issuance of the 2005 Series A Senior Sales Tax Bonds. The refunding qualified as an "in-substance defeasance". The difference in cash flows between the prior debt service and new debt service is approximately $57,282. The net present value or economic gain on the refunding is $51,167. The accounting loss of $47,138 has been presented as a reduction in the amount of outstanding debt and will be amortized over the life of the refunded bonds.

During fiscal 2004, the Authority refunded $111,685 in General Transportation System Bonds and $141,230 of Series 2000 A Assessment Bonds with the proceeds from the issuance of the Senior Sales Tax Bonds, Series 2003 C. The refunding qualified as an "in-substance defeasance." The difference in cash flows between the old and new bonds was approximately $11,427. The net present value or economic gain on the refunding is $12,342. The accounting loss of $32,124 has been presented as a reduction in the amount of outstanding debt and will be amortized over the life of the old bonds.

Additionally, the Authority refunded $17,085 in General Transportation System Bonds with the proceeds from the issuance of the Senior Sales Tax Bonds, Series 2004 A. The refunding qualified as an "in-substance defeasance." The difference in cash flows between the old and new bonds was approximately $682. The net present value or economic gain on the refunding is $851. The accounting loss of $2,182 has been presented as a reduction in the amount of outstanding debt and will be amortized over the life of the old bonds.

Lastly, the Authority issued the Senior Sales Tax Series 2004 B Bonds in the amount of $519,785 for the purposes of refunding higher interest rate debt. Proceeds from the 2004 Series B Sales Tax Bonds refunded a portion of five series of General Transportation System bonds in the amount of $345,345. In addition, proceeds were also used to refund $27,665 in 2000 Series A Assessment Bonds, $40,455 in 2000 Series A Sales Tax Bonds and $105,330 in 2002 Series A Sales Tax Bonds. The refunding qualified as an "in-substance defeasance." The difference in cash flows between the old and new bonds was approximately $52,801. The net present value or economic gain on the refunding is $27,097. The accounting loss of $56,327 has been presented as a reduction in the amount of outstanding debt and will be amortized over the life of the old bonds.

(Dollars in thousands)

(c) Certificates of Participation

Outstanding Certificates of Participation (COPs) of the Authority totaled $1,135 and $2,270 at June 30, 2005 and 2004, respectively. Under the Forward Funding legislation effective July 1, 2000, these COP payments are not reimbursable from the Commonwealth. However, the Commonwealth will continue to guarantee the debt until it is repaid.

A rollforward of the COPs for the years ended June 30, 2005 and 2004 is as follows:

Outstanding – June 30, 2003	$	3,410
Payments		(1,140)
Outstanding – June 30, 2004		2,270
Payments		(1,135)
Outstanding – June 30, 2005	$	1,135

The remaining COPs outstanding bear interest at rates ranging from 7.75% to 7.8% and mature as follows:

		Principal		Interest
Fiscal years:				
2006	$	1,135		88
		1,135	$	88
Less current maturities		1,135		
Total long-term COPs payable	$	—		

The remaining outstanding principal balance of COPs that were defeased in-substance in prior years is $9,075 at June 30, 2005.

(d) Derivative Investments

The Authority has entered into interest rate swaps and swaptions (referred to herein collectively as Swaps) in order to lower its cost of capital, protect against rising interest rates, lock in interest rate savings, realize refinancing savings according to schedules that suit the Authority's needs, and to provide the Authority with a stable and predictable cost of fuel. When the Authority has entered into Swaps, the Authority has done so in order to: (1) provide lower cost fixed rate financing for its capital needs through synthetic fixed rate structures; (2) lock in long-term fixed rate returns on invested assets in its required reserve funds; (3) create synthetic refinancing with cash flow savings realized as the Authority designates; or (4) create a synthetic fixed rate for the purchase of vehicular fuel for fixed periods of time rather than being exposed to unpredictable variations in fuel prices on the spot market. All premiums received by the Authority in connection with the swaps/swaptions are deferred and amortized into income over the life of the swap/swaption. Should a swap/swaption be terminated, any unamortized premiums are recognized as income in the period the termination occurs. In addition, any termination fees will be recorded as interest expense.

(Dollars in thousands)

Summary of Swap Transactions by Category

Synthetic Fixed Rate Swap Transactions

Date of execution	Notional amount	Termination date	Associated bonds	Fixed payable swap rate	Variable receivable swap rate	Lump-sum payment from counterparty	Counterparty credit rating at June 30, 2005	Fair value at June 30, 2005
June 2000	$ 188,000	2005	GTS Series 2000 VRDO	4.9284%	BMA	$ N/A	A2/A	$ (741)
December 2001	87,805	2022	Senior Sales Tax Series 2003 B	5.20%	BMA	4,338 (August 2006)	Aaa/AAA	(9,974)
February 2004	25,005	2020	*Senior Sales Tax Series 2003 C	4.13%	CPI+79 basis points	N/A	Aa3/A+	(1,567)

* This swap relates only to the July 1, 2020 maturity which has a variable rate of interest.

Swap Payments and Associated Debt. As of June 30, 2005, debt service requirements of the GTS Series 2000 VRDO (2000 Bonds) bonds and net swap payments, applying the fixed rate on the swap of 4.9284% and assuming the BMA rate is 2.28% and the variable rate on the 2000 Bonds is 2.22% through the term of the swap, were as follows. As rates vary, variable rate interest rate payments on the 2000 Bonds and net swap payments will vary.

Fiscal year ending June 30	2000 Bonds principal	2000 Bonds interest	Interest rate swap, net	Total
2006*	$ —	696	830	1,526

* Through September 1, 2005.

As of June 30, 2005, debt service requirements of the 2003 B-1 and 2003 B-2 hedged bonds and net swap payments, applying the fixed rate on the swap of 5.2% and assuming the BMA rate is 2.28%

(Dollars in thousands)

and the variable rate on the 2003 B-1 bonds is 2.44% and 2003 B-2 bonds is 2.60% through the term of the swap, were as follows. As rates vary, variable rate interest rate payments on the 2003 bonds and net swap payments will vary.

Fiscal year ending June 30		2003 B Bonds principal	2003 B Bonds interest	Interest rate swap, net	Total
2006	$	—	2,347	2,564	4,911
2007		—	2,347	2,564	4,911
2008		—	2,347	2,564	4,911
2009		—	2,347	2,564	4,911
2010		—	2,347	2,564	4,911
2011-2015		18,990	11,736	11,867	42,593
2016-2020		39,895	11,736	3,931	55,562
2021-2022		28,920	4,695	(1,471)	32,144
	$	87,805	39,902	27,147	154,854

As of June 30, 2005, debt service requirements on the 2003 Series C Sales Tax bonds and net swap payments, applying the fixed rate on the swap of 4.13% and assuming the CPI rate of 3.908% plus 79 basis points through the term of the swap, were as follows. As rates vary, variable interest rate payments on the 2003 Series C bonds and net swap payments will vary.

Fiscal year ending June 30		2003 C Bonds principal	2003 C Bonds interest	Interest rate swap, net	Total
2006	$	—	977	(142)	835
2007		—	977	(142)	835
2008		—	977	(142)	835
2009		—	977	(142)	835
2010		—	977	(142)	835
2011-2015		—	4,886	(710)	4,176
2016-2020		25,005	4,642	(968)	28,679
	$	25,005	14,413	(2,388)	37,030

(Dollars in thousands)

Swaptions for Forward Refundings

	Date of execution of swaption	Notional amount	Lump-sum payment from counter-party	Counter-party option exercise date	Term of swap	Associated bonds	Fixed payable swap rate	Variable receivable swap rate	Counter-party credit rating at June 30, 2005	Fair value at June 30, 2005
*	July 2001	$ 188,000	$ 12,230 (August 2005)	Each March and September from September 2005 through and including March 2010	2030	GTS Series 2000 VRDO	5.000%	67% of one-month LIBOR	Aa2/AA+	$ (32,455)
	December 2001	79,645	4,140 (August 2005)	Each March and September from 2009 through and including 2011	2030	GTS Bonds, 1999 Series A maturing 2026 and 2030	5.610%	BMA	Aaa/AAA	(9,836)
	June 2005	248,485	N/A	Not a swaption, but a forward swap, effective commencing December 2, 2006 through July 1, 2023	2023	GTS Bonds, 1997 Series B and 1997 Series C	3.783%	BMA	Aa2/AA+	(2,269)
	June 2005	47,055	N/A	Not a swaption, but a forward swap, effective commencing April 3, 2010 through July 1, 2030	2030	2000 Series A Assessment Bonds	4.132%	BMA	(Aa2/AA+)	(514)

* On August 2, 2005, the Authority was notified by UBS AG that the option, as described in the swap agreement, will be exercised.

These four swaptions are generally exercisable from September 2005 through March 2011.

Asset-Side Swaption for Reserve Investment

Date of execution of swaption	Notional amount	Lump-sum payment from counter-party	Counter-party option exercise date	Term of swap	Associated bonds	Fixed payable swap rate	Variable receivable swap rate	Counter-party credit rating at June 30, 2005	Fair value at June 30, 2005
December 2000	$ 49,123	$ 1,265 (July 2001)	January 1st and July 1st from July 2010 through July 2030	2030	Debt Service Reserve Fund for 2000 Assessment and Sales Tax Bonds	5.60%	BMA	Aa2/AA+	$ (1,630)

Risk Disclosure

Credit Risk. Because all of the Authority's Swaps rely upon the performance of the third parties who serve as swap counterparties, the Authority is exposed to credit risk, or the risk that a swap counterparty fails to perform according to its contractual obligations. The appropriate measurement of this risk at the reporting date is the fair value of the swaps, as shown in the columns labeled Fair Value in the tables above. All Fair Values have been calculated using the Mark to Market or Par Value Method. To mitigate credit risk, the Authority maintains strict credit standards for swap counterparties. All swap counterparties for longer term swaps are rated in the double-A category by both Moody's and Standard & Poor's. On the Authority's shorter term swap that expired in September 2005, the counterparty is rated in the single-A category by both rating agencies. To further mitigate credit risk, the Authority's swap documents require counterparties to post collateral for the Authority's benefit if they are downgraded below a designated threshold.

Basis Risk. The Authority is exposed to basis risk if the relationship between the floating index the Authority receives on the swaps (BMA, CPI plus 79 basis points, or 67% of LIBOR) falls short of the variable rate on the associated bonds. Should this occur, the expected savings may not be realized. As of June 30, 2005, the BMA rate was 2.28%, while the variable rate on the 2000 Bonds was 2.22% and the variable rates on the 2003 B-1 hedged bonds and 2003 B-2 hedged bonds were 2.24% and 2.60%, respectively. For the Series 2003 C in the amount of $25,005, the Authority has basis risk should CPI plus 79 basis points fall below the 4.13%. CPI plus 79 basis points as of June 30, 2005 was 3.90%.

Termination Risk. The Authority's swap agreements do not contain any out-of-the-ordinary termination events that would expose it to significant termination risk. In keeping with market standards the authority or the counterparty may terminate each swap if the other party fails to perform under the terms of the contract. In addition, the swap documents allow either party to terminate in the event of a significant loss of creditworthiness. The Authority views such events to be remote at this time. If at the time of the termination a swap has a negative value, the Authority would be liable to the counterparty for a payment equal to the fair value of such swap.

Rollover Risk. With the exception of the swap on the 2000 bonds, the Authority is not exposed to rollover risk. Because the swap for the 2000 bonds terminates prior to the maturity of such bonds, the Authority is exposed to rollover risk. Upon the termination of the swap, the Authority will no longer realize the synthetic rate on the 2000 bonds and will be exposed to floating rate risk on the underlying bonds if no new hedge is put in place. On August 2, 2005, the Authority was notified by UBS AG that the option, as described in the swap agreement, will be exercised.

Market Access Risk and Potential Basis Risk. In the case of the swaptions, other than one issued in July 2001, if any option is exercised and refunding bonds are not issued, the bonds expected to be refunded would not be refunded and the Authority would make net swap payments as required by the terms of each contract, as set forth above. There is no market access risk for the July 2001 swaption. If the option is exercised and the two forward swaps commence, (and assuming the variable rate bonds are issued in the case of these transactions), the actual savings ultimately recognized by the transaction will be affected by the relationship between the interest rate terms of the variable rate bonds versus the variable payment on the swap.

(6) Deferred Revenue

The deferred revenue amount relates principally to a settlement received from a supplier of green line cars. The deferral will be amortized over a remaining life of 6 years.

(7) Retirement Plans

The Authority provides retirement benefits to employees through four defined benefit retirement plans and one defined contribution plan: The MBTA Retirement Plan, the MBTA Police Association Plan, the MBTA Deferred Compensation Plan, the MBTA Qualified Deferred Compensation Plan, and the MBTA Deferred Compensation Savings Plan. The Authority also provides supplemental pension benefits after retirement.

The MBTA Retirement Plan, a single-employer plan, covers all employees except the MBTA police, who are covered separately, and certain executives who elect coverage under an alternate plan. This retirement plan and the MBTA Police Association Plan, a single-employer plan, provide retirement, disability, and death benefits. Both plans issue a publicly available financial report that includes financial statements and required supplementary information for that plan. The MBTA Retirement Plan report may be obtained by writing to One Washington Mall, Boston, Massachusetts 02108, or by calling (617) 316-3800. The MBTA Police Association Plan may be obtained by writing to P.O. Box 6807, Boston, MA 02102 or by calling 1-800-281-0063.

The MBTA Deferred Compensation Plan, a single-employer plan, provides supplemental pension benefits for certain executive and Local 453 (collective bargaining unit) employees after retirement. Employees may participate in both the MBTA Retirement Plan and the MBTA Deferred Compensation Plan.

The Authority created a new Qualified Deferred Compensation Plan effective January 1, 2001. The Plan is designed to supplement the Authority’s Retirement Fund (Main Fund). Covered employees include all actively employed nonunion employees who are participating in the Authority Main Fund or the Police Association Retirement Plan. Employees are eligible after five years with the Authority, if they have reached age 30 and are paid as part of the executive payroll. The Plan currently provides benefits for 147 retirees. An actuarial valuation was performed on this plan; however, the cost of this plan to the Authority for fiscal 2005 was minimal and no contributions were made to this Plan in fiscal 2005. In addition, the net pension obligation is considered immaterial.

(a) Funding Policy and Annual Pension Cost

The board of trustees of each plan establishes the contribution requirements; however, the Authority may amend these requirements. The MBTA Retirement Plan requires members to contribute 4% with the Authority currently paying an amount equal to approximately 11.00% of total payroll. The actuarial required contribution rate for the Authority was 9.71%. The contribution requirements for the Police Association Plan were 13.62% for the Authority and 8.40% for employees. Both were determined in accordance with actuarial valuations. Actual contributions made to this Plan in 2005 and 2004 were in accordance with these contribution requirements.

(Dollars in thousands)

Deferred Compensation contributions are made on a "pay-as-you-go" basis. The Authority's annual pension cost for the years ended June 30, 2005 and 2004 and related information for each plan is as follows:

		2005		
Pension		**MBTA Retirement Plan**	**MBTA Police Association Plan**	**Deferred Compensation Plan**
Annual pension cost – Authority	$	30,160	1,686	4,531
Contributions made – Authority		34,201	1,734	4,057
Actuarial valuation date/update		6/30/2005	6/30/2005	7/1/2004
Actuarial cost method		Entry age	Entry age	Entry age
Amortization method		Level dollar	Level dollar	Level dollar
Amortization period remaining		31 years	10 years	31 years
Asset valuation method average		5-year moving	4-year smoothing	None
Actuarial assumptions:				
Interest rate		7.25%	7.00%	8.00%
Projected salary increases		5.00%	5.50%	5.00%

		2004		
Pension		**MBTA Retirement Plan**	**MBTA Police Association Plan**	**Deferred Compensation Plan**
Annual pension cost – Authority	$	34,847	1,636	4,392
Contributions made – Authority		21,180	1,500	3,926
Actuarial valuation date/update		6/30/04	6/30/04	7/1/03
Actuarial cost method		Entry age	Entry age	Entry age
Amortization method		Level dollar	Level dollar	Level dollar
Amortization period remaining		32 years	11 years	32 years
Asset valuation method average		5-year moving	4-year smoothing	None
Actuarial assumptions:				
Interest rate		7.25%	7.00%	8.00%
Projected salary increases		5.00%	5.50%	5.00%

(Continued)

(Dollars in thousands)

Changes in the net pension assets (obligation) for these plans for the years ended June 30, 2005 and 2004 are as follows:

		2005		
Pension		**MBTA Retirement Plan**	**MBTA Police Association Plan**	**Deferred Compensation Plan**
Net pension obligation – beginning of year	$	(6,524)	(143)	(6,200)
Annual pension cost		(30,160)	(1,686)	(4,531)
Contributions		34,201	1,734	4,057
Net pension obligation – end of year	$	(2,483)	(95)	(6,674)

		2004		
Pension		**MBTA Retirement Plan**	**MBTA Police Association Plan**	**Deferred Compensation Plan**
Net pension asset (obligation) – beginning of year	$	7,143	(7)	(5,734)
Annual pension cost		(34,847)	(1,636)	(4,392)
Contributions		21,180	1,500	3,926
Net pension obligation – end of year	$	(6,524)	(143)	(6,200)

(Dollars in thousands)

(b) Three-Year Trend Information

	Year ending	Annual pension cost (APC)	Percentage of APC contributed	Net pension asset (obligation)
MBTA Retirement Plan				
	06/30/03	$ 18,618	118%	7,143
	06/30/04	34,847	61	(6,524)
	06/30/05	30,160	113	(2,483)
MBTA Police Association Plan				
	06/30/03	1,303	67%	(7)
	06/30/04	1,636	92	(143)
	06/30/05	1,686	103	(95)
MBTA Deferred Compensation Plan				
	06/30/03	4,364	75%	(5,734)
	06/30/04	4,392	89	(6,200)
	06/30/05	4,531	90	(6,674)

(c) The MBTA Deferred Compensation Savings Plan

The Authority provides a defined contribution retirement plan for nonunion and grandfathered union management not participating in the MBTA Retirement Plan. Authority employee trustees administer the Plan and recommend benefit amendments which require approval from the Authority's General Manager. The Plan requires members to contribute 4% of total covered payroll with the Authority contributing 8%. The Plan has approximately 261 and 286 members at June 30, 2005 and 2004, respectively, and the cost of the Plan to the Authority was $787 and $850 for fiscal years 2005 and 2004, respectively. Member contributions vest to Plan members immediately, while contributions made by the Authority vest to Plan members as follows: 50% after three years; 75% after four years; and 100% after five years of credited service.

(d) Other Post-Employment Benefits

The Authority pays 100% of health insurance to retired employees eligible under the Deferred Compensation Savings Plan, MBTA Retirement Plan and MBTA Police Association Plan. These benefits are expensed on a current (pay-as-you-go) basis. There were approximately 6,296 and 6,231 retired employees eligible to receive post-retirement benefits at June 30, 2005 and 2004, respectively. The cost of these benefits was approximately $47,880 and $41,153 in fiscal years 2005 and 2004, respectively.

(Dollars in thousands)

(8) Lease Obligations

(a) Lease-In/Lease-Out

In prior years the Authority entered into various lease/sublease financing arrangements for heavy rail, commuter rail cars and buildings. These agreements provide for the lease of the property and equipment owned by the Authority to a financial party lessee and the sublease of such equipment back to the Authority for various periods. At the time of these transactions, the Authority deposited funds with a financial institution sufficient to meet all of its payment obligations under the terms of the lease and acquired United States Treasury Strips which would mature to an amount sufficient to satisfy each agreement's purchase option provided for in the leases. Because these transactions do not meet the criteria for an "in-substance defeasance," the funds on deposit, United States Treasury Strips, and the related lease liability have been included in the accompanying financial statements.

(b) Cross-Border Leases and Other Capital Lease Arrangements

In prior years, the Authority entered into several cross-border leases related to the financing of certain buses and heavy rail cars. The leases provide for the Authority to sell and lease back the equipment over a period of years. Additionally, there is a purchase option at the end of the lease terms. The Authority has deposited funds with financial institutions sufficient to meet all of its payment obligations under the terms of the leases. Because the transaction does not meet the criteria for an "in-substance defeasance," funds on deposit and the related lease liability have been included in the accompanying financial statements.

Transportation property and facilities under capital leases is summarized as follows and is included in capital assets (see note 9) at June 30, 2005 and 2004:

	2005	2004
Ways and structures	$ 298,168	298,168
Rail cars	293,526	293,526
Equipment	8,324	—
	600,018	591,694
Less accumulated depreciation	(202,658)	(184,275)
Net transportation property in service under capital lease	$ 397,360	407,419

(Dollars in thousands)

The following is a schedule by year of future minimum lease payments under the lease-in/lease-out, cross-border and other capital lease arrangements (including COPs) together with the present value of net minimum lease payments as of June 30, 2005:

Fiscal years:		
2006	$	45,629
2007		49,700
2008		54,830
2009		49,345
2010		41,305
2011 – 2015		376,519
2016 – 2020		131,719
		749,047
Less amount representing interest		(200,464)
Present value of net minimum lease payments		548,583
Less current principal maturities		(15,490)
Obligations under capital leases	$	533,093

The long-term liability for these leases changed for 2005 and 2004 as follows:

Outstanding – June 30, 2003	$	552,822
Net change in obligation		(14,724)
Outstanding – June 30, 2004		538,098
Net change in obligation		10,485
Outstanding – June 30, 2005	$	548,583

(c) Operating Leases

The Authority has entered into several sale-leaseback agreements with major financial institutions (the lessors) covering equipment and rolling stock. The leases mature through 2013. At the end of the lease terms, the Authority may purchase the vehicles at prices equal to the lesser of a stated percentage (40% – 70%) of the lessors' original purchase price or residual fair market value, as defined.

The leases have been accounted for as operating leases. Prior to July 1, 2000, these lease payments were eligible for 90% reimbursement from the Commonwealth. After July 1, 2000, the Authority is no longer entitled to and has not received any of this assistance from the Commonwealth. However, these leases will continue to be guaranteed by the Commonwealth.

(Dollars in thousands)

Future minimum operating lease payments at June 30, 2005 are as follows:

Fiscal years:		
2006	$	16,636
2007		16,396
2008		13,766
2009		13,466
2010		13,297
2011-2013		27,584
	$	101,145

(9) Capital Assets

Capital assets at June 30, 2005 and 2004 are as follows:

		Beginning balance June 30, 2004	Increases	Decreases	Ending balance June 30, 2005
Capital assets not being depreciated:					
Land	$	306,837	13,264	—	320,101
Construction work in progress		1,262,027	517,029	930,715	848,341
Total capital assets not being depreciated		1,568,864	530,293	930,715	1,168,442
Other capital assets:					
Ways and structures		6,593,549	738,946	—	7,332,495
Buildings and equipment		1,995,722	201,845	20,588	2,176,979
Total other capital assets at historical cost		8,589,271	940,791	20,588	9,509,474
Less accumulated depreciation for:					
Ways and structures		2,066,543	159,520	—	2,226,063
Buildings and equipment		976,568	103,218	20,588	1,059,198
Total accumulated depreciation		3,043,111	262,738	20,588	3,285,261
Other capital assets, net		5,546,160	678,053	—	6,224,213
Capital assets, net	$	7,115,024	1,208,346	930,715	7,392,655

(Dollars in thousands)

	Beginning balance June 30, 2003	Increases	Decreases	Ending balance June 30, 2004
Capital assets not being depreciated:				
Land	$ 269,615	37,222	—	306,837
Construction work in progress	1,018,524	639,283	395,780	1,262,027
Total capital assets not being depreciated	1,288,139	676,505	395,780	1,568,864
Other capital assets:				
Ways and structures	6,408,416	185,133	—	6,593,549
Buildings and equipment	1,814,750	189,283	8,311	1,995,722
Total other capital assets at historical cost	8,223,166	374,416	8,311	8,589,271
Less accumulated depreciation for:				
Ways and structures	1,929,339	137,204	—	2,066,543
Buildings and equipment	881,842	103,037	8,311	976,568
Total accumulated depreciation	2,811,181	240,241	8,311	3,043,111
Other capital assets, net	5,411,985	134,175	—	5,546,160
Capital assets, net	$ 6,700,124	810,680	395,780	7,115,024

(10) Risk Management

The Authority is exposed to various risks of loss related to general liability, property and casualty, worker's compensation, unemployment, and employee health insurance claims.

Buildings are fully insured to the extent that losses exceed $100 per incident. The Authority is self-insured for workers' compensation, unemployment claims, vehicle damage and loss, and health insurance. The Authority pays 85% of all health premiums up to a maximum of $200 per individual for all Blue Cross plans and $100 per individual for Harvard and Tufts plans. Stop loss insurance is carried on health insurance claims in excess of these amounts per individual per illness.

The Authority self-funds a $7,500 per occurrence deductible for general liability. The Authority has a program of excess public liability insurance to provide for $67,500 of layered coverage on a per occurrence and annual aggregate basis. In the opinion of the General Counsel to the Authority, payments of claims by the Authority for amounts not covered by insurance, in the aggregate, are not expected to have a material adverse effect on the Authority's financial position.

(Dollars in thousands)

During fiscal 2005 and 2004, expenditures for claims and judgments, excluding worker's compensation, and health and life, were $14,673 and $19,613, respectively. Expenditures for claims related to worker's compensation were $20,971 and $19,305, and expenditures for the self-insured health plans were $94,035 and $89,363 for the years ended June 30, 2005 and 2004, respectively.

GASB Statement No. 10 requires that liabilities for self-insured claims be reported if it is probable that a loss has been incurred and the amount can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. The Authority reserves such liabilities, which consist of workers' compensation, health claims and injuries and damages (legal claims), as accrued expenses as of June 30, 2005, 2004 and 2003. Changes in the self-insurance liabilities in fiscal 2005, 2004 and 2003 were as follows:

		2005	2004	2003
Liability, beginning of year	$	89,106	73,931	86,644
Provisions for claims		129,679	128,281	98,101
Payments		(122,857)	(113,106)	(110,814)
Liability, end of year	$	95,928	89,106	73,931

These liabilities are all presented as current liabilities in the accompanying financial statements.

(11) Commitments and Contingencies

(a) Capital Investment Program

The Authority's capital investment continuing program for mass transportation development has projects in service and in various stages of approval, planning, and implementation. The following table shows, as of June 30, 2005 and 2004, capital project costs approved, expenditures against these projects, and estimated costs to complete these projects, as well as the major funding sources:

Funding source		Approved project costs	Expenditures through June 30, 2005	Unexpended costs
Federal grants	$	5,178,405	5,013,558	164,847
State and local sources		1,356,067	1,292,417	63,650
Authority bonds		4,753,075	4,271,446	481,629
Total	$	11,287,547	10,577,421	710,126

(Dollars in thousands)

Funding source		Approved project costs	Expenditures through June 30, 2004	Unexpended costs
Federal grants	$	4,995,750	4,837,998	157,752
State and local sources		1,287,798	1,227,580	60,218
Authority bonds		4,595,229	3,992,311	602,918
Total	$	10,878,777	10,057,889	820,888

The Authority is presently authorized by law to issue bonds for capital purposes other than refunding, to an amount not exceeding $5,256,300 outstanding at any time. Such bonds outstanding as of June 30, 2005 amounted to $3,000,000.

The terms of the federal grant contracts require the Authority to, in part, utilize the equipment and facilities for the purposes specified in the grant agreement, maintain these items in operation for a specified time period, which normally approximates the useful life of the equipment, and to comply with the Equal Employment Opportunity and Affirmative Action programs required by the Transportation Equity Act for the 21st Century. Failure to comply with these terms may jeopardize future funding and require the Authority to refund a portion of these grants to the Federal Transit Administration (FTA). In management’s opinion, no events have occurred that would result in the termination of these grants or require the refund of a significant amount of funds received under these grants.

Other cases and claims include disputes with contractors and others arising out of the Authority’s capital construction program. In the opinion of the General Counsel to the Authority, amounts reasonably expected to be paid by the Authority would be within the scope of grant funds and other funds available to the Authority for the respective projects.

The Authority has entered into several long-term contracts to purchase coaches, locomotives, buses, rapid transit cars and other transportation equipment. Unpaid amounts under these contracts total approximately $390,927 and $452,422 at June 30, 2005 and 2004, respectively.

(b) Legal and Other

The Authority is involved in numerous lawsuits, claims, and grievances arising in the normal course of business, including claims for personal injury and personnel practices, property damage, and disputes over eminent domain proceedings. In the opinion of the General Counsel to the Authority, payment of claims by the Authority, for amounts not covered by insurance, in the aggregate, are not expected to have a material adverse effect on the Authority’s financial position.

During 2003, a wrongful death claim was made against the Authority and AMTRAK, the operator of the Authority’s commuter rail system at the time of the incident, for both compensatory and punitive damages, in connection with an incident on a commuter rail train. The Authority has settled this case. The amount has been accrued as of June 30, 2005.

The Authority participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits by the grantors or their representatives. In the opinion of Authority Management, liabilities resulting from such disallowed expenditures, if any, will not be material to the accompanying financial statements.

(12) Subsequent Events

In fiscal 2006, the Authority issued Assessment Bonds Series 2005 A for $425,000. Principal is payable on July 1, 2006 through July 1, 2035. Interest is payable semiannually on July 1st and January 1st. The first interest payment on these bonds is January 1, 2006. The 2005 Series A assessment bonds were issued to refund $112,500 in Bond Anticipation Notes (BANs) and use the remaining proceeds to finance systemwide improvements, vehicle replacements, and a commuter rail expansion project.

In August 2005, the Authority entered into a forward starting swap with Bear Stearns Financial Products Inc. for a notional amount of $280,000, equal to the approximate par amount of sales tax bonds anticipated to be issued in January 2007. The proceeds of which will be used to finance systemwide improvements, vehicle replacement and commuter rail expansion. The swap is effective commencing January 10, 2007 and the Authority will receive a variable rate equal to the BMA index and pay a fixed rate of 4.158%. This swap agreement is a Qualified Hedge Agreement under the Sales Tax Bond Trust Agreement.

(Dollars in thousands)

MBTA Retirement Plan

Valuation date	Actuarial value of assets (a)	Actuarial accrued liability (AAL) (b)	(Funded) unfunded AAL (UAAL) (b-a)	Funded ratio (a/b)	Covered payroll (c)	UAAL as a percentage of covered payroll ((b-a)/c)
Year ended December 31:						
1998	$ 1,389,496	1,410,753	21,257	98.49%	$ 274,661	7.74%
1999	1,578,162	1,477,993	(100,169)	106.78	284,677	(35.19)
2000	1,757,327	1,533,284	(224,043)	114.61	301,132	(74.40)
2001	1,889,500	1,626,998	(262,502)	116.13	316,403	(82.96)
2002	1,701,048	1,871,543	170,495	90.89	318,824	53.48
2003	1,834,834	1,881,974	47,140	97.50	317,598	14.84

Deferred Compensation Plan

The Deferred Compensation Plan is not currently funded; however, management intends to start funding the plan. As a result, the normal Schedule of Funding Progress would show no provision having been made for the cost of this plan.

In the table below, Column (b) which normally would have contained the Plan's assets, contains instead the Net Pension Obligation (amounts previously charged against operations but not yet contributed to the Plan). This alternative presentation shows how much of the cost of the program has been charged against operations in prior years.

Valuation date	Actuarial accrued liability (a)	Net pension obligation (b)	Unrecognized actuarial accrued liability (c) (a)-(b)	Recognized ratio (d) (b)/(a)	Unrecognized ratio (e) (c)/(a)	Covered payroll (f)
07/01/99	$ 29,225	6,413	22,812	21.9%	78.1%	$ 31,299
07/01/00	28,357	5,688	22,669	20.1	79.9	34,507
07/01/01	40,509	4,708	35,801	11.6	88.4	34,590
07/01/02	41,094	5,211	35,883	12.7	87.3	36,319
07/01/03	41,865	5,734	36,131	13.7	86.3	31,787
07/01/04	42,254	6,200	36,054	14.7	85.3	33,376

See accompanying independent auditors' report.

MASSACHUSETTS BAY TRANSPORTATION AUTHORITY

(A Component Unit of the Commonwealth of Massachusetts)

Required Supplementary Information

June 30, 2005

(Unaudited)

(Dollars in thousands)

Police Association Retirement Plan

Valuation date		Actuarial value of assets (a)	Actuarial accrued liability (b)	(Funded) unfunded actuarial accrued liability (c) (b)-(a)	(Unfunded) funded ratio (d) (a)/(b)		Covered payroll (e)	UAAL as a percentage of covered payroll (c)/(e)
12/31/99	$	30,078	22,511	(7,567)	133.6%	$	8,391	(90.2)%
12/31/00		28,962	31,971	3,009	90.6		10,351	29.1
12/31/01		31,282	35,447	4,165	88.3		10,814	38.5
12/31/02		31,377	40,852	9,475	76.8		11,598	81.7
12/31/03		32,263	41,373	9,110	78.0		12,485	73.0

See accompanying independent auditors' report.