MASSACHUSETTS BAY TRANSPORTATION AUTHORITY

Financial Statements

June 30, 2001

(With Independent Auditors' Report Thereon)

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Independent Auditors' Report

The Board of Directors of the
Massachusetts Bay Transportation Authority:

We have audited the accompanying balance sheet of the Massachusetts Bay Transportation Authority (the "Authority" or "MBTA"), a component unit of the Commonwealth of Massachusetts, as of June 30, 2001, and the related statements of revenue, expenses and changes in retained deficit and cash flows for the year 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 audit.

We conducted our audit 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. 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 audit provides 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, 2001, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 2(f) to the financial statements, the Authority implemented Governmental Accounting Standards Board Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*.

The historical pension information on pages 26-27 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the 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 12, 2001 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 and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

KPMG LLP

October 12, 2001

MASSACHUSETTS BAY TRANSPORTATION AUTHORITY

Balance Sheet

June 30, 2001

(Dollars in thousands)

Assets

Current assets:		
Cash and temporary cash investments (note 3)	$	181,407
Accounts receivable, net:		
Commonwealth of Massachusetts		100,999
Other		15,297
Materials and supplies, at average cost		34,871
Prepaid expenses		4,791
Total current assets		337,365
Restricted and other special funds (notes 2(j) and 3):		
Bond construction funds		412,165
Lease funds		548,730
Bond reserve funds		95,797
Stabilization fund		3,677
Other funds		49,713
Total restricted and other special funds		1,110,082
Transportation property, at cost (notes 9 and 11):		
Transportation property in service		7,958,767
Less accumulated depreciation		2,388,710
Transportation property, net		5,570,057
Construction in progress		725,163
		6,295,220
Other assets:		
Net pension asset (note 8)		1,452
Deferred charges		92,401
Total other assets		93,853
Total assets	$	7,836,520

(Continued)

MASSACHUSETTS BAY TRANSPORTATION AUTHORITY

Balance Sheet

June 30, 2001

(Dollars in thousands)

Liabilities and Equity

Current liabilities:	
Current maturities of bonds payable (note 6)	$ 115,804
Current capital lease and other current obligations (notes 6 and 9)	10,572
Accounts payable and accrued other	56,957
Accrued liabilities:	
Payroll and vacation	44,392
Interest	79,751
Injuries and damage claims, workers' compensation claims and other (note 10)	82,918
Total current liabilities	390,394
Long-term liabilities, less current maturities:	
Bonds payable, net (note 6)	3,879,473
Other noncurrent obligations (note 6)	5,690
Obligations under capital leases (note 9)	539,352
Pension liability (note 8)	4,811
Deferred credits (note 7)	27,590
Total long-term liabilities	4,456,916
Total liabilities	4,847,310
Equity:	
Contributions from the Commonwealth	425,000
Contributed capital:	
Federal grants	4,169,867
State and local grants	120,127
	4,289,994
Less accumulated amortization	(1,438,055)
Contributed capital, net	2,851,939
Retained deficit	(287,729)
Total equity	2,989,210
Commitments and contingencies (notes 10 and 11)	
Total liabilities and equity	$ 7,836,520

See accompanying notes to financial statements.

MASSACHUSETTS BAY TRANSPORTATION AUTHORITY

Statement of Revenue, Expenses and Changes in Retained Deficit

Year ended June 30, 2001

(Dollars in thousands)

Operating revenue, not including local and federal assistance:		
Revenue from transportation	$	280,983
Other		38,817
		319,800
Operating expenses:		
Wages and related employee benefits:		
Wages		291,093
Medical and dental insurance		68,766
Pensions		29,515
Social security taxes		25,347
Workers' compensation		14,394
Other		2,575
Capitalized costs		(16,790)
		414,900
Other operating expenses:		
Depreciation and amortization		201,932
Materials, supplies and services		131,461
Injuries and damages		14,042
Commuter railroad and local subsidy expenses (note 5)		202,252
Other		897
		550,584
Total operating expenses		965,484
Operating loss		(645,684)
Nonoperating income (expense):		
Sales tax revenue		654,581
Local assessments		144,554
Other income		12,951
Interest expense, net		(184,159)
Total nonoperating income		627,927
Loss before capital grants and depreciation add-back		(17,757)
Capital grants (note 2f)		136,834
Income before depreciation add-back		119,077
Add-back: depreciation on assets funded with contributed capital		115,852
Decrease in retained deficit		234,929
Beginning of year deficit		(522,658)
End of year deficit	$	(287,729)

See accompanying notes to financial statements.

MASSACHUSETTS BAY TRANSPORTATION AUTHORITY

Statement of Cash Flows

Year ended June 30, 2001

(Dollars in thousands)

Cash flows from operations:	
Cash provided by (used for):	
Operating loss	$ (645,684)
Charges to cost of service not requiring current expenditure of cash:	
Depreciation and amortization	201,932
Change in net pension asset/obligation	(1,271)
Changes in all other working capital accounts except cash, temporary cash investments and short-term debt	45,372
Net cash used for operations	(399,651)
Cash provided for operations and bond payments by:	
Reimbursement of net cost of service and contract assistance	319,554
Other income	12,951
Cash provided for operations and bond payments	332,505
Cash flows from capital and related financing activities:	
Cash used for:	
Additions to transportation property	(318,547)
Interest paid	(211,694)
Decrease in deferred credits	(27,387)
Payments on long-term debt	(160,079)
Payments for capital leases	(1,150)
Payments on short-term borrowings	(160,000)
Net cash used for capital and related financing activities	(878,857)
Cash flows from noncapital and related financing activities:	
Capital grants	136,834
Sales tax and local assessment	698,136
Proceeds from long-term borrowings	600,000
Interest income	41,255
Cash provided by noncapital and related financing activities	1,476,225
Change in cash, temporary cash investments, restricted and other special funds	530,222
Cash, temporary cash investments, restricted and other special funds, beginning of year	761,267
Cash, temporary cash investments, restricted and other special funds, end of year	$ 1,291,489

See accompanying notes to financial statements.

(1) The Reporting Entity

The Massachusetts Bay Transportation Authority (the "Authority") was originally created in 1964 and is 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 and Construction 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. 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.

On July 12, 1999, the Authority created Rail Connections, Inc. ("Rail Connections"), a private Massachusetts nonprofit corporation organized under the provisions of Chapter 180 of Massachusetts General Laws, for the limited purpose of taking action necessary to provide for the financing of the Route 128 Train Station Parking Garage. Rail Connections began operations on January 18, 2000. The Authority is the sole member of Rail Connections and the Board of Directors consists of three *ex officio* management employees of the Authority. On April 1, 2001, the Authority and Rail Connections, refunded the 1999 Parking Garage Revenue Bonds dated August 12, 1999 with proceeds from the 2000 Series A Assessment Bonds and from proceeds included in Rail Connections Debt Service Reserve Funds. As of June 30, 2001, the operations of Rail Connections have been consolidated with the Authority.

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, Rail Connections was 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 the legislation. As part of the Commonwealth's "Forward Funding Legislation" (Chapter 127 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.

(Dollars in thousands)

(b) Financial Reporting

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. All GASB pronouncements issued after this date will be followed.

(c) Transportation Property

Transportation property is 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:

	Estimated useful life	Amount
Ways and structure	10-60 years	$ 6,014,971
Equipment	3-25 years	1,801,977
Land	—	141,819
		$ 7,958,767

(d) Construction in Progress

During 2001, major construction projects aggregating $239,001 were completed and transferred to the appropriate transportation property accounts. Major projects included transit service extensions, right of way improvements and extensions 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 fixed 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 year 2001, the net interest cost, eligible for capitalization was not material.

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 2001 were approximately $32 million. Amounts owed to the Authority for these costs as of June 30, 2001 were approximately $1.5 million.

(e) Self Insurance

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

(f) Capital Grants

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. In fiscal 2001, the Authority adopted GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, which requires capital grants to be reported as revenue rather than contributed capital. The amount recorded as capital grant revenue in fiscal 2001 was $136,834.

Prior to fiscal 2001, these grants had been recorded directly to contributed capital.

Depreciation related to the assets funded by these grants prior to fiscal 2001 is charged to contributed capital over the estimated useful life of the assets. Depreciation of assets begins when the related facilities and equipment are put into service.

(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 generally accepted accounting principles 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, 2001 was approximately $14,944.

(j) Restricted and Other Special Funds

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 funds:

- Bond Construction Funds – represents unexpended bond proceeds
- Lease Funds – represents cash held by trustees to be used to pay lease payments on the Authority's defeased capital leases
- Bond Reserve Funds – represents cash funds required to be maintained by bond indentures
- Stabilization Fund – 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 Funds – represents funds held in accordance with the Authority's Trust Agreements for capital maintenance, debt service and other expenses.

(3) Deposits and Investments

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, and repurchase agreements secured by U.S. government and agency obligations. 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 balance sheets at June 30, 2001:

Construction funds	$ 412,165
Other funds	149,187
Lease funds	548,730
Cash and temporary cash investments	181,407
	$ 1,291,489

(a) Deposits

The Authority's deposits are categorized as those that are fully insured or collateralized with securities held by the Authority or its agent in the Authority's name (Category 1), those deposits that are collateralized with securities held by the pledging financial institution's trust department or agent in the Authority's name (Category 2), and those deposits that are not collateralized (Category 3). Managed investment pools are not categorized.

(Dollars in thousands)

A summary of these deposits as of June 30, 2001 is as follows:

	Category 1	Category 2	Category 3	Total bank balance	Carrying amount
Cash and cash equivalents	$ 169,348	—	465,313	634,661	633,532
Not categorized:					
Mass Municipal Depository Trust	—	—	—	117,202	117,202
	$ 169,348	—	465,313	751,863	750,734

In 2001, outstanding checks largely account for the difference between the bank balance and carrying amount of deposits. The Authority's cash on hand as of June 30, 2001 was $3,078.

(b) Investments

The Authority's investments are categorized according to the level of risk assumed by the Authority. Category 1 includes investments that are insured, registered or held by a trustee in the Authority's name. Category 2 includes uninsured and unregistered investments held by the counterparty's trust department or agent in the Authority's name. Category 3 includes uninsured or unregistered investments held by the counterparty, its trust department or agent but not in the Authority's name.

A summary of these investments as of June 30, 2001 is as follows:

	Category 1	Category 2	Category 3	Estimated fair value
U.S. government obligations	$ 214,782	—	—	214,782
Repurchase agreements	—	317,385	—	317,385
Common stock	—	—	516	516
Municipal bond obligations	—	4,994	—	4,994
	$ 214,782	322,379	516	537,677

The maximum amount of the Authority's uninsured deposits and investments in repurchase agreements was approximately $217,813 during fiscal 2001. These amounts vary during the year due to the timing of cash receipts. U.S. government and agency obligations that secure the repurchase agreements are held by the broker's agent in a safe-keeping account on behalf of the Authority, but such obligations do not bear the Authority's name.

(4) Federal Assistance

The Transportation Equity Act of the 21st Century was passed in May 1998 which provides for capital and preventative maintenance grants. No federal assistance for preventative maintenance was received in 2001.

(5) 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 has agreed to pay AMTRAK a fixed price per year for the services specified in the agreement. The agreement terminated on June 30, 1998 and contained two one-year options for renewal. A three-year contract extension was executed during fiscal 2000 at a fixed price of $476,251.

(6) Long-Term Debt

(a) Bonds Payable

The Authority's restated enabling act provided for its ability 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 previously issued by the Authority was backed by the full faith and credit of the Commonwealth and principal and interest payments on that debt were subsidized by the Commonwealth. While debt outstanding at June 30, 2000 ("prior debt") will continue to be backed by the full faith and credit of the Commonwealth, debt issued by the Authority after June 30, 2000 ("new debt") will not be supported by the Commonwealth's guarantee. Additionally, the Authority will not receive any principal or interest subsidies from the Commonwealth for the repayment of the prior debt or new debt of the Authority.

(Dollars in thousands)

During fiscal 2001, the Authority issued Assessment Bonds 2000 Series A, payable in annual installments on July 1st beginning in fiscal 2005, and Sales Tax Bonds 2000 Series A, payable in annual installments on July 1st from July 1, 2004 through July 1, 2010 and from July 1, 2020 through July 1, 2030. Interest is paid semiannually on July 1st and January 1st for both the Assessment and Sales Tax Bonds.

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 bonds outstanding are as follows at June 30:

	Year of maturity	Interest rates	Outstanding balance
General Transportation System Bonds:			
1967 Series A Bonds dated March 1, 1967	2007	3.85%	$ 15,600
1974 Series A Bonds dated June 1, 1974	2014	5.0-6.6%	22,800
1991 Series A Bonds dated November 15, 1991	2021	6.3-7.0%	80,395
1992 Series A Bonds dated October 1, 1992	2022	5.5-5.6%	3,590
1992 Series B Refunding Bonds dated December 1, 1992	2021	5.5-6.25%	347,910
1992 Series C Bonds dated November 15, 1992	2023	5.6-6.1%	21,525
1993 Series A Refunding Bonds dated June 1, 1993	2022	4.9-5.5%	439,275
1994 Series A Refunding Bonds dated June 1, 1994	2019	5.0-7.0%	290,395
1994 Series B Bonds dated June 1, 1994	2024	5.0-5.3%	16,775
1995 Series A Bonds dated April 1, 1995	2025	4.9-5.88%	145,375
1995 Series B Bonds dated September 15, 1995	2025	4.5-5.38%	140,245
1996 Series A Bonds dated March 1, 1996	2026	4.7-5.38%	53,330
1996 Series B Bonds dated October 1, 1996	2026	5.0-5.25%	144,380
1997 Series A Bonds dated June 1, 1997	2027	4.5-6.0%	166,350
1997 Series B Bonds dated August 1, 1997	2014	4.25-5.0%	8,940
1997 Series C Bonds dated August 1, 1997	2024	4.5-6.0%	240,915
1997 Series D Bonds dated November 1, 1997	2027	5.0-5.5%	153,865
1998 Series A Bonds dated February 15, 1998	2026	4.0-5.5%	303,145
1998 Series B Bonds dated November 1, 1998	2028	4.1-5.25%	200,000
1998 Series C Bonds dated November 1, 1998	2022	4.0-5.75%	249,825
1999 Series A Variable Interest Rate Bonds dated June 29, 1999	2014	Variable	62,815
1999 Series A Bonds dated December 1, 1999	2021	4.5-6.0%	200,000
2000 Series Variable Interest Rate Bonds dated March 10, 2000	2030	4.93%	188,000
Total General Transportation System Bonds payable			3,495,450

(Dollars in thousands)

	Year of maturity	Interest rates	Outstanding balance
Boston Metropolitan District Bonds:			
Boston Elevated Railway Company and Metropolitan Transit Authority Debt	2014	5.0%-6.0%	$ 18,295
Purchase of City of Boston Transit Properties	2014	5.25%-5.75%	7,990
Construction Bonds	2008	5.00%-5.75%	3,151
Construction Bonds	2002	5.00%-5.75%	1,389
			4,540
Total Boston Metropolitan District Bonds payable			30,825
Revenue Bonds:			
2000 Series A Assessment Bonds dated August 1, 2000	2030	4.9%-5.75%	496,645
2000 Series A Senior Sales Tax Bonds dated August 1, 2000	2030	4.4%-5.7%	103,355
Total Revenue Bonds payable			600,000
Total bonds payable			4,126,275
Less: current maturities			115,804
Total long-term bonds payable			4,010,471
Less: unamortized discount			60,832
unamortized losses on refundings			70,166
Total long-term bonds payable, net			$ 3,879,473

(Continued)

(Dollars in thousands)

The annual maturities of long-term bonds payable as of June 30, 2001 are as follows:

2002	$	115,804
2003		124,081
2004		127,915
2005		135,420
2006		147,330
Thereafter		3,475,725
Total	$	4,126,275

For debt that existed on the Authority's books prior to July 1, 2000, the guarantee of the Commonwealth will continue to be in effect until the debt is paid off. However, the Authority will not be subsidized for the future principal and interest payments due on this debt. After June 30, 2000, the Authority will no longer have the ability to issue debt supported by the guarantee of the Commonwealth. Instead, the Authority will have the ability to issue its own general obligation debt and revenue debt.

(b) Debt Refundings

Prior Year

In 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, 2001, $1,943,220 of these bonds, considered defeased in-substance, are still outstanding.

Current Year

During fiscal 2001, the Authority and Rail Connections, Inc. refunded the 1999 Parking Garage Revenue Bonds dated August 12, 1999 with proceeds from the 2000 Series A Assessment Bonds and amounts included in Rail Connections, Inc. Debt Service Reserve Funds. The refunding qualified as an "in-substance defeasance." The difference in cash flows between the old and new bonds was approximately $6 million. The economic loss on the refunding was approximately $3 million. The loss has been presented as a reduction in the amount of outstanding debt and will be amortized over the life of the new bonds.

(Dollars in thousands)

(c) Certificates of Participation

The Authority issued Certificates of Participation ("COPs") of $28,565 on December 15, 1988 and $85,795 on August 30, 1990. For purposes of reporting under generally accepted accounting principles, the long-term portion of these COPs has been classified as "Other noncurrent obligations" in the accompanying balance sheet, for $5,690 at June 30, 2001. Previously, these future debt service payments, if appropriated, on the COPs would be 90% reimbursable. Under the Forward Funding legislation effective July 1, 2000, these COP payments are not reimbursable from the Commonwealth. However, these COPs will continue to be guaranteed by the Commonwealth.

The remaining COPs outstanding bear interest at rates ranging from 7.3% to 7.8% and mature as follows:

2002	$	1,150
2003		1,140
2004		1,140
2005		1,140
2006		1,135
Thereafter		1,135
		6,840
Less: Current maturities		1,150
Total long-term COPs payable	$	5,690

The remaining outstanding principal balance of COPs that were refunded in-substance in prior years is $9,075 at June 30, 2001.

(d) Interest Rate Swap

In fiscal 2000, the Authority entered into an interest rate swap agreement for its General Transportation System Bonds, Variable Rate Demand Obligations, 2000 Series (the "2000 Bonds"). The interest rate swap matures in fiscal 2006. Under this agreement, the Authority pays to the swap counterparty fixed interest rates of 4.9284% on a notional amount equal to the total outstanding principal of the 2000 Bonds. The swap counterparty pays interest on the same notional amount based on the Municipal Swap Index. Only the net difference is exchanged with the counterparty. The Authority continues to pay interest to the holders of the 2000 Bonds at the variable rate provided by the bonds. However, during the term of the swap agreement, to the extent that the Municipal Swap Index is equivalent to the variable interest rate on the 2000 Bonds, the Authority effectively pays a fixed rate on the 2000 Bonds. The Authority will be exposed to variable rates if the counterparty to the swap defaults or if the swap is terminated. Because this transaction occurred prior to July 1, 2000, the Commonwealth is liable to make the swap payments to the extent the dedicated revenues of the Authority are insufficient.

(Continued)

In fiscal 2002, the Authority entered into a five-year option for a swap agreement effective from September 1, 2005 up to September 1, 2010 to execute a new swap agreement in connection with the 2000 Bonds after the existing one expires. If exercised, the Authority will enter into a swap with a counterparty under which the Authority will pay a fixed interest rate of 5% and receive a floating rate equal to 67% of LIBOR. The swap agreement would terminate on March 1, 2030. From the sale of this option, the Authority will receive $5,663 in August 2002 and 2003.

In fiscal 2001, the Authority sold an option to a counterparty to enter into a future swap agreement. The option is in a notional amount of $219,255. The option may be exercised on February 1, 2003. If exercised, the Authority will issue bonds to refund General Transportation System Bonds in an outstanding amount equal to the notional amount of the option. The bonds will be issued to bear interest at a variable rate. If exercised, the Authority will enter into a swap agreement pursuant to which it pays a fixed rate of 5.27% on the notional amount and receives a floating rate equal to BMA Municipal Swap Index. The swap agreement would terminate on March 1, 2021, the final maturity of the refunded bonds. From the sale of this option, the Authority received $3,000 in August 2001 and will receive an additional $5,362 in July 2002.

In fiscal 2001, the Authority sold an option to a counterparty to enter into a future swap agreement. The option is in a notional amount of $49,123, which is equal to the aggregate amount on deposit in the Debt Service Reserve Funds for the Assessment Bonds, 2000 Series A and Senior Sales Tax Bonds, 2000 Series A. The option may be exercised from July 1, 2010 through January 1, 2030. If exercised, the Authority will enter into a swap agreement pursuant to which it pays a fixed rate of 5.60% on the notional amount and receives a floating rate equal to the BMA Municipal Swap Index. The swap agreement would terminate on July 1, 2030. From the sale of this option, the Authority received $1,265 on July 2, 2001.

(e) Subsequent Event – Debt Refunding

In August 2001, the Authority defeased $117,975 of General Transportation System Bonds by placing $122,680 of proceeds from the assessment bonds in an irrevocable trust fund to provide for future debt service payments on the old debt.

(7) Deferred Credits

An amount received in prior years for a settlement with a supplier of green line cars has been recorded as a deferred credit in the accompanying balance sheet and is being amortized over a remaining period of 10 years.

(8) 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 those executives who elect coverage under an alternate plan. This retirement plan and the MBTA Police Association 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 99 Summer Street, Suite 1700, Boston, MA 02110, or by calling (617) 222-5266. 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 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 103 retirees. The cost of this plan to the Authority for fiscal 2001 was minimal and no contributions were made to this Plan in fiscal 2001. No actuarial valuation was performed on this plan.

(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 7.79% of total payroll. The actuarial required contribution rate for the Authority was 7.75%. The contribution requirements for the Police Association Plan were 11.02% for the Authority and 4.17% for employees. Both were determined in accordance with actuarial valuations. Actual contributions made to this Plan in 2001 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 current year and related information for each plan is as follows:

Pension	MBTA Retirement Plan	MBTA Police Association Plan	Deferred Compensation Plan
Annual pension cost - Authority	$22,051	$837	$2,525
Contributions made - Authority	$22,332	$950	$3,402
Actuarial valuation date/update	06/30/01	06/30/01	07/01/00
Actuarial cost method	Entry age	Entry age	Entry age
Amortization method	Level dollar	Level dollar	Level dollar
Amortization period remaining	35 years	14 years	35 years
Asset valuation method average	5 year moving	Market value	None
Actuarial assumptions:			
Interest rate	7.25%	7%	8%
Projected salary increases	5%	5.5%	5%

(b) Three-Year Trend Information

	Year ending	Annual pension cost (APC)	Percentage of APC contributed	Net pension asset (obligation)
MBTA Retirement Plan				
	06/30/99	$ 27,954	96%	$ 553
	06/30/00	26,391	111%	711
	06/30/01	22,051	101%	992
MBTA Police Association Plan				
	06/30/99	$ 723	123%	$ 164
	06/30/00	805	123%	347
	06/30/01	837	114%	460
MBTA Deferred Compensation Plan				
	06/30/99	$ 2,596	124%	$ (7,029)
	06/30/00	2,569	128%	(5,688)
	06/30/01	2,525	135%	(4,811)

(c) The MBTA Deferred Compensation Savings Plan

The Authority provides a defined contribution retirement plan for nonunion 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 200 members at June 30, 2001, and the cost of the Plan to the Authority was $1,027 for fiscal year 2001. 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 are approximately 6,000 retired employees eligible to receive post-retirement benefits at June 30, 2001. The cost of these benefits was approximately $32,157 in fiscal 2001.

(9) Lease Obligations

(a) Lease-in/Lease-out

In fiscal 1996, the Authority entered into two lease/sublease arrangements (collectively "Agreement I"), with Fleet Bank for a total of 40 heavy rail and 27 commuter rail cars. Agreement I provides for the lease of the equipment owned by the Authority to a financial party lessee and the sublease of such equipment back to the Authority for a period of approximately 18 years commencing April 1996. At the time of the transaction, 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 of the Head Lease Rights option. The present value of the remaining rents and the purchase of the Head Lease Rights option is approximately $95,629 at June 30, 2001. Because this transaction does 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.

In fiscal 1997, the Authority entered into four lease/sublease arrangements (collectively "Agreement II"), with Fleet Bank for a total of 50 heavy rail and 64 commuter rail cars. Agreement II provides for the lease of the equipment owned by the Authority to a financial party lessee and the sublease of such equipment back to the Authority for a period of approximately 14 years commencing January 1997. At the time of the transaction, 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 of the Head Lease Rights option. The present value of the remaining rents and the purchase of the Head Lease Rights option is approximately $77,101 at June 30, 2001. Because this transaction does 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.

In fiscal 1998, the Authority entered into five lease/sublease arrangements (collectively "Agreement III"), with Wilmington Trust Company for a total of 66 heavy rail and 8 commuter rail cars. Agreement III provides for the lease of the equipment owned by the Authority to a financial party lessee and the sublease of such equipment back to the Authority for a period ranging from approximately 10 to 16 years commencing August 1997. At the time of the transaction, 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 of the Head Lease Rights option. The fair value of equipment under lease is approximately $110,407. The present value of the remaining rents and the purchase of the Head Lease Rights option is approximately $123,573 at June 30, 2001. Because this transaction does not meet the criteria for an "in-substance" defeasance, the funds on deposit, the United States Treasury Strips, and the related lease liability have been included in the accompanying financial statements.

In fiscal 1998, the Authority entered into a lease/sublease arrangement ("Agreement IV") with Wilmington Trust Company for the Boston Engine Terminal ("BET"), a repair facility for the Authority's commuter rail rolling stock fleet. Agreement IV provides for the lease of the facility owned by the Authority to a financial party lessee and sublease of the facility back to the Authority for a period of approximately 20 years commencing May 1998. The fair market value of the facility under lease is $228,000. The present value of the remaining rents and purchase of the Head Lease Rights option is approximately $184,305 at June 30, 2001. At the time of the transaction, the Authority deposited funds with a financial institution and acquired United States Treasury Strips which would mature to an amount sufficient to satisfy the payment of the Head Lease Rights option. Because this transaction does not satisfy the criteria for an "in-substance" defeasance, the funds on deposit, the United States Treasury Strips, and the related lease liability have been included in the accompanying financial statements.

(Dollars in thousands)

(b) Cross-Border Leases

In fiscal 1996, the Authority entered into two cross-border leases for a total of 150 buses with JL Charles Lease Co., LTD. ("JLC"), a corporation formed under the laws of Japan. The leases provide for the Authority to sell and lease back the buses over a period of eight years. There is a bargain purchase option at the end of the lease term. The present value of the minimum lease payments approximates \$51,495 at June 30, 2001. The Authority has deposited funds with financial institutions sufficient to meet all of its payment obligations under the terms of the leases.

On September 27, 1998, JLC filed for a voluntary petition seeking rehabilitation due to difficulties in obtaining financial support from major financial institutions. On April 22, 1999, JLC executed a share purchase agreement with BankAmerica Leasing and Capital Group. All shares held by JLC were transferred to BankAmerica Leasing and Capital Group. 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.

The Authority also has a cross-border lease agreement with ABB Credit Finans AB of Sweden for 40 heavy rail cars. The agreement provided for the Authority to lease the heavy rail cars for a period of 15 years commencing December 1994 with an option to extend the lease for another five years. The agreement allows the Authority to purchase these cars at the end of the lease for a specified amount. The remaining rental payments and fair option purchase price have a net present value of approximately \$16,626 at June 30, 2001. The Authority has made investment arrangements to meet all of its payment obligations throughout the term of the lease. Because the transaction does not meet the criteria for an "in-substance" defeasance, the funds on deposit and the related lease liability have been included in the accompanying financial statements.

Transportation property under capital leases is summarized as follows and is included in transportation property in service (see note 2(c)) at June 30, 2001:

Ways and structures	$ 295,476
Rail cars	365,587
Buses	35,783
	696,846
Less accumulated depreciation	(168,801)
Net transportation property in service under capital lease	$ 528,045

(Dollars in thousands)

The following is a schedule by years of future minimum lease payments under capital leases together with the present value of net minimum lease payments as of June 30, 2001:

Fiscal year		
2002	$	43,825
2003		46,773
2004		48,380
2005		41,140
2006		42,097
Thereafter		652,814
		875,029
Less amount representing interest		(326,299)
Present value of net minimum lease payments		548,730
Less current principal maturities		(9,378)
Obligations under capital leases	$	539,352

(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 will no longer be entitled to or receive any of this assistance from the Commonwealth. However, these leases will continue to be guaranteed by the Commonwealth.

(Dollars in thousands)

Future minimum lease payments are as follows:

Fiscal year		
2002	$	13,382
2003		14,071
2004		13,651
2005		12,804
2006		13,370
Thereafter		84,083
	$	151,361

(10) Risk Management

The Authority is exposed to various risks of loss related to general liability, property and casualty, workers' 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 $5,000 per occurrence deductible for general liability. The Authority has a program of excess public liability insurance to provide for $70,000 of layered coverage on a per-accident 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.

During fiscal 2001, expenditures for claims and judgments, excluding workers' compensation and health and life, were $14,046. Expenditures for claims related to workers' compensation were $14,394 and expenditures for the self-insured health plans were $62,518.

(Continued)

(Dollars in thousands)

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 as accrued expenses as of June 30, 2001 and 2000. Changes in the self-insurance liabilities in fiscal 2001 and 2000 were as follows:

	2001	2000
Liability, beginning of year	$ 60,846	73,218
Provisions for claims	90,958	69,973
Payments	(82,328)	(82,345)
Liability, end of year	$ 69,476	60,846

The liability at year-end includes $41,584 for workers' compensation, $3,661 for health claims, and $24,231 for injuries and damages.

(11) Commitments and Contingencies

(a) Capital Improvement Program

The Authority's 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, 2001, 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, 2001	Unexpended costs
Federal Grants	$ 3,374,312	3,241,778	132,534
State and Local Sources	371,991	329,789	42,202
Authority Bonds	4,374,069	4,090,531	283,538
Total	$ 8,120,372	7,662,098	458,274

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, 2001, amounted to $2,862,000.

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 Department of Transportation. 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 and rapid transit cars. Unpaid amounts under these contracts total approximately $133,239 at June 30, 2001.

(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.

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.

(Dollars in thousands)

MBTA Retirement Plan

Year ended June 30	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)
1991	$ 849,578	$ 1,010,989	$ 161,411	84.03%	$ 250,820	64.35%
1992	900,412	1,069,181	168,769	84.22	273,441	61.72
1993	954,571	1,089,321	134,750	87.63	276,712	48.70
1994	983,556	1,150,035	166,479	85.52	259,938	64.05
1995	1,050,103	1,198,745	148,642	87.60	261,953	56.74
1996	1,138,225	1,237,705	99,480	91.96	257,141	38.69
1997	1,254,695	1,268,938	14,243	98.88	254,723	5.59
1998	1,389,496	1,410,753	21,257	98.49	274,661	7.74
1999	1,578,162	1,477,993	(101,169)	106.78	284,677	(35.19)
2000	1,601,279	1,501,620	(99,659)	106.64	294,776	(33.81)

Deferred Compensation Plan

The Deferred Compensation Plan is not funded and management does not currently intend to fund the plan in the future other than to make benefit payments as they come due. As a result, the normal Schedule of Funding Progress would show no provision having been made for the cost of this plan.

(Continued)

MASSACHUSETTS BAY TRANSPORTATION AUTHORITY

Required Supplementary Information

June 30, 2001

(Unaudited)

(Dollars in thousands)

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)
07/01/96	$ 30,234	$ 7,887	$ 22,347	26.1%	73.9%	$ 27,779
07/01/97	29,827	7,562	22,265	25.4	74.6	27,779
07/01/98	29,881	7,029	22,852	23.5	76.5	31,299
07/01/99	29,225	6,413	22,812	21.9	78.1	31,299
07/01/00	28,357	5,688	22,669	20.0	79.9	34,507

Information about the unrecognized actuarial accrued liability for this plan for other years is currently not available.

Police Association Retirement Plan

Valuation date	Actuarial value of assets (a)	Actuarial accrued liability (b)	(Funded) unfunded actuarial accrued liability (c) (b)-(a)	Funded ratio (d) (a/b)	Covered payroll (e)	UAAL as a percentage of covered payroll (c/e)
12/31/96	$ 17,730	$ 17,851	$ 121	99.3%	$ 7,517	1.6%
12/31/97	21,676	19,527	(2,149)	111.0	7,186	(29.9)
12/31/98	25,440	23,596	(1,844)	108.0	7,534	(24.5)

Information about the unrecognized actuarial accrued liability for this plan for other years is currently not available.