MASSACHUSETTS TURNPIKE AUTHORITY

(A Component Unit of the Commonwealth of Massachusetts)

Financial Statements, Required Supplementary Information, and Supplementary Schedules

As of and for the Eighteen-Month Period ended June 30, 2008

(With Independent Auditors' Report Thereon)

MASSACHUSETTS TURNPIKE AUTHORITY
(A Component Unit of the Commonwealth of Massachusetts)

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Independent Auditors' Report

Members of the Board of Directors
Massachusetts Turnpike Authority:

We have audited the accompanying statement of net assets of the Massachusetts Turnpike Authority (the Authority), a component unit of the Commonwealth of Massachusetts, as of June 30, 2008, and the related statement of revenues, expenses, and changes in net assets, and cash flows for the eighteen-month period 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. 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 audit provides a reasonable basis for our opinion.

During the period under audit, the Authority changed its fiscal year end from December 31 to June 30 in order to be consistent with the Commonwealth of Massachusetts. Because of this change in fiscal year end, the Authority's financial results are presented as an eighteen-month period ending June 30, 2008.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority at June 30, 2008, and the changes in its financial position and cash flows for the eighteen-month period then ended, in conformity with U.S. generally accepted accounting principles.

As described in note 6, the Authority adopted GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

The Authority has not presented Management's Discussion and Analysis that U.S. generally accepted accounting principles require to supplement, although not to be part of, the basic financial statements.

The schedules of OPEB and pension funding progress on page 34 are not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. 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.

Our audit was made for the purpose of forming an opinion on the financial statements of the Authority taken as a whole. The combining schedule of net assets as of June 30, 2008 (schedule I) and the combining schedule of revenues, expenses, and changes in net assets for the eighteen-month period then ended (schedule II) are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

In accordance with *Government Auditing Standards,* we have also issued our report dated December 1, 2008 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and 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 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 audit.

KPMG LLP

December 1, 2008

MASSACHUSETTS TURNPIKE AUTHORITY
(A Component Unit of the Commonwealth of Massachusetts)

Statement of Net Assets

June 30,2008

(In thousands)

Assets		
Current assets:		
Cash and cash equivalents (note 2)	$	837
Unrestricted investments (note 2)		194,581
Restricted and board-designated cash and cash equivalents (note 2)		18,934
Restricted and board-designated investments (note 2)		312,289
Accounts receivable, net of allowance for doubtful accounts of $587		20,242
Other receivables:		
Mass Highway		12,021
Other, net of allowance for doubtful accounts of $1,418		3,553
Total receivables		35,816
Prepaid expenses and other assets		9,013
Total current assets		571,470
Noncurrent assets:		
Restricted and board-designated investments (note 2)		64,665
Capital assets, net (note 3)		6,777,054
Prepaid expenses and other assets		11,069
Total assets	$	7,424,258
Liabilities		
Current liabilities:		
Accounts payable	$	20,038
Accrued payroll and related taxes		2,830
Compensated absences (note 4)		4,239
Current portion of long-term debt (note 4)		49,235
Accrued expenses and miscellaneous liabilities		17,653
Contract retainage		971
Payable from restricted assets:		
Accrued interest on bonds payable		59,420
Accrued arbitrage liability		2,501
Total current liabilities		156,887
Noncurrent liabilities:		
Deposits and deferred revenue		73,401
Deferred credits (note 2)		59,627
Compensated absences (note 4)		8,134
Net OPEB obligation (note 6)		2,449
Accrued interest on capital appreciation bonds (note 4)		77,628
Long-term debt, net (note 4)		2,260,287
Total liabilities		2,638,413
Net Assets		
Invested in capital assets, net of related debt		4,755,443
Restricted for other purposes		50,843
Unrestricted		(20,441)
Commitments and contingencies (notes 6, 7, 8, and 9)		
Total net assets	$	4,785,845

See accompanying notes to financial statements.

MASSACHUSETTS TURNPIKE AUTHORITY
(A Component Unit of the Commonwealth of Massachusetts)

Statement of Revenues, Expenses, and Changes in Net Assets

For the eighteen-month period ended June 30, 2008

(In thousands)

Operating revenues:		
Toll revenue pledged as security for revenue bonds, net	$	410,556
Restaurants, concessions, and service stations		25,606
Other rentals		25,627
Court fines		8,069
Other		18,741
Total operating revenues		488,599
Operating expenses:		
Operations and public protection		209,117
Repair and reconstruction		33,191
General and administration		32,659
Fringe benefits		25,901
Retirement		19,977
Depreciation		204,688
Total operating expenses		525,533
Operating loss		(36,934)
Nonoperating revenue and (expense):		
Investment income		41,558
Contract assistance (note 9)		28,463
Insurance settlement		10,000
Interest expense		(191,010)
Total nonoperating expense		(110,989)
Special item:		
Contributed capital assets (note 3)		4,360,885
Total special item		4,360,885
Increase in net assets		4,212,962
Net assets, beginning of year		572,883
Net assets, end of year	$	4,785,845

See accompanying notes to financial statements.

MASSACHUSETTS TURNPIKE AUTHORITY
(A Component Unit of the Commonwealth of Massachusetts)

Statement of Cash Flows

For the eighteen-month period ended June 30, 2008

(In thousands)

Cash flows from operating activities:		
Receipts from toll payers	$	413,675
Receipts from others		95,975
Payments to vendors		(128,462)
Payments to employees		(200,879)
Net cash provided by operating activities		180,309
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets		(67,413)
Interest paid on bonds and notes		(178,043)
Principal payments on long-term debt		(42,175)
Premiums received on swaptions		12,407
Insurance settlement		10,000
Reimbursements received from the Commonwealth		28,463
Net cash used in capital and related financing activities		(236,761)
Cash flows from investing activities:		
Sales (purchase) of investments, net		(32,933)
Interest received		41,938
Net cash provided by investing activities		9,005
Net decrease in cash and cash equivalents		(47,447)
Cash and cash equivalents, beginning of year		67,218
Cash and cash equivalents, end of year	$	19,771
Reconciliation of operating income to net cash provided by operating activities:		
Cash flows from operating activities:		
Operating loss	$	(36,934)
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization		204,688
Changes in operating assets and liabilities:		
Trade receivables		(17,526)
Prepaid expenses and other assets		(7,039)
Prepaid expenses and other assets – long-term		29,727
Accounts payable		4,882
Accrued payroll		273
Compensated absences		700
Accrued expenses, deferred revenue, and other liabilities		1,538
Net cash provided by operating activities	$	180,309

Noncash financing activities:

On June 22, 2007, the Authority received a contribution of capital assets of $4.4 billion from the Commonwealth of Massachusetts

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies and Practices

(a) Description of Business

The Massachusetts Turnpike Authority (the Authority) was established by Chapter 354 of the Acts of 1952 of the Commonwealth of Massachusetts (the Commonwealth). It is a public instrumentality that was authorized and empowered to construct, maintain, repair, and operate a toll express highway, known as the Massachusetts Turnpike (the Turnpike). Chapter 598 of the Acts of 1958 authorized and empowered the Authority to acquire from the City of Boston, the Sumner Tunnel and to construct an additional vehicular tunnel between Boston proper and East Boston, the Callahan Tunnel, and to operate and maintain both facilities. Chapter 102, as amended by Chapter 273 of the Acts of 1995, authorized the transfer of ownership of the Ted Williams Tunnel from the Commonwealth to the Authority. Since this date, its operations have been included in the accompanying financial statements.

The Authority is a component unit of the Commonwealth. The Authority's financial statements are incorporated into the financial statements of the Commonwealth.

In March 1997, the Commonwealth established pursuant to Chapter 3 of the Acts of 1997, a new enabling act, and repealed the two prior special acts noted above that previously had governed the Authority. The new enabling act establishes two separate systems to be owned and operated by the Authority, the Metropolitan Highway System, and the Western Turnpike.

The Metropolitan Highway System comprises the Boston Extension of the Turnpike, the Callahan Tunnel, the Central Artery/Tunnel (CA/T Project), the Central Artery North Area (CANA), the Sumner Tunnel and the Ted Williams Tunnel. The Western Turnpike consists of that portion of the Turnpike extending from the New York border in the Town of West Stockbridge to Route 128 in Weston.

As of July 1, 1997, the Massachusetts Highway Department (MHD) and the Authority entered into the Project Management Agreement whereby the Authority assumed all responsibility for managing and overseeing the remaining construction and other activities related to the CA/T Project, also known as the "Big Dig." The Authority entered into the Project Management Agreement in anticipation of its ultimate ownership and operation of the facilities currently under construction. The Project Management Agreement provides that the Authority is not liable for any CA/T Project costs other than with respect to any payment required under law or any other payment the Authority agreed to make (see note 9).

(b) Basis of Presentation

The Authority's financial statements are reported on the accrual basis of accounting as specified by the Governmental Accounting Standards Board's (GASB) requirements for an enterprise fund. Under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the Authority applies all Financial Accounting Standards Board Statements and Interpretations issued on or before November 30, 1989, except those that conflict with or contradict GASB pronouncements.

The Authority distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from its toll and rental activities. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

During the period under audit, the Authority changed its fiscal year end from December 31 to June 30 in order to be consistent with the Commonwealth of Massachusetts. Because of this change in fiscal year end, the Authority's financial results are presented as an eighteen-month period ending June 30, 2008.

(c) Cash and Cash Equivalents

For purposes of the statements of cash flows, the Authority considers unrestricted investments purchased with a maturity date of three months or less to be cash equivalents.

(d) Investments

Investment securities are recorded at fair value, based on quoted market price. The Authority recorded unrealized holding losses of approximately $4.3 million as of June 30, 2008. This amount is included in investment income.

(e) Restricted and Board-Designated Cash and Investments

Certain cash, cash equivalents and investments are restricted for use by bond indentures and other external requirements. Other cash, cash equivalents and investments have been designated primarily for expenditures related to future construction or asset acquisitions.

(f) Capital Assets

Capital assets are recorded at historical cost. Infrastructure consists of the construction costs to initially build or replace the highways, bridges, structures, pavement, shoulders, service areas, and other similar items. The costs of normal upkeep, maintenance, and repairs, including repaving of roads, are not capitalized. Such costs consist of reconditioning of the highway structure and improvements to protection devices, lighting systems, signage, and other similar costs.

(g) Depreciation

The Authority provides for depreciation using the straight-line method. Depreciation is intended to distribute the cost of depreciable properties over the following estimated average useful lives:

	Years
Infrastructure	40 – 60
Buildings	30
Improvement to roadways and tunnels	30
Equipment	5 – 12

(h) Other Assets

Other assets consist of the unamortized portion of bond issue costs, and amounts held in escrow.

(i) Amortization

Revenue bond discounts are deferred and amortized on a weighted average basis over the term of the bonds. Unamortized amounts are presented as a reduction of the face amount of bonds payable.

Costs related to the issuance of bonds are amortized on a weighted average basis over the life of the bonds. The weighted average amortization method approximates the effective interest method.

The difference between the reacquisition price and net carrying amount of defeased bonds is deducted from, or added to the refunding debt liability and amortized on the straight-line method over the shorter of the maturity of the new debt or the defeased debt.

(j) Compensated Absences

Certain employees of the Authority accumulate unused vacation and sick time (subject to certain limitations) to be used at a later date or paid in cash upon termination and/or retirement from the Authority. The liability for vacation leave is based on the amount earned but not used; for sick leave, it is based on the amount accumulated at the balance sheet dates based on years of service (vesting method). The liability for both amounts is calculated based on the pay or salary rates in effect at the balance sheet dates.

(k) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

(2) Deposits and Investments

The Authority has adopted GASB No. 40, *Deposit and Investment Risk Disclosure*. The standard requires that entities disclose essential risk information about deposits and investments.

The Authority is authorized to invest in obligations of the U.S. Treasury, its agencies and instrumentalities; bonds or notes of public agencies, states, or municipalities; bank time deposits, guaranteed interest contracts, money market accounts, interest rate swap agreements and swaptions, repurchase agreements or commercial paper; and notes, bonds or other obligations of any corporation that has obtained specific ratings.

(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 deposits at June 30, 2008, were $19.6 million. Of this amount, $0.3 million was insured and $19.3 million collateralized.

(b) Investments

The Authority has implemented an investment policy which incorporates the investment protocols within the Trust Agreements.

In most cases, the Authority has chosen to limit investing to U.S. Government Treasuries or agencies of the U.S. government. U.S. Government Agency Obligations purchased may include, but not be limited to, debt issued by: the Student Loan Marketing Association, the Federal Home Loan Bank, the Federal Home Loan Mortgage Corporation, and the Federal National Mortgage Association.

The following guaranteed investment contracts were in force as of June 30, 2008, all of which are fully collateralized and appear as follows:

2008
Guaranteed Investment and Forward Delivery Contracts

	Fund	Investment agreement provider	Rate	Maturity	Amount
MHS 1999 Series A	Sub. DSRF	AIG Financial Products	5.951%	January 1, 2029	$ 64.67 million
MHS	General Fund	Lehman Bros.	1.890	December 15, 2008	2.49 million

Subsequent to year-end, the financial deterioration of AIG, the investment provider, required AIG to increase the collateral held by Wells Fargo as security for this investment to 105% of the investment's market value. The value of the collateral posted was $69.7 million (105.7%) as of October 31, 2008.

Additionally, subsequent to year-end, Lehman Brothers Special Financing, Inc., failed to fulfill its obligation under a Reserve Fund Agreement, which expires in December 2008. The cash flow from this Agreement was pledged for Debt Service payments on all of the Authority's outstanding 1999 bond issue. The security held by the Trustee as collateral in the Reserve Fund at October 15, 2008 was General Electric (GE) Commercial Paper. No adverse impact on the Authority is expected with respect to this agreement as the Trustee is holding the underlying security and the agreement ends on December 15, 2008, when the GE Commercial Paper matures and the related obligation is paid.

The Authority's investments at June 30 are presented below. All investments are presented by investment type and debt securities are presented by maturity.

Investments by Fund

June 30, 2008

(Expressed in thousands)

Fund name	Fund	Investment type: Money market mutual funds	US Government agency obligations	Guaranteed investment contracts and other	Fair value	Investment maturities (in years): Less than 1	1 – 3	4 – 8	More than 9
WT Revenue Fund	515	$ 16,251	—	—	16,251	16,251	—	—	—
WT Operating	520	16,417	—	—	16,417	16,417	—	—	—
WT Sr. Debt Service	530	13,735	—	—	13,735	13,735	—	—	—
WT Capital Reinvestment	550	103	—	—	103	103	—	—	—
WT General Fund	560	70,035	—	—	70,035	70,035	—	—	—
MHS Capital Fund	601	5,809	—	—	5,809	5,809	—	—	—
MHS Revenue Fund	615	6,088	—	—	6,088	6,088	—	—	—
MHS Operating	620	8,446	—	—	8,446	8,446	—	—	—
MHS 97 Sr. Debt Service	630	211	33,427	—	33,638	33,638	—	—	—
MHS 97 Sr. Debt Service Reserve Fund	635	87	100,312	—	100,399	100,399	—	—	—
MHS 97/99 Sub. Debt Service	640	17,827	38,671	—	56,498	56,498	—	—	—
MHS 97/99 Sub. Debt Service Reserve Fund	645	3,623	15,350	64,665	83,638	18,973	—	—	64,665
MHS Capital Reinvestment	650	13,582	—	—	13,582	13,582	—	—	—
MHS General Fund	660	87,155	—	36,440	123,595	123,595	—	—	—
MHS Sr. Rebate Fund	670	3,437	—	—	3,437	3,437	—	—	—
MHS Sub. Rebate Fund	675	452	—	—	452	452	—	—	—
MTA General Fund	690	19,412	—	—	19,412	19,412	—	—	—
		$ 282,670	187,760	101,105	571,535	506,870	—	—	64,665

Investment type	Fair value	Investment maturities (in years): Less than 1 year	1 – 3	4 – 8	More than 9
Money market mutual funds	$ 282,670	282,670	—	—	—
U.S. agency obligations	187,760	187,760	—	—	—
Guaranteed investment contracts	67,155	2,490	—	—	64,665
Auction rate securities	33,950	33,950	—	—	—
	$ 571,535	506,870	—	—	64,665

The 1997 and 1999 MHS Debt Service and Debt Service Reserve funds held by the Trustee are invested in Guaranteed Forward Delivery Agreements established in 1997 and 1999 for the respective funds. The underlying investments for these agreements are in U.S. Government Agency obligations. Each of the agreements requires that all funds in the accounts be collateralized for the life of the agreements. These Agreements provide the Authority with a guaranteed rate of return on trusteed deposits held for debt payments until such time as payments are due. These deposits are recorded on the Authority's financial statements at the fair value of the underlying securities.

Eligible securities purchased under these agreements are limited to those permitted by the MHS Trust Agreement.

Subsequent to year-end, Lehman Brothers Special Financing, Inc., failed to fulfill its obligation under a Debt Service Deposit Agreement and the Authority sent a notice of intention to terminate the agreement with the counterparty. As a result of the default, the Authority will not receive the guaranteed interest earnings provided for in the Agreement. Unless the Authority can arrange a new Agreement with a new counterparty, the Authority will be responsible for paying the shortfall in lost interest earnings resulting from this transaction. The fair value of this agreement on September 25, 2008 was $9.5 million.

Additionally, subsequent to year-end, Lehman Brothers Special Financing, Inc., filed for bankruptcy, which constitutes an event of default under a Debt Service Reserve Fund Agreement. Despite the default of the counterparty, the Authority has not yet chosen to terminate the Agreement but expects to do so. As such, the Agreement remains in effect until a new counterparty is found or until the Authority terminates the Agreement. The failure of the counterparty is expected to result in the loss of estimated future interest earnings of $25 million.

(c) Credit Ratings

With respect to MHS and WT operating accounts, all securities purchased, such as FNMA, FHLMC, FHLB issues and auction rate securities, have credit ratings of AAA. Trust Funds Securities purchased for the MHS Debt Service and Debt Service Reserve funds include only those Agencies with a AAA rating, as this requirement is included in the terms of the respective agreements noted in the table above. The GICs are generally not rated.

Institutional Money Market mutual funds purchased for both Trust and Operating Funds are AAA rated.

(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):

GICs:		
AIG	$	64,665
Lehman		2,490
U.S. agency obligations:		
Federal Home Loan Bank (FHLB)		15,267
Federal Home Loan Mortgage Corporation (FHLMC)		53,483
Federal National Mortgage Association (FNMA)		119,010
Auction Rate Securities		33,950
	$	288,865

(e) 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 attempts to minimize interest rate risk by structuring investment portfolios to anticipate cash requirements and investing in securities guaranteed by the U.S. Government or under the Federal government's oversight.

(f) Cash and Investments by Fund

The following summarizes cash and investments as of June 30, 2008 by the various funds and accounts established by the Authority for debt covenant requirements and other purposes (in thousands):

Revenue Fund	$	35,590
Operating and Maintenance Fund		27,793
General Fund		213,420
Rebate Fund		3,889
Senior Debt Service Fund		47,372
Senior Debt Service Reserve Fund		100,402
Subordinated Debt Service Fund		56,498
Subordinated Debt Service Reserve Fund		83,638
Maintenance Capital Reinvestment Fund		22,704
Total	$	591,306

The restrictions and board designations placed on these funds are as follows (in thousands):

Unrestricted	$	195,418
Board-designated for capital and other expenditures		45,923
Externally restricted by bond and other requirements		349,965
Total	$	591,306

(g) Summary of Swap and Swaption Transactions

1999 Tax Basis Swap

The Authority received a premium payment on July 20, 1999 of $5.35 million as part of the swaption agreement. This premium amount was recorded as a deferred credit and is being recognized as an adjustment of interest expense over the 30-year life of the agreement. The counterparty, JP Morgan Chase Bank (JPMC), exercised its option on October 1, 2002. As such, the Authority's payment obligation is equal to the difference between the BMA and 67% of 3-month LIBOR, multiplied by the $100 million. Conversely, the Authority receives payments under this agreement when 67% of 3-month LIBOR exceeds the BMA.

As of June 30, 2008, the long term ratings for JPMC were AA (Fitch), Aa2 (Moody's) and AA (Standard & Poor's). As of October 14, 2008, the ratings were AA-, Aaa, and AA, respectively. The following table summarizes the provisions of the 1999 Tax Basis Swap.

Date of trade	Exercise date	Notional amount	Termination date	Variable receivable swap rate	Variable payable swap rate	Premium payment from counterparty		Net fair option value at June 30, 2008
		(000's)					(000's)	(000's)
06/18/1999	10/01/2002	$ 100,000	07/01/2029	67% of 3 month LIBOR	BMA	07/20/1999	$ 5,350	(7,009)

Subsequent to year-end, Moody's Investors Service downgraded the credit rating on the Authority's MHS Senior Bonds to Baa2 and the Subordinated Bonds to Baa3. As a result of the downgrade, the Authority was required to post collateral on behalf of JPMC equal to the market value of the swaption. The market value of the collateral posted was approximately $12.0 million as of November 14, 2008.

2004 Lehman Swap

In December 2004, the Authority entered into a basis swap with Lehman Brothers Special Financing, Inc. (Lehman) as a way to reduce the risk associated with the 1999 Tax Basis Swap with JP Morgan Chase Bank (JPMC) that was exercised on October 1, 2002. Under the contract with JPMC, the Authority's payment obligation would be equal to the difference between the Bond Market Association Municipal Swap Index (BMA) and 67% of the 3-month London Interbank Offered Rate (LIBOR), multiplied by $100 million. In the current low interest rate environment, 67% of LIBOR has not equaled BMA. Therefore, the Authority has been a payer under the contract. The Lehman swap overlays a basis swap on the three-month LIBOR component of the JPMC swap to adjust the way the Authority receives its floating payment. Instead of receiving 67% of three-month LIBOR, the Authority will receive from Lehman 55% of three-month LIBOR plus 50 basis points and pay Lehman 67% of three-month LIBOR that it was receiving from JPMC.

As of June 30, 2008, the long term ratings for Lehman, the counterparty to the transaction, were A1 (Moody's), and A (Standard & Poor's). As of October 14, 2008, the ratings were B3 and D, respectively. The following table summarizes the 2004 Lehman basis swap.

Date of trade	Effective date	Notional amount	Termination date	Floating receivable swap rate	Floating payable swap rate	Net fair option value at June 30, 2008
		(000's)				(000's)
12/23/2004	01/01/2005	$ 100,000	Optional on any Business Day	55% of three-month LIBOR plus 0.50%	67% of three-month LIBOR	$ (1,048)

Subsequent to year-end, Lehman Brothers Special Financing, Inc., failed to meet its obligation under the terms of this swap by not remitting the required swap payment of approximately $42,000 for the quarter ended September 30, 2008. As of October 15, 2008, the swap has not been terminated by the Authority and remains in effect.

As a result of the bankruptcy filing, the Authority has the right, but not the obligation to terminate the swaptions. To date, the Authority has made no decision with respect to termination of the Lehman swaptions.

2001 UBS Swaptions

In May 2001, the Authority entered a “swaption” with five tranches with UBS AG. This swaption grants UBS the right to enter a swap with the Authority under which the Authority would pay a fixed rate and receive a floating rate from UBS. The swaption exercise dates and the fixed rates due from the Authority are designed to match the call provisions and rates of certain of the Authority’s bonds.

Additionally, in 2001 UBS paid $6.2 million on behalf of the Authority to purchase insurance for the payments that the Authority may be required to make under the swaps, if exercised. This amount was recorded in the accompanying financial statements as prepaid insurance and will be amortized over the life of the swap, which is 35 years. Under the agreement, UBS made premium payments on the swaption over eight years totaling $29.1 million, which was originally recorded as a receivable and deferred credit in 2001. The remaining premium receivable recorded by the Authority was received on January 2, 2008.

A corresponding deferred credit totaling $29.1 million was recorded at December 31, 2001 related to this transaction. This amount is being amortized over the life of the swap, which is 35 years. The balance at June 30, 2008 is $23.7 million.

During the eighteen-month period ending June 30, 2008, UBS exercised three of the five tranches in the swaption resulting in the commencement of three related swaps. The swaptions exercised were associated with the 1997 Series A and Series B Bonds and had a total notional amount of $334.39 million. The Authority received $4.013 million in exercise premiums during this period as part of the exercise of the swaption and recorded these premiums as a reduction in interest expense. It was anticipated that when UBS exercised its option, the Authority would refund certain of its fixed rate bonds with floating rate bonds. If this floating-to-fixed swap were to occur, the floating rate received by the Authority under the swap would provide a hedge for the floating rate due on its refunding bonds. In turn, the Authority’s payments to UBS would match the payments expected to be made to fixed rate bond holders. In addition to the savings from the premium paid by the counterparty, it was anticipated at the time the Authority entered into the agreement that the resulting synthetic fixed rate debt structure could result in lower debt service payments for the Authority. Due to market conditions, the Authority has been unable to issue refunding bonds associated with these swaps. During the 18 month period, the Authority incurred $1.8 million in additional interest expense related to the floating rate on the bonds. This interest was paid in July 2008.

Subsequent to June 30, 2008, UBS notified the Authority of its intent to exercise the remaining two swaptions related to the 1999 Series A Bonds having a notional amount of $465.61 million. The related swaps will become effective on January 1, 2009. The Authority received and deferred an exercise premium of $2.5 million before June 30, 2008.

As of June 30, 2008, the long term ratings for UBS, the counterparty to the transaction, were AA+ (Fitch London), Aa2 (Moody's NY) and AA+ (Standard & Poor's NY). As of October 14, 2008, the ratings were AA-, Aa2, and AA-, respectively. The following table summarizes the 2001 UBS swaptions.

First exercise date	Notional amount (000's)	Termination date	Associated bonds	Fixed payable swap rate	Variable receivable swap rate	Premium payments from counterparty		Net fair option value at June 30, 2008* (000's)
						06/04/2001	$ 1,751,663	
						01/01/2002	875,897	
						01/01/2003	875,897	
01/01/2007	$ 207,665	01/01/2037	1997 Series A	4.750%	68% of	01/01/2004	875,897	(45,840)
					1 month	01/01/2005	875,897	
					LIBOR	01/01/2006	875,897	
						01/01/2007	875,897	
						01/01/2008	875,897	
						06/04/2001	673,872	
						01/01/2002	388,650	
						01/01/2003	388,650	
01/01/2007	83,100	01/01/2037	1997 Series B	4.875	68% of	01/01/2004	388,650	(20,237)
					1 month	01/01/2005	388,650	
					LIBOR	01/01/2006	388,650	
						01/01/2007	388,650	
						01/01/2008	388,650	
						06/04/2001	303,162	
						01/01/2002	212,112	
						01/01/2003	212,112	
01/01/2007	43,625	01/01/2029	1997 Series B	5.000	68% of	01/01/2004	212,112	(9,875)
					1 month	01/01/2005	212,112	
					LIBOR	01/01/2006	212,112	
						01/01/2007	212,112	
						01/01/2008	212,112	
						06/04/2001	2,848,263	
						01/01/2002	1,393,901	
						01/01/2003	1,393,901	
01/01/2009	371,380	01/01/2039	1999 Series A	4.750	68% of	01/01/2004	1,393,901	(77,964)
					1 month	01/01/2005	1,393,901	
					LIBOR	01/01/2006	1,393,901	
						01/01/2007	1,393,901	
						01/01/2008	1,393,901	
						06/04/2001	575,495	
						01/01/2002	410,119	
						01/01/2003	410,119	
01/01/2009	94,230	01/01/2029	1999 Series A	5.000	68% of	01/01/2004	410,119	(18,610)
					1 month	01/01/2005	410,119	
					LIBOR	01/01/2006	410,119	
						01/01/2007	410,119	
						01/01/2008	410,119	
			Total fair value					$ (172,526)

* The net fair option value includes the present value of the unpaid premiums at June 30, 2008, if any.

2002 Lehman Swaptions

In 2002, the Authority entered into an interest rate swaption with five tranches with Lehman Brothers Special Financing Inc. (Lehman). This swaption grants Lehman the right to enter a swap with the Authority under which the Authority would receive from Lehman a fixed rate of 5% and the Authority would pay Lehman a floating rate of BMA. As a fixed-to-floating swap, the transaction was designed to offset some of the risks inherent in the 2001 UBS Swaptions and, as a result, has the effect of mitigating certain risks inherent in that transaction if both are executed. Lehman paid a premium of $6.4 million to the Authority during 2002 and will pay an additional $28.8 million in premiums in subsequent years. This amount was recorded in the accompanying financial statements as a receivable and a deferred credit and will be amortized over the life of the swap, which is 35 years. The remaining premium receivable recorded by the Authority was received on January 2, 2007.

A corresponding deferred credit totaling $35.2 million was recorded at December 31, 2002 related to this transaction. This amount is being amortized over the life of the swap, which is 35 years. The unamortized balance at June 30, 2008 is $29.7 million.

Subsequent to year-end, Lehman Brothers Special Financing, Inc., filed for bankruptcy and, as of October 15, 2008, had not exercised any of its options related to this transaction. As a result of the bankruptcy filing, the Authority has the right, but not the obligation to terminate the swaptions. To date, the Authority has made no decision with respect to termination of the Lehman swaptions.

As of June 30, 2008, the long term ratings for Lehman, the counterparty to the transaction, were A1 (Moody's), A (Standard & Poor's). As of October 14, 2008, the ratings were B3 and D, respectively.

First exercise date	Notional amount (000's)	Termination date	Associated bonds	Fixed receivable swap rate	Variable payable swap rate	Premium payments from counterparty		Net fair option value at June 30, 2008* (000's)
						12/05/2002	$ 1,739,020	
						01/01/2003	1,431,150	
01/01/2007	$ 207,665	01/01/2037	1997 Series A	5.0%	BMA	01/01/2004	1,600,250	(9,482)
						01/01/2005	1,600,250	
						01/01/2006	1,600,250	
						01/01/2007	1,600,250	
						12/05/2002	691,800	
						01/01/2003	623,882	
						01/01/2004	621,928	
01/01/2007	83,100	01/01/2037	1997 Series B	5.0	BMA	01/01/2005	621,928	(3,561)
						01/01/2006	621,928	
						01/01/2007	621,928	
						12/05/2002	381,870	
						01/01/2003	353,257	
						01/01/2004	340,908	
01/01/2007	43,625	01/01/2029	1997 Series B	5.0	BMA	01/01/2005	340,908	(1,445)
						01/01/2006	340,908	
						01/01/2007	340,908	
						12/05/2002	2,897,250	
						01/01/2003	2,384,322	
						01/01/2004	2,666,048	
01/01/2009	371,380	01/01/2039	1999 Series A	5.0	BMA	01/01/2005	2,666,048	(18,555)
						01/01/2006	2,666,048	
						01/01/2007	2,666,048	
						12/05/2002	690,060	
						01/01/2003	623,841	
						01/01/2004	619,901	
01/01/2009	94,230	01/01/2029	1999 Series A	5.0	BMA	01/01/2005	619,901	(3,377)
						01/01/2006	619,901	
						01/01/2007	619,901	
			Total fair value					$ (36,420)

* The net fair option value includes the present value of the unpaid premiums at June 30, 2008, if any.

Risk Disclosures

Basis Risk. The Authority is exposed to basis risk in the 1999 Tax Basis swap when 67% of 3 month LIBOR does not exceed BMA.

If all swaptions are exercised by the counterparties, the Authority will be exposed to basis risk if the fixed-to-floating (2002 Lehman) swap does not offset the floating-to-fixed (2001 UBS) swap. This will occur when BMA exceeds 68% of LIBOR by more than 19 basis points. The 19 basis points represents the difference in the fixed rate the Authority will receive from 2002 Lehman (5.00%) and the fixed rate it will pay to UBS (4.81%). The Authority may also be exposed to additional basis risk if the swaptions are not exercised concurrently. As of October 15, 2008, all of the 2001 UBS swaptions and none of the 2002 Lehman swaptions have been exercised.

The Authority has deposited a portion of the premiums received from each counterparty into a cash "hedge reserve fund" to mitigate any short-term exposure to basis risk. As of June 30, 2008, the reserve fund balance was $14.9 million. The Authority and its financial advisor review the balance of this fund on an annual basis and make additions if necessary. As of June 30, 2008, management believes the balance in this "hedge reserve fund" was sufficient based on current market conditions.

Tax Risk. If maximum tax rates were to decline, it is possible that the 68% of LIBOR the Authority receives under the 2001 UBS swap would be less than the amount needed to pay its variable rate bonds. The Authority and its financial advisor take this risk into consideration when analyzing the sufficiency of the hedge reserve fund balance.

Termination Risk. The Authority or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. Termination risk is related to credit risk and represents the risk that a swap is terminated and the swap counterparty is unable to make the termination payment if necessary. The Authority funds the hedge reserve fund to mitigate any exposure resulting from one of the counterparties terminating the agreement or defaulting on terms. Additionally, the Lehman swaption can be terminated by the counterparty if the Authority's credit rating on certain outstanding bonds is withdrawn, suspended or falls below specified levels (Moody's – Baa2 or Fitch – BBB). If any of the swaps are terminated, the related variable rate bonds would no longer be hedged. Finally, if at the time of termination the swap has a negative fair value, the Authority would be liable for a payment equal to the swaps' fair value.

Credit Risk. The net fair values were calculated by the Authority's financial advisor on a mark to market basis. As of June 30, 2008, the Authority was not exposed to credit risk on its outstanding swaps/swaptions because they had negative fair values. However, if interest rates and volatilities change and the fair values of the swaps/swaptions were to become positive, the Authority would be exposed to credit risk in the amount of the positive fair values. To mitigate credit risk, the Authority's counterparties are all rated in the A category or higher by at least two of the three rating agencies (FitchRatings, Moody's Investors Service, and Standard & Poor's). The Authority also funds the hedge reserve fund to mitigate any exposure resulting from one of the counterparties terminating the agreement or defaulting on terms.

(3) Capital Assets

Capital assets consisted of the following at June 30 (in thousands):

	Beginning balance	Increases	Decreases	Ending balance
Capital assets, not being depreciated:				
Land	$ 152,854	159,893	—	312,747
Construction in progress	315,969	51,724	356,911	10,782
Total capital assets, not being depreciated	468,823	211,617	356,911	323,529
Capital assets, being depreciated:				
Infrastructure	2,311,155	4,968,168	—	7,279,323
Improvements	603,352	19,100	—	622,452
Buildings	47,919	—	—	47,919
Equipment	124,129	12,587	—	136,716
Total capital assets, being depreciated	3,086,555	4,999,855	—	8,086,410
Less accumulated depreciation for:				
Infrastructure	673,142	578,906	—	1,252,048
Improvements	225,303	30,371	—	255,674
Buildings	25,378	1,721	—	27,099
Equipment	80,582	17,482		98,064
Total accumulated depreciation	1,004,405	628,480	—	1,632,885
Total capital assets, being depreciated, net	2,082,150	4,371,375	—	6,453,525
Capital assets, net	$ 2,550,973	4,582,992	356,911	6,777,054

(a) Contributed Capital Assets

As of July 1, 1997, the Authority entered into a Project Management Agreement with respect to the Central Artery/Tunnel Project in anticipation of the Authority's ultimate ownership and operation of the assets being constructed. These assets being constructed include the following major components:

- Ted Williams Tunnel
- I-90 Connector
- Leonard P. Zakim/Bunker Hill Bridge
- Central Artery/I-93 Tunnel
- Central Artery North Area (CANA) – two tunnels beneath City Sq. and a series of connection ramps

As of June 30, 2003 (the Commonwealth's fiscal year end), the construction of these assets has been accounted for in the Commonwealth's financial statements as construction in progress until such time as the title to the assets is transferred to the Authority. Through December 31, 2002, title to only two assets – the Ted Williams Tunnel and CANA – had been transferred to the Authority and, as such, the estimated cost of these assets were recorded as a capital asset in the Authority's December 31, 2002 financial statements.

During calendar 2003, in connection with the imminent completion of the Big Dig, the Commonwealth determined that additional costs associated with the previously transferred assets had been incurred and, as such, the net impact of these additional costs of $236 million were recorded as being transferred to the Authority from the Commonwealth during the current year. Additionally, it was determined that the estimated cost previously allocated to the Ted Williams Tunnel and CANA required a reallocation based upon the new cost information produced by the Commonwealth in 2003. The impact of this reallocation was to reassign costs between the two assets to which the Authority held title. The overall impact of this reallocation was not material to the financial statements.

During calendar 2004, there were no assets transferred that were material to the financial statements. During calendar 2005, the Authority received a parcel of land and certain vehicles from the Commonwealth valued at approximately $793 thousand. In future years, it is expected that the Authority will continue to record contributed capital assets in its financial statements as title to those assets are transferred from the Commonwealth to the Authority. See note 11.

On June 22, 2007, the Authority received a transfer from the Commonwealth of land and infrastructure with a net book value to the Commonwealth of $4.592 billion. This amount was recorded by the Authority, net of cash contributions previously recorded, in the amount of $4.361 billion.

(4) Bonds and Notes Payable

Long-term debt at June 30, 2008 consisted of the following (in thousands):

		Beginning balance	Additions	Reductions	Ending balance	Due within one year
Revenue bonds:						
Metropolitan Highway System:						
1997, Series A, 5.05% to 5.65%, issued September 24, 1997 due 2010 to 2037	$	1,183,047	—	—	1,183,047	—
1997, Series C, 5.40% to 5.55%, issued September 24, 1997 due 2016 to 2023		89,136	—	—	89,136	—
Western Turnpike:						
1997, Series A, 5.55%, issued September 24, 1997 due 2017 (mandatory sinking fund requirements from 1999 to 2017)		195,405	—	32,975	162,430	17,245
Subordinated debt:						
Metropolitan Highway System:						
1999, Series A, 3.90% to 5.26%, issued March 11, 1999 due 2004 to 2039		774,110	—	9,200	764,910	31,990
1997 Series B, 5.00% to 5.57%, issued September 24, 1997 due 2010 to 2037		194,680	—	—	194,680	—
Subtotal		2,436,378	—	42,175	2,394,203	49,235
Less unamortized amounts:						
Bond discounts		92,201	—	7,596	84,605	
Net unamortized excess of reacquisition price over net carrying value of defeased bonds		(433)		(509)	76	
Total bonds payable		2,344,610	—	35,088	2,309,522	49,235
Compensated absences, net		11,674	699	—	12,373	4,239
Total long-term liabilities	$	2,356,284	699	35,088	2,321,895	53,474

Interest is payable semiannually on all debt, except on Capital Appreciation Bonds which accrued over the lives of the Bonds and is payable upon maturity of the Bonds.

(Continued)

Revenue Bonds are collateralized by a lien and a pledge on substantially all of the Authority's cash and revenues.

Debt service requirements on revenue bonds are as follows (in thousands):

		Principal	Interest	Total
Year ending June 30:				
2009	$	49,235	113,497	162,732
2010		49,860	110,934	160,794
2011		52,615	108,281	160,896
2012		46,930	105,693	152,623
2013		48,555	103,205	151,760
2014 – 2018		269,715	542,948	812,663
2019 – 2023		238,911	558,535	797,446
2024 – 2028		334,754	475,571	810,325
2029 – 2033		469,098	331,851	800,949
2034– 2038		692,530	126,168	818,698
2039		142,000	7,100	149,100
Total	$	2,394,203	2,583,783	4,977,986

At June 30, 2008, the principal amounts outstanding on revenue bonds and notes outstanding that are considered defeased are as follows (dollars in thousands):

Description	Redemption date	Redemption price		Principal amount outstanding
1993 Series A Term	2013 to 2023	100%	$	263,355

Outstanding bonds that are redeemable before their scheduled due dates are as follows at June 30, 2008 (dollars in thousands):

Description	Redemption date	Redemption price		Principal amount outstanding
Metropolitan Highway System:				
1999 Series A	2009 to 2039	100% to 101%	$	764,910
1997 Series B	2010 to 2037	100 to 102		194,680
Western Turnpike:				
1997 Series A	2008 to 2017	100		162,430

(5) Employee Benefit Plans

(a) Plan Description – Pension Plan

The Massachusetts Turnpike Authority Employees' Retirement Plan (the Plan) is a single employer contributory defined benefit pension plan administered by the Massachusetts Turnpike Authority Employees' Retirement System (the System). The Plan provides retirement, disability, and death benefits to plan members and beneficiaries.

Massachusetts General Laws (MGL), principally Chapter 32, establishes and amends benefit provisions. The System does not issue publicly available audited financial statements for the Plan. The report may be obtained by writing to the Massachusetts Turnpike Employees' Retirement System at the State Transportation Building, 10 Park Plaza, Boston, Massachusetts 02116.

(b) Funding Policy

The contribution requirements of plan members and the Authority are established and may be amended by the State Legislature. Depending upon their employment date, active plan members are required to contribute 5% to 9% of their annual covered compensation. Members hired after December 31, 1978 must contribute an additional 2% of regular compensation in excess of $30 thousand. The Authority is required to contribute amounts pursuant to MGL Section 22(6A) of Chapter 32 which is the normal cost plus estimated expenses, less a ten-year level amortization of the January 1, 1998 surplus with interest to July 1999.

(c) Annual Pension Cost

The annual required contribution (ARC) for the eighteen-month period ended June 30, 2008 was determined as part of the January 1, 2008 actuarial valuation using the individual entry age normal cost method. The actuarial assumptions included (a) 8.25% investment rate of return, and (b) projected salary increases of 5%. Both (a) and (b) include an inflation component of 4.5%. Liabilities for cost of living increases have been approximated, assuming an annual cost of 3% on the first $12 thousand annual pension. The ARC equaled the annual pension cost (APC) and the employer contributions for the last three years. Those amounts are as follows (in thousands):

	Annual pension cost (APC)	Percentage of APC contributed
Eighteen months ended June 30, 2008	$ 8,512	100%
Fiscal year ending December 31:		
2006	4,500	100
2005	3,000	100

(6) Other Postemployment Benefits

During the period ended June 30, 2008, the Authority implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.* Statement

No. 45 requires governments to account for other postemployment benefits, primarily healthcare, on an accrual basis rather than on a pay-as-you-go basis. The effect is the recognition of an actuarially required contribution as an expense on the statement of revenues, expenses, and changes in net assets when a future retiree earns their postemployment benefit rather than when they use their postemployment benefit. To the extent that an entity does not fund their actuarially required contribution, a postemployment benefit liability is recognized on the balance sheet over time.

(a) Plan Description

In addition to providing the pension benefits described in note 5, the Authority provides post-employment health care and life insurance benefits (OPEB) for retired employees. The benefits, benefit levels, employee contributions and employer contributions are governed by the Authority and can be amended by the Authority. As of December 31, 2005, the actuarial valuation date, approximately 982 retirees and 1,099 active employees meet the eligibility requirements. As part of the implementation of GASB 45, this valuation was rolled forward to January 1, 2007. The plan does not issue a separate financial report.

(b) Benefits Provided

The Authority provides medical, prescription drug, mental health/substance abuse and life insurance to retirees and their covered dependents. All active employees who retire from the Authority and meet the eligibility criteria will receive these benefits.

(c) Funding Policy

Plan members contribute between 0% to 20% of premiums depending on their union or non-union status and the type of Plan selected. The Authority made a contribution of $1.823 million as well as $6.995 million on a pay as you go basis for these postemployment benefits.

(d) Annual OPEB Costs and Net OPEB Obligation

The Authority's 2008 OPEB expense is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize the unfunded actuarial liability over a period of thirty years. The following table shows the components of the Authority's annual OPEB cost for the eighteen-month period ending June 30, 2008, the amount actually contributed to the plan, and the change in the Authority's net OPEB obligation based on an actuarial valuation as of December 31, 2005 (in thousands).

Annual Required Contribution (ARC)	$	11,267
Interest on net OPEB obligation		—
Adjustment to ARC		—
Annual OPEB cost		11,267
Contributions made		(8,818)
Change in net OPEB obligation		2,449
Net OPEB obligation – beginning of period		—
Net OPEB obligation – end of period	$	2,449

The Authority's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation were as follows (in thousands):

Eighteen-month period ended		Annual OPEB cost	Percentage of OPEB cost contributed		Net OPEB obligation
2008	$	11,267	78.3%	$	2,449

(e) Funded Status and Funding Progress

The funded status of the plan, based on an actuarial valuation as of December 31, 2005, was as follows (in thousands):

Actuarially accrued liability (AAL)	$	127,242
Actuarial value of plan assets		48,560
Unfunded actuarial accrued liability (UAAL)	$	78,682
Funded ratio (actuarial value of plan assets/AAL)		38.2%
Covered payroll (active plan members)	$	69,223
UAAL as a percentage of covered payroll		113.7%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the Authority are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

(f) Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the plan as understood by the Authority and the plan members and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the Authority and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the December 31, 2005 actuarial valuation the projected unit credit cost method was used. The actuarial value of assets was $48.6 million. The actuarial assumptions included an 8.5% investment rate of return and an initial annual healthcare cost trend rate of 10.0% which decreases to a 5% long-term trend rate for all healthcare benefits after five years. The amortization costs for the initial UAAL is a level percentage of payroll for a period of 30 years, on a closed basis. This has been calculated assuming an inflation rate of 4.5%.

(7) Leases

(a) Commitments

The Authority has commitments under various operating leases. The principal lease is with the Commonwealth for administrative office space and other facilities and expires in June 2010. Total lease expense in 2008 was $1,432, of which $1,285 was paid to the Commonwealth. The Commonwealth lease is cancelable by either party with 12 months written notice. The minimum lease payment due in 2009 under the Commonwealth lease is approximately $944.

(b) Rental Income

The Authority leases property and air rights to others. During the period ended June 30, 2008, the Authority earned $14 million (6 month period) and $28.6 million (12 month period), respectively, in rental income, of which $8.7 million (6 month period) and $16.9 million (12 month period), respectively, was received for restaurant, concessions, and service station rentals.

The following is a schedule by years of minimum future rental income on noncancelable operating leases as of June 30, 2008 (in thousands):

Years	Amount	Years	Amount
2009	$ 27,521	2054 – 2058	$ 11,002
2010	24,807	2059 – 2063	12,225
2011	21,834	2064 – 2068	13,829
2012	31,388	2069 – 2073	13,706
2013	22,326	2074 – 2078	13,024
2014 – 2018	116,965	2079 – 2083	14,414
2019 – 2023	124,843	2084 – 2088	16,335
2024 – 2028	56,556	2089 – 2093	18,078
2029 – 2033	16,670	2094 – 2098	20,487
2034 – 2038	11,764	2099 – 2101	12,532
2039 – 2043	10,781		
2044 – 2048	8,753		
2049 – 2053	9,725		
Total			$ 629,565

On May 3, 2006, the Authority executed five (5) separate Ground and Air Rights Lease Agreements (collectively, the Leases) for air rights over property of the Authority and air rights over adjacent property owned by the Massachusetts Bay Transportation Authority (MBTA) for the development and construction of the proposed residential and commercial project at Columbus Center (the Project). Each of the Leases is between the Authority and limited liability companies owned and controlled by a joint venture entity established by WDC Development Associates Limited Partnership and its equity partner, California Urban Investment Partners, LLC.

Each of the Leases runs for a term of 99 years and provides for a Base Rent payment to the Authority in the aggregate amount $12.2 million, payable as follows:

- $2.0 million that was paid upon execution of the Leases;

- $2.0 million, payable upon the first draw on a construction loan for any component of the Project. $1.0 million of this amount has been advanced and paid to the Authority in order for the Authority to pay the MBTA pursuant to its Leases with the MBTA;
- $1.1 million payable upon the issuance of the certificates of occupancy for the components of the Project;
- $1.1 million payable upon sell-out of 50% of the residential units in the Project;
- $3.0 million payable upon sell-out of 75% of the residential units in the Project; and
- $3.0 million payable upon sell-out of 90% of the residential units in the Project.

Any unpaid balance of the $12.2 million Base Rent payment shall be automatically due and payable on that date which is seventy (70) months following the execution of the Leases. The Authority is also entitled to receive other contingent payments based on provisions outlined in the Leases.

Concurrent with the execution of the Leases, the Authority entered into air rights leases with the MBTA for that portion of the Project to be located over MBTA owned property. Under these leases, the Authority is obligated to pay and paid $2.0 million in rent payments to the MBTA in 2006. Except for these rent payments, the tenants of the Project will be primarily liable for all payment and performance obligations under the MBTA Leases, and will indemnify the Authority for all obligations and liabilities under the MBTA Leases.

In March 2008, the Tenants suspended construction of the Project and requested that the Authority agree to an extension of time to complete construction under the Leases. As of October 1, 2008, the Authority had not agreed to the request and construction remains suspended.

(8) Risk Management

As part of its normal operations, the Authority encounters the risk of accidental loss stemming from third party liability claims, property loss or damage, and job-related injuries and illnesses. In managing these loss exposures, a combination of risk management measures is applied, including safety and loss prevention programs, emergency planning, contractual risk transfer, self insurance, and insurance.

In connection with the self insurance and insurance programs, the Authority retains part of the losses incurred and internally manages the self insured claims. The self insured retention currently includes $500,000 for worker's compensation per job-related accident, up to $250,000 per occurrence for automobile liability, general liability and other types of third party claims, $250,000 per loss involving damage to buildings and their contents, and $10,500,000 per bridge and tunnel loss. Insurance is purchased above the self-insured amounts, subject to availability and reasonableness of cost.

Liabilities for self-insured claims are 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 at year-end and are based on the historical cost of settling similar claims. The Authority records such liabilities as accrued expenses. The Authority from time to time is engaged in various matters of routine litigation. These matters include personal injury and property damage claims for which the Authority's liability is covered in whole or in part by insurance. The Authority does not expect that these matters will require any amounts to be paid which in the aggregate would materially affect the financial statements.

Settled claims resulting from the risks discussed above have not exceeded the amount of insurance coverage in force in any of the past three fiscal periods. Further, insurance maintained in fiscal 2008 and calendar 2007 has not changed significantly from prior periods.

Changes in the claims liability insurance reserves in the eighteen-month period ended 2008 were as follows (in thousands):

		Workers' compensation
Liability balance, December 31, 2006	$	7,894
Provision to record estimated losses		6,110
Payments		(5,324)
Liability balance, June 30, 2008	$	8,680

(9) Commitments

The Authority enters into construction contracts for the Metropolitan Highway System and the Western Turnpike with various construction and engineering companies. Construction contracts outstanding at June 30, 2008 approximated $23.7 million.

During the construction of the Central Artery/Tunnel Project, the Authority has been responsible for and funded a portion of the cost of the Project. In accordance with the October 2004 Finance Plan, the Authority had agreed to fund a total of $1.858 billion of Project and related costs. Of this amount, $1.355 billion was contributed to the Project and $200 million was contributed to the Commonwealth's Transportation Infrastructure Fund. The Authority funded its Project contributions through the issuance of various bonds.

Subsequent to submission of the October 2004 Finance Plan, the Central Artery/Tunnel Project prepared and submitted it's April 1, 2005 "Cost/Schedule Status" report. Recognizing that the Authority would likely not realize $94 million from the sale of real estate assets in the short term, the Central Artery/Tunnel Project funding sources were adjusted accordingly. To replace the $94 million from real estate sales, the Project intends to use excess earnings from the Transportation Infrastructure Fund ($67 million) and additional interest earnings from the Allston Landing proceeds ($27 million), increasing the Authority's Allston Landing commitment from $156 million to $183 million. In total, the Authority's commitment to the Central Artery/Tunnel Project is reduced by $67 million. This funding plan remains under review by the Executive Office of Administration and Finance (EOAF).

The Authority's remaining commitment to the Project of $236 million is expected to be paid principally from the sale of Authority-owned real estate ($152 million of the proceeds from sale of Allston Landing were received in 2003, interest earnings from the Allston Land sale proceeds ($31 million), and other available cash ($53 million). Through June 30, 2008, the Authority has incurred and paid Project expenses that have reduced this commitment as follows (amounts in thousands):

Committed amount	$	236,000
Amount expended:		
Legal and claims and changes		29,674
Cost recovery		18,886
Other		187,440
Total remaining commitment	$	—

All amounts shown above as expended were funded by the proceeds of the Allston Landing sale. The Authority has capitalized these amounts as part of construction in progress on the accompanying balance sheet.

Also during 2005, the cost recovery program was transferred to the Office of the Attorney General of the Commonwealth and the Authority paid $9.5 million of the Allston Landing proceeds to fund this effort.

The Authority has committed to pay an amount not to exceed $55 million for certain construction costs associated with the CA/T Project. These costs will be paid by the Authority over the life of the CA/T Project as specific construction activities occur. The Authority expended approximately $191,000 under this agreement during the fiscal period ended June 30, 2008, representing construction costs paid by the Authority in that fiscal period. As of June 30, 2008, the Authority has expended a total of approximately $54.9 million under this commitment.

On July 31, 1998, the Massachusetts Legislature enacted Chapter 235 of the Acts of 1998 (Chapter 235), which, among other matters, authorized the Commonwealth, acting through the Secretary of Administration and Finance, to enter into a contract with the Authority providing for payments, by the Commonwealth to the Authority related to the cost of the operation and maintenance of the CA/T Project and CANA, as certified annually by the Authority. Chapter 235 establishes the following payment schedule:

- Not less than $2 million for the State fiscal year July 1, 1999 – June 30, 2000
- Not less than $5 million for each fiscal year thereafter prior to the transfer of the final segments of the CA/T Project and CANA to the Authority
- Not more than $25 million for each fiscal year during and after such transfer.

Chapter 235 provides that the term of the contract shall extend until the end of the 40th fiscal year following the transfer. The Authority received $28.5 million from the Commonwealth during the fiscal period ended June 30, 2008 for reimbursement of CA/T Project and CANA operation and maintenance costs incurred by the Authority.

(10) Litigation

(a) Lessee Default

On June 1, 2006, Level 3 Communications, LLC and WilTel Communications, LLC (now affiliates) were due to make annual payments on easement agreements (Rental Payments) in effect since 1999 with the Authority (the Agreements). The Rental Payment, totaling approximately $4 million, was withheld. The Authority timely presented default letters to each, and on August 24, 2006 filed an action in the Suffolk Superior Court to recover the Rental Payment together with the default interest provided for in the Agreements and legal fees. On August 25, 2006, Level 3 filed an action in the United States District Court for the District of Massachusetts seeking a declaration that the Rental Payment provision, as well as certain other terms, of the Agreements was unenforceable because they violated Section 253 of the Federal Telecommunications Act. Level 3's action also sought to recover from the Authority some portion of the Rental Payments previously made by it to the Authority since 1999 on grounds of "unjust enrichment." On September 25, 2008, the Authority and Level 3 executed an agreement that settles all existing litigation between the Authority and the Level 3 Parties for amounts owed to the Authority and makes certain prospective modification to the lease agreements. Under the terms of the agreement, the Authority received $8.6 million. The rental rates set forth in the Agreements remain in effect and are unchanged by the settlement. Aggregate annual rent payable in June, 2009 pursuant to the easement agreements will be approximately $2.3 million.

(b) Tunnel Ceiling Accident

On July 10, 2006, concrete ceiling panels in the eastbound portal of the I-90 Seaport Access Tunnel (the Tunnel) came loose, fell on a traveling automobile and the roadway, causing bodily injury and the death of the passenger of the automobile and extensive property damage to the Tunnel (the Accident). As a result of the Accident, eastbound, westbound and high occupancy vehicle lanes and associated ramps to the Tunnel were closed for extended periods of time while investigation, repair and remediation work was completed in the Tunnel. State and federal law enforcement officials are investigating the Accident. The Authority has incurred total costs, the amount of which, has not yet been finalized and has notified its insurers of the property damage and loss of revenue caused by the Accident. On or about August 29, 2006, a lawsuit asserting claims arising from the Accident was filed by the estate and the family of the deceased, naming multiple defendants including the Authority. On or about November 28, 2006, the Authority and the Commonwealth of Massachusetts filed a lawsuit asserting claims arising from the property damage caused by the Accident.

In October 2008, a settlement in principle was reached as to all parties to the litigation. The parties are currently in the process of finalizing the documentation that will result in a stipulation of dismissal of all claims against all parties in the lawsuit. The total settlement amount is approximately $30 million with any of the Authority's contribution expected to be funded by the insurance carrier pursuant to coverage under the CA/T Project Owner Controlled Insurance Program (OCIP). With the finalization of this settlement, the Authority will have extinguished its potential tort liability exposure from the ceiling accident and will incur no expenses.

(c) Central Artery Claims Settlement

On January 24, 2008, the Attorney General of the Commonwealth and the United States Attorney for the District of Massachusetts announced a settlement of certain claims against a variety of consultants that had performed services on the CA/T Project. Bechtel, Parsons Brinkerhoff, the Bechtel/Parsons Brinkerhoff Joint Venture, and several design consultants have agreed to pay over $450 million to settle several historical claims against them. Of that sum, approximately $400 million has been deposited in the newly created CA/T Repair and Maintenance Trust Fund. The Trust Fund will be administered by the Secretary of Transportation and Public Works, with approval from the Federal Highway Administration and funds will be used solely for paying or reimbursing the Commonwealth or the Authority for costs associated with repair or maintenance of CA/T Project facilities not caused by ordinary or routine "wear and tear." The fund is scheduled to expire in 2083. This settlement does not release the defendants from future catastrophic events having an aggregate cost of greater than $50 million, with a cap of $100 million. The Authority has entered into a Memorandum of Agreement with the Federal Highway Administration and the Executive Office of Transportation concerning the submission of requests for reimbursement and disbursements from the Fund and has received disbursements from the Fund.

(d) Sick Leave Benefits

The Massachusetts Appeals Court upheld a superior court ruling in the amount of approximately $82,317 (plus interest and costs) in favor of a retired, non-union Authority engineer. The Appeals Court held that the plaintiff was entitled, upon retirement, to the benefit of each of the successive Authority's policies regarding sick leave pay-outs to retirees that were in effect during the course of his employment. Because some of the policies in effect during the course of his employment were more generous than the policy in effect upon his retirement, the Appeals Court upheld the award of compensation reflecting those more generous policies. The Authority was granted further appellate review by the Massachusetts Supreme Judicial Court and a decision is pending. This case could apply to many of the Authority's non-union employees upon retirement.

(e) CA/T Project Contract C11A1 Dispute

In several related cases and potential litigation, plaintiffs make claims for alleged increased costs arising from differing site conditions and other causes of delay on the Central Artery/Tunnel Project. Plaintiffs have asserted claims in excess of $130 million. These claims are at various stages of resolution, including the Superior Court and the Central Artery Tunnel Project Dispute Review Board (DRB) panel. The DRB has recently issued decisions on some of the claims, awarding plaintiffs $55.0 million on claims of $73.8 million. Those decisions may be subject to further proceedings. Plaintiffs also still have in excess of $60 million in claims pending.

(f) Regulatory Activity

In August 2006, the Securities & Exchange Commission sent the Authority a letter requesting voluntary provision of documents and information regarding safety reviews of the Central Artery Tunnel Project and related disclosures. The Authority is cooperating with the SEC.

(11) Subsequent Events

(a) Legislation

On August 11, 2008 the Governor approved legislation authorizing the Secretary of Administration and Finance of the Commonwealth to provide certain types of credit support for payment obligations of the Authority on certain bonds and interest rate swap agreements of the Authority.

The legislation authorizes the Commonwealth to agree to pay debt service on certain refunding bonds to be issued by the Authority relating to the exercised UBS swaption described in note 2(g) above in the event that the Authority fails to do so. The obligation of the Commonwealth is subject to appropriation of the necessary funds. In the event of further downgrades of Ambac or of the Authority, the legislation also authorizes the Commonwealth to guarantee the Authority's payment obligations to the counterparties under certain swap agreements if the Secretary and the Authority determine such a guaranty to be necessary to avoid a termination of the swaptions.

The authorization to provide any such guaranty of the Authority's payment obligations to counterparties under the swap agreements is not effective until October 1, 2008 and expires on January 15, 2009.

On September 4, 2008, Fitch Ratings (Fitch) affirmed its "A+" rating on the Authority's Western Turnpike Bonds and placed the long-term ratings on the MHS Bonds on "Rating Watch Negative". Fitch currently rates the MHS Senior Bonds "BBB+" and the MHS Subordinated Bonds "BBB." An explanation of the significance of this action and these ratings may be obtained from Fitch. On October 2, 2008, Moody's Investor's Service, Inc. announced a downgrade of its ratings of the Authority's senior and subordinated Metropolitan Highway System bonds to Baa2 from A3 and Baa3 from Baa1, respectively. As a result of this downgrade, the Authority was required to post collateral with respect to a "basis" swap it entered into in 1999 with JPMorgan Chase Bank in a notional amount of $100 million (note 2(g)). The estimated collateral value at November 14, 2008 required to be posted is approximately $12.0 million. The Authority has posted the necessary collateral.

(b) Toll Increase

At its meeting in November 2008, the Authority's Board of Directors voted to approve a plan to raise tolls on the MHS. The proposed toll increases would result in estimated additional yearly revenue of approximately $90 to $100 million. The proposed toll increases will require public hearings and the Board currently anticipates voting to give final approval to the proposed toll increases at its January 2009 meeting. If approved, the proposed toll increases would take effect in approximately March or April 2009.

MASSACHUSETTS TURNPIKE AUTHORITY
(A Component Unit of the Commonwealth of Massachusetts)

Required Supplementary Information

June 30, 2008

(In thousands)

Schedule of Pension Funding Progress

(1) Actuarial valuation date	(2) Actuarial value of plan assets*	(3) Actuarial accrued liability (AAL)	(4) (Overfunded) unfunded (UAAL) AAL(2) – (3)	(5) Actuarial value of assets as a percentage of AAL (funded ratio) (2)/(3)	(6) Annual covered payroll	(7) (UAAL) AAL as a percentage of covered payroll (4)/(6)
1/1/2008	$ 223,447	288,569	65,122	77.4%	$ 71,887	90.6%
1/1/2006	196,826	251,898	55,072	78.1	70,554	78.1
1/1/2004	194,784	224,272	29,488	86.9	64,285	45.9
1/1/2003	170,928	203,425	32,497	84.0	58,100	55.9
1/1/2002	197,134	191,249	(5,885)	103.1	61,615	(9.6)

* Five-year smoothed market value.

Schedule of OPEB Funding Progress

(1) Actuarial valuation date	(2) Actuarial value of plan assets	(3) Actuarial accrued liability (AAL)	(4) (Overfunded) unfunded (UAAL) AAL(2) – (3)	(5) Actuarial value of assets as a percentage of AAL (funded ratio) (2)/(3)	(6) Annual covered payroll	(7) (UAAL) AAL as a percentage of covered payroll (4)/(6)
12/31/2005	$ 48,560	127,242	78,682	38.2%	$ 69,223	113.7%

See accompanying independent auditors’ report.

Schedule I

MASSACHUSETTS TURNPIKE AUTHORITY
(A Component Unit of the Commonwealth of Massachusetts)

Combining Schedule of Net Assets

June 30, 2008

(In thousands)

Assets		Metropolitan Highway System	Western Turnpike	MTA General Fund	Eliminations	Combined totals
Current assets:						
Cash – unrestricted	$	128	709	—	—	837
Investments – unrestricted		93,219	81,950	19,412	—	194,581
Restricted cash		12,154	6,780	—	—	18,934
Restricted investments		277,697	34,592	—	—	312,289
Accounts receivable, net of allowance for doubtful accounts of $587		13,614	6,628	—	—	20,242
Other receivables:						
Mass Highway		11,992	29	—	—	12,021
Other, net of allowance for doubtful accounts of $1,418		2,933	620	—	—	3,553
Total receivables		28,539	7,277	—	—	35,816
Prepaid expenses and other assets		3,276	5,737	—	—	9,013
Due from other funds		19,992	16,272	33	(36,297)	—
Total current assets		435,005	153,317	19,445	(36,297)	571,470
Noncurrent assets:						
Restricted investments		64,665	—	—	—	64,665
Capital assets, net		6,445,693	331,361	—	—	6,777,054
Prepaid expenses and other assets, long-term		9,840	1,229	—	—	11,069
Total assets	$	6,955,203	485,907	19,445	(36,297)	7,424,258

(Continued)

Schedule I

MASSACHUSETTS TURNPIKE AUTHORITY
(A Component Unit of the Commonwealth of Massachusetts)

Combining Schedule of Net Assets

June 30, 2008

(In thousands)

Liabilities	**Metropolitan Highway System**	**Western Turnpike**	**MTA General Fund**	**Eliminations**	**Combined totals**
Current liabilities:					
Accounts payable	$ 12,336	7,702	—	—	20,038
Accrued payroll and related taxes	528	2,302	—	—	2,830
Compensated absences	1,815	2,424	—	—	4,239
Current portion of long-term debt	31,990	17,245	—	—	49,235
Accrued expenses and miscellaneous liabilities	5,844	11,809	—	—	17,653
Contract retainage	583	388	—	—	971
Due to other funds	21,376	14,921	—	(36,297)	—
Payable from restricted assets:					
Accrued interest on bonds payable	54,894	4,507	19	—	59,420
Accrued arbitrage liability	2,501	—	—	—	2,501
Total current liabilities	131,867	61,298	19	(36,297)	156,887
Deposits and deferred revenue	66,503	6,898	—	—	73,401
Deferred credits	55,881	—	3,746	—	59,627
Compensated absences	3,205	4,929	—	—	8,134
Net OPEB obligation	590	1,859	—	—	2,449
Accrued interest on capital appreciation bonds	77,628	—	—	—	77,628
Long-term debt, net	2,115,895	144,392	—	—	2,260,287
Total liabilities	2,451,569	219,376	3,765	(36,297)	2,638,413
Net Assets					
Invested in capital assets, net of related debt	4,571,984	183,459	—	—	4,755,443
Restricted for other purposes	25,705	25,138	—	—	50,843
Unrestricted	(94,055)	57,934	15,680	—	(20,441)
Total net assets	$ 4,503,634	266,531	15,680	—	4,785,845

See accompanying independent auditors' report.

Schedule II

MASSACHUSETTS TURNPIKE AUTHORITY
(A Component Unit of the Commonwealth of Massachusetts)

Combining Schedule of Revenues, Expenses, and Changes in Net Assets

Period ended (18 Months) June 30, 2008

(In thousands)

	Metropolitan Highway System	Western Turnpike	MTA General Fund	Combined totals
Operating revenues:				
Toll revenue, net	$ 238,882	171,674	—	410,556
Restaurants, concessions, and service stations	—	25,606	—	25,606
Rentals	17,493	8,134	—	25,627
Court fines	2,974	5,095	—	8,069
Other	12,538	6,203	—	18,741
Total operating revenues	271,887	216,712	—	488,599
Operating expenses:				
Operations and public protection	113,852	95,265	—	209,117
Repair and reconstruction	20,366	12,825	—	33,191
General and administration	16,648	16,011	—	32,659
Fringe benefits	10,793	15,108	—	25,901
Retirement	6,992	12,985	—	19,977
Depreciation	172,641	32,047	—	204,688
Total operating expenses	341,292	184,241	—	525,533
Operating income (loss)	(69,405)	32,471	—	(36,934)
Nonoperating revenue and (expense):				
Investment income	34,314	5,863	1,381	41,558
Contract assistance	28,463	—	—	28,463
Insurance Settlement	10,000	—	—	10,000
Interest expense	(176,839)	(14,581)	410	(191,010)
Total nonoperating (expense) revenue, net	(104,062)	(8,718)	1,791	(110,989)
(Decrease) increase in net assets before Special item	(173,467)	23,753	1,791	(147,923)
Special item:				
Contributed capital assets	4,360,885	—	—	4,360,885
Increase (decrease) in net assets	4,187,418	23,753	1,791	4,212,962
Net assets, beginning of year	316,216	242,778	13,889	572,883
Net assets, end of year	$ 4,503,634	266,531	15,680	4,785,845

See accompanying independent auditors’ report.