



LOS ANGELES WORLD AIRPORTS
(Department of Airports of
the City of Los Angeles, California)
LOS ANGELES INTERNATIONAL AIRPORT

Financial Statements

June 30, 2005 and 2004

(With Independent Auditors' Reports Thereon)

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KPMG LLP
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Independent Auditors' Report

The Members
Board of Airport Commissioners
City of Los Angeles, California:

We have audited the accompanying financial statements of Los Angeles International Airport (LAX), a proprietary fund of the City of Los Angeles and a part of Los Angeles World Airports (Department of Airports of the City of Los Angeles, California) (LAWA), as of and for the years ended June 30, 2005 and 2004, as listed in the table of contents. These financial statements are the responsibility of LAX's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 LAX's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements referred to above are intended to present only the financial position of LAX and changes in its financial position and its cash flows. They do not purport to, and do not, present fairly the financial position of LAWA or the City of Los Angeles, California as of June 30, 2005 and 2004, the changes in their financial position or their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated November 10, 2005, on our consideration of LAX'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 controls over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The management's discussion and analysis on pages 3 to 14 and required supplemental pension information on page 37 are not required parts of the financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

Los Angeles, California
November 10, 2005

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Management's Discussion and Analysis

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This section presents Management's Discussion and Analysis (MD&A) of Los Angeles International Airport's (LAX) financial activities during the fiscal year ended June 30, 2005 and 2004. The discussion has been prepared by management and should be read in conjunction with the basic financial statements and the notes thereto, which follow this section.

LAX is operated by Los Angeles World Airports (LAWA), an independent and financially self-sufficient department of the City of Los Angeles, California. LAWA is an airport system comprised of four separate airports. LAWA also owns and operates Ontario International Airport (ONT), Van Nuys Airport (VNY), and Palmdale Regional Airport (PMD). The information presented is intended to be a narrative overview of LAX's financial statements as of and for the fiscal years ended June 30, 2005 and 2004. We encourage readers to consider this information in conjunction with the accompanying basic financial statements.

LAX is accounted for in an enterprise fund of the City of Los Angeles. The financial statements contained in this report are prepared in accordance with accounting principles generally accepted in the United States of America using the accrual basis of accounting. LAX applies Governmental Accounting Standards Board (GASB) pronouncements as well as Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins issued on or before November 30, 1989, unless such pronouncements conflict with or contradict GASB pronouncements. LAX recognizes the financial reporting model set forth in GASB 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and related GASB pronouncements and interpretations, and hereby presents its financial statements in conformance with such pronouncements.

Financial Highlights of Airport Activities

As with the rest of North America's air transportation system, LAX has been adversely affected by the terrorist events that occurred in the United States on September 11, 2001. Since those events, LAX has addressed heightened security concerns and has successfully implemented increased security controls and baggage screening as required by the Federal Government's new Transportation Security Administration (TSA). Due to the post-September 11th decline in airline activity for the fiscal year ended on June 30, 2002, LAX had experienced an approximate 16% reduction in passenger levels by June 30, 2003. Since that time, however, LAX has experienced limited improvement in the level of passenger activity. During fiscal year 2004, passenger traffic at LAX increased by 2.7 million passengers, or 4.9%, over fiscal year 2003 levels to 58.0 million. During fiscal year 2005, passenger traffic at LAX increased by 3.3 million passengers, or 5.7%, over fiscal year 2004 levels to 61.3 million.

Although passenger traffic has been slowly returning and operating revenues are anticipated to continue to recover, security expenses associated with the post-September 11th operating environment are anticipated to remain at increased levels for an indefinite period of time. The long-term results of this restructuring, however, remain unknown.

For the fiscal year ended June 30, 2005, LAX had income from operations of \$15.0 million, or 41.2% lower than the prior fiscal year of \$25.5 million. Although total operating revenues grew by \$18.5 million, or 4.0% to \$482.6 million, the growth was offset by the \$29.7 million, or 7.9%, increase in operating expenses, excluding depreciation and amortization.

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The largest component of the \$18.5 million growth in operating revenues came from concession revenues, which increased \$23.2 million, or 13.5%, over the prior fiscal year. The concession categories that contributed the most to growth in operating revenues include duty free sales and auto parking, which increased \$11.4 million and \$6.3 million, respectively. The increase in concession-related businesses was due primarily to the growth in passenger traffic. However, the growth in concession revenues was offset by a decline in miscellaneous revenues and aviation revenues of \$2.4 million and \$1.9 million, respectively.

During fiscal year 2005, LAX's operating and administrative expenses – excluding depreciation and amortization – increased \$29.7 million, or 7.9%, to \$408.0 million. The largest contributor to this growth in operating expenses was salaries and benefits with \$23.7 million, or 13.5% to \$199.2 million. Contractual services also increased by \$11.6 million, or 9.4%, to \$135.3 million for fiscal year 2005. Included in total operating expenses for fiscal year 2005 are \$53.3 million in incremental operating and capital security costs associated with the post-September 11th operating environment as discussed above. For fiscal year 2004, incremental operating and capital security costs, were \$45.5 million.

The change in net assets for fiscal year ended June 30, 2005 is \$144.8 million, which is 9.9%, or \$13.0 million higher than the prior fiscal year results of \$131.8 million. Offsetting the 41.2% decline in net income from operations was a \$30.9 million, or 30.5%, increase in net nonoperating revenues to \$132.4 million. Net income before capital grant contributions and interagency transfer was \$147.4 million, which is \$20.4 million, or 16.1%, higher than the \$127.0 million earned in fiscal year 2004.

In addition to the focus on post-September 11th security requirements, LAX continued to invest in the residential sound insulation program. Funding for this program, in which noise mitigation features impact affected homes, comes primarily from Passenger Facility Charges (PFC), collected from enplaned passengers at LAX. As of June 30, 2005, the PFC collection rate is \$4.50 per airline ticket at LAX. During fiscal year 2005, cumulative cash PFC collections increased by \$113.7 million to \$756.4 million.

Net Asset Summary

Fiscal Year 2005 Compared to 2004. Total net assets serve as an indicator of LAX's financial position. As of June 30, 2005, LAX's assets exceed liabilities by \$2,024.5 million for an increase of \$144.8 million, or 7.7%, over June 30, 2004.

Fiscal Year 2004 Compared to 2003. For the fiscal year ended June 30, 2004, LAX's assets exceed liabilities by \$1,879.8 million, which represented a \$131.8 million, or 7.5%, increase over June 30, 2003.

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A summary of LAX net assets for fiscal years (FY) 2005, 2004, and 2003 is shown below:

Summary Statement of Net Assets

(Dollars in thousands)

	FY2005	FY2004	FY2003
Assets:			
Current assets	\$ 718,195	638,067	582,417
Restricted assets	502,975	532,306	461,549
Capital assets, net	1,403,909	1,306,519	1,294,826
Deferred bond issuance expenses	3,139	3,440	3,669
Total assets	<u>2,628,218</u>	<u>2,480,332</u>	<u>2,342,461</u>
Liabilities:			
Current liabilities payable from unrestricted assets	72,728	57,942	65,019
Current liabilities payable	204,320	191,330	153,637
Long-term liabilities	326,634	351,308	375,810
Total liabilities	<u>603,682</u>	<u>600,580</u>	<u>594,466</u>
Net assets:			
Invested in capital assets, net of related debt	1,090,005	988,222	942,721
Restricted:			
Capital projects	153	147	271
Debt service	27,071	28,041	42,593
Special purpose	227,849	252,132	178,398
Unrestricted	679,458	611,210	584,012
Total net assets	<u>\$ 2,024,536</u>	<u>1,879,752</u>	<u>1,747,995</u>

Current Assets and Restricted Assets

Fiscal Year 2005 Compared to 2004. For fiscal year 2005, LAX current assets increased by \$80.1 million, or 12.6%, largely due to an increase in cash and pooled investments held by the City Treasurer of \$79.4 million. Restricted assets decreased in fiscal year 2005 by \$29.3 million, or 5.5%, to \$503.0 million primarily as a result of a net decrease of \$23.7 million in cash and securities lending transactions.

Fiscal Year 2004 Compared to 2003. For fiscal year 2004, LAX current assets increased by \$55.7 million, or 9.6%, largely due to an increase in unbilled receivables of \$32.3 million. The growth was caused mainly by the \$21.0 million landing fee calculation adjustment for fiscal year 2004, and \$10.5 million additional landing fees that were accrued in fiscal year 2004, instead of fiscal year 2003. Restricted assets increased in fiscal year 2004 by \$70.8 million, or 15.3%, to \$532.3 million primarily as a result of a net increase of \$73.8 million in cash and

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securities lending transactions, as well as a \$7.7 million increase in PFC receivables. The increase in restricted assets for fiscal year 2004 was partially offset by a decrease of \$14.0 million in investments with fiscal agents and interest receivable.

Capital Assets

Fiscal Year 2005 Compared to 2004. Capital assets at LAX increased by \$97.4 million, or 7.5%, due primarily to a \$118.4 million acquisition of residential property. Significant capital expenditures were also made for noise mitigation of \$18.6 million, and security capital projects of \$20.3 million. Most of the growth was offset by the increase in depreciation of \$59.7 million, or 7.8%.

Fiscal Year 2004 Compared to 2003. Capital assets at LAX increased by \$72.1 million, or 3.6%, due primarily to a \$24.8 million acquisition of residential property. Significant capital expenditures were also made for noise mitigation of \$13.5 million, and security capital projects of \$9.7 million. Most of the growth was offset by the increase in depreciation of \$60.4 million, or 8.5%, for a net increase of \$11.7 million, or 0.9%, in net capital assets.

Current Liabilities

Fiscal Year 2005 Compared to 2004. Current liabilities payable from unrestricted assets of \$72.7 million increased by \$14.8 million, or 25.5%, due largely to a \$12.8 million increase in contracts and accounts payable as a result of payment date timing differences at fiscal year-end. Current liabilities payable from restricted assets of \$204.3 million increased by \$13.0 million, or 6.8%, consisting of a growth of \$18.7 million in contracts and accounts payable accruals at year-end. This growth was offset by a \$3.7 million decrease in obligations under the City's securities lending program.

Fiscal Year 2004 Compared to 2003. Current liabilities payable from unrestricted assets of \$57.9 million decreased by \$7.1 million, or 10.9%, due largely to a \$5.5 million decrease in contracts and accounts payable as a result of payment date timing differences at fiscal year-end. Also contributing to the decrease in current liabilities was a \$3.7 million, or 74.2% decrease in salaries payable. Current liabilities payable from restricted assets of \$191.3 million, however, increased by \$37.7 million, or 24.5%, consisting of a growth of \$16.9 million in contracts and accounts payable accruals at year-end and a \$21.1 million increase in obligations under the City's securities lending program.

Long-Term Liabilities

Fiscal Year 2005 Compared to 2004. Long-term liabilities decreased by \$24.7 million, or 7.0%, primarily due to bond principal payments of \$22.4 million on the 1995 revenue bonds.

Fiscal Year 2004 Compared to 2003. Noncurrent liabilities decreased by \$24.5 million, or 6.5%, primarily due to bond principal payments of \$23.2 million on the 1995 revenue bonds.

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Highlights of Changes in Net Assets

The following table illustrates a condensed summary of changes in LAX's net assets for fiscal years 2005, 2004, and 2003:

Condensed Summary of Statement of Revenue, Expenses, and Change in Net Assets

(Dollars in thousands)

	<u>FY2005</u>	<u>FY2004</u>	<u>FY2003</u>
Operating revenue	\$ 482,642	464,137	422,677
Operating expenses, excluding depreciation and amortization	<u>407,953</u>	<u>378,234</u>	<u>346,498</u>
Income from operations before depreciation and amortization	74,689	85,903	76,179
Depreciation expense and amortization	<u>(59,710)</u>	<u>(60,432)</u>	<u>(49,936)</u>
Operating income	14,979	25,471	26,243
Other nonoperating revenue, net	<u>132,424</u>	<u>101,490</u>	<u>85,305</u>
Income before capital grants	147,403	126,961	111,548
Capital grant contributions	791	4,390	12,300
Inter-agency transfers	<u>(3,410)</u>	<u>406</u>	<u>—</u>
Change in net assets	144,784	131,757	123,848
Net assets at beginning of year	<u>1,879,752</u>	<u>1,747,995</u>	<u>1,624,147</u>
Net assets at end of year	<u>\$ 2,024,536</u>	<u>1,879,752</u>	<u>1,747,995</u>

Passengers

Fiscal Year 2005 Compared to 2004. Total passengers increased by approximately 5.7% in fiscal year 2005 to 61.3 million annual passengers at LAX when compared to the previous year. Immediately after September 11th, LAX experienced a significant reduction in passenger traffic that extended through the second quarter of fiscal year 2002. Passenger traffic levels began to recover during the last half of fiscal year 2002 and have continued to slowly regain during fiscal year 2003. Prior to the significant fluctuations experienced during fiscal year 2002, passenger traffic levels had remained relatively flat for several years due to the downturn in the local as well as the national economy. Future restructuring of the airlines industry could materially affect passenger traffic levels at LAX.

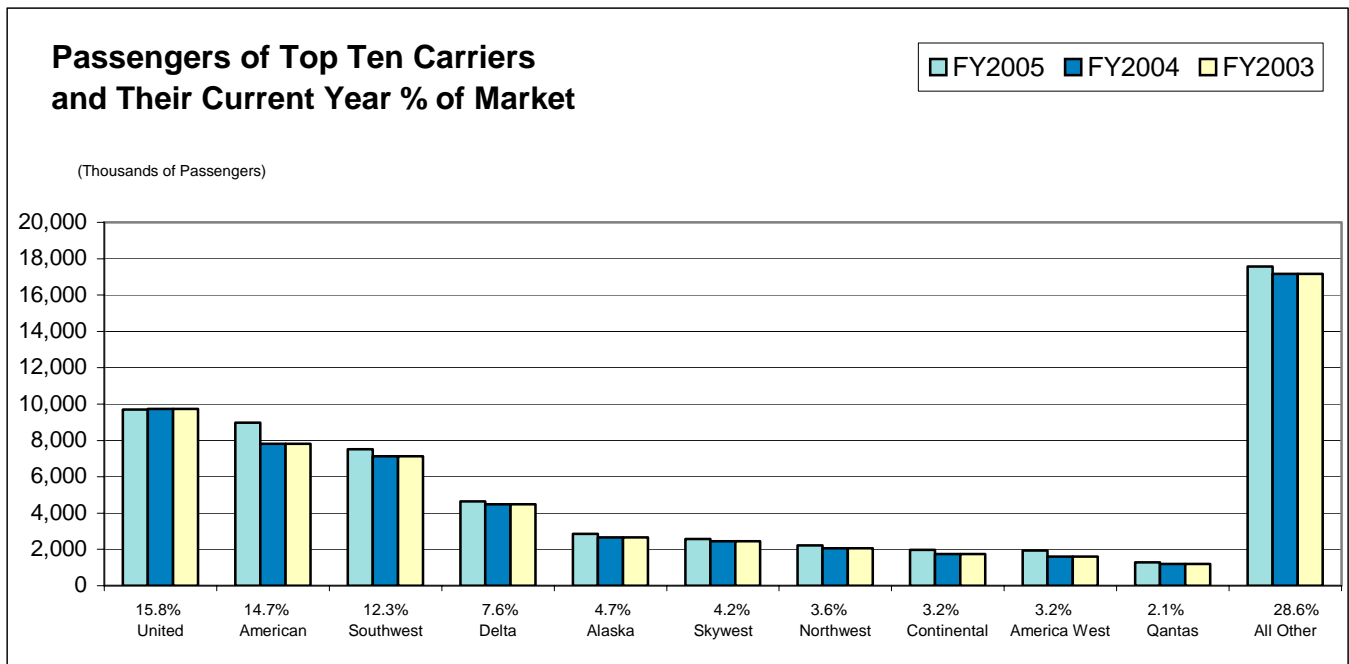
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Fiscal Year 2004 Compared to 2003. Total passengers increased by approximately 4.9% in fiscal year 2004 to 58.0 million annual passengers at LAX when compared to the previous year.

The following chart illustrates the top ten airlines at LAX by number of passengers for fiscal years 2005, 2004, and 2003:



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Operating Revenues

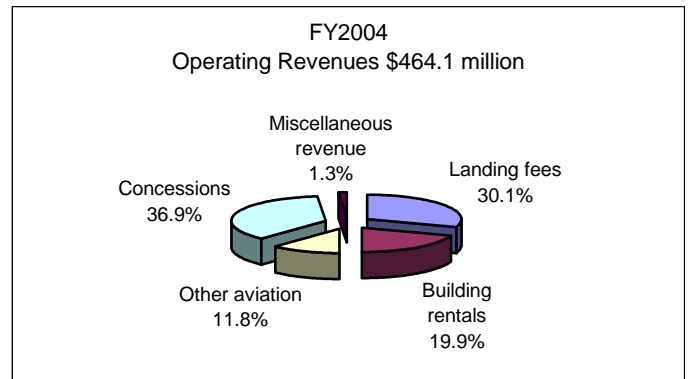
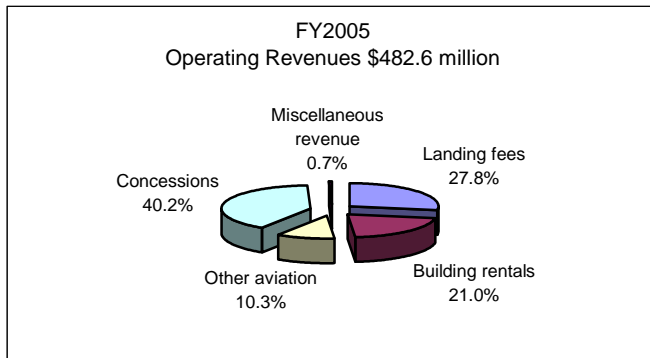
LAX derives its operating revenue from several major airport business activities. The following table illustrates a comparative summary of the major operating revenue categories for fiscal years 2005, 2004, and 2003:

Summary of Operating Revenues

(Dollars in thousands)

	<u>FY2005</u>	<u>FY2004</u>	<u>FY2003</u>
Aviation revenue:			
Landing fees	\$ 134,015	139,890	119,800
Building rentals	101,153	92,206	83,358
Other aviation revenue	49,876	54,875	45,296
Concession revenue	194,386	171,192	165,870
Airport sales and services	1,978	2,389	6,697
Miscellaneous revenue	1,234	3,585	1,656
Total operating revenue	<u>\$ 482,642</u>	<u>464,137</u>	<u>422,677</u>

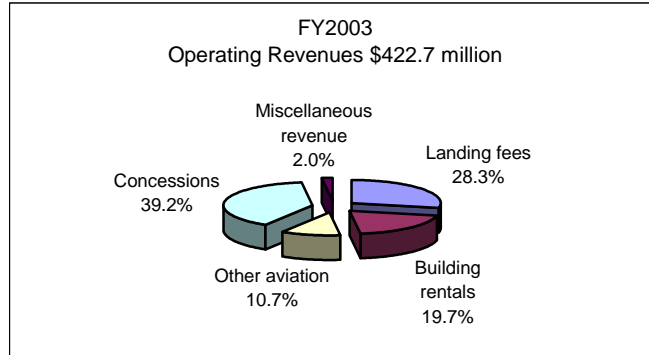
The following charts illustrate the distribution of the major sources of operating revenues for fiscal years 2005, 2004, and 2003:



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Fiscal Year 2005 Compared to 2004. During fiscal year 2005, total operating revenues increased by \$18.5 million, or 4.0%, due primarily to a \$23.2 million, or 13.5% increase in concession revenues to \$194.4 million. The growth in many categories of concession business was caused by the increase in passenger traffic. Duty free sales led the way by increasing \$11.4 million, or 58.2%, to \$31.1 million. Auto parking increased by \$6.3 million, or 10.6%, to \$66.3 million. In addition, there were smaller increases of about \$3.0 million each in luggage carts, rent-a-car revenues, and food and beverage.

The increase in concession revenues was offset by a \$1.9 million, or 0.7% decrease in aviation revenues to \$285.0 million. Although building and land rentals increased by \$8.9 million and \$3.0 million, respectively, TSA revenues and landing fees decreased by \$6.7 million and \$5.9 million, respectively. Other categories of aviation revenues decreased by smaller amounts, which contributed to the general revenue decline in this business area.

Fiscal Year 2004 Compared to 2003. During fiscal year 2004, total operating revenues increased by \$41.5 million, or 9.8%, due to increased activity on nearly every major revenue area of LAX business. Landing fees at LAX resulted with growth of \$20.1 million, or 16.8%, to \$139.9 million. Other aviation revenue increased by \$9.6 million, or 21.1%, to \$54.9 million primarily due to land rentals increasing by \$5.4 million, or 14.1%, to \$43.4 million. Negotiated increases in agreements for LAX building rentals resulted in a growth of \$8.8 million, or 10.6%, over the prior fiscal year. Additionally, LAX concession revenues increased by \$5.3 million, or 3.2%, to \$171.2 million.

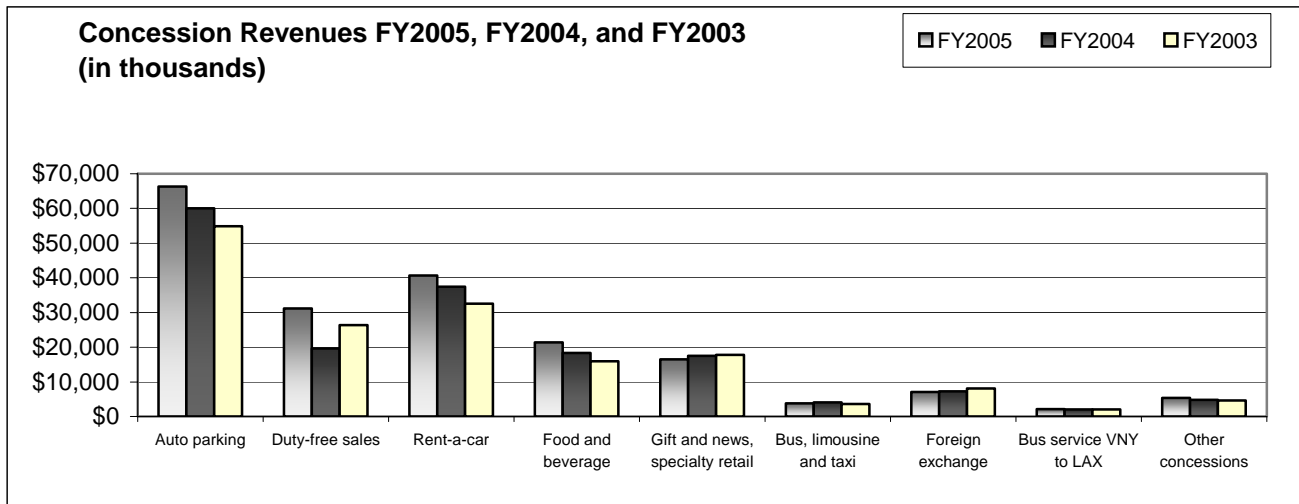
The general increase in passenger traffic at all airports resulted in increases in LAX concession revenues for fiscal year 2004, particularly from auto parking and rent-a-car services. For the fiscal year, auto parking at LAX increased by \$5.1 million, or 9.3%, to \$60.0 million, and revenues from rent-a-car services grew by \$4.9 million, or 15.1%, to \$37.4 million. Likewise, food and beverage revenues increased by \$2.4 million, or 15.0%, to \$18.4 million. These increases, however, were offset by a \$6.7 million, or 25.3%, decrease in duty free sales to \$19.7 million, indicating that the sales were very slow to return to the pre-September 11th levels. This is due to facility restrictions at all airport terminals caused entirely by increased airport security checkpoints and TSA baggage screening.

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The following chart illustrates the categories of concession revenues by type for fiscal years 2005, 2004, and 2003:



Operating Expenses

The following table illustrates a comparative summary of operating expenses in fiscal year 2005, 2004, and 2003:

Summary of Operating Expenses

(Dollars in thousands)

	<u>FY2005</u>	<u>FY2004</u>	<u>FY2003</u>
Salaries and benefits	\$ 199,238	175,493	149,963
Contractual services	135,313	123,692	117,627
Administrative expenses	3,970	2,909	2,103
Materials and supplies	37,692	36,178	38,717
Utilities	24,378	19,799	18,831
Advertising and public relations	8,820	6,527	5,006
Other operating expenses, net	(1,458)	13,636	14,251
Total operating expenses before depreciation	<u>407,953</u>	<u>378,234</u>	<u>346,498</u>
Depreciation and amortization	<u>59,710</u>	<u>60,432</u>	<u>49,936</u>
Total operating expenses	<u>\$ 467,663</u>	<u>438,666</u>	<u>396,434</u>

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Fiscal Year 2005 Compared to 2004. For fiscal year 2005, LAX operating expenses before depreciation and amortization increased by \$29.7 million, or 7.9%, over fiscal year 2004 to \$408.0 millions. The category showing the largest increase is LAX's salaries and benefits, which grew \$23.7 million, or 13.5%, over fiscal year 2004. There are several reasons for this increase. First, retirement contributions grew by \$8.2 million, or 55.8%, to \$22.9 million. Secondly, regular salaries and overtime increased \$6.0 million, or 4.0%, to \$155.0 million. Finally, City of Los Angeles contributions to health subsidy increased \$4.4 million, or 34.4%, to \$17.1 million.

Two other categories of operating expenses increased in fiscal year 2005: contractual services and incremental security costs. Contractual services increased \$11.6 million, or 9.4%, to \$135.3 million. Incremental costs associated with post-September 11th security measures at LAX increased \$7.8 million, or 17.1%, over fiscal year 2004 to \$53.3 million. This amount, which consists of LAX security-related capital and operating costs, is \$7.8 million more than the prior fiscal years amount of \$45.5 million. Given that heightened security measures have significantly impacted all areas of the travel and cargo handling industry, the complex business of running a major airport system more safely and securely, while effectively managing related costs, continues to be of paramount importance to LAX.

Fiscal Year 2004 Compared to 2003. For fiscal year 2004, LAX operating expenses, before depreciation and amortization, increased by \$31.7 million, or 9.2%, over fiscal year 2003 to \$378.2 million. The category showing the largest increase is LAX salaries and benefits, which grew \$25.5 million, or 17.0%, over the previous fiscal year. Four factors contribute primarily to this increase. First, regular salaries grew \$16.1 million, or 14.0%, to \$130.5 million. Second, City of Los Angeles contributions to health subsidy increased \$6.2 million, or 72.1%, to \$14.8 million. Third, retirement contributions increased \$5.4 million, or 62.7%, to \$14.1 million. And finally, overtime expenses grew by \$2.3 million, or 15.3%, to \$17.1 million. Partially offsetting the increase in salaries and benefits was a reduction of \$4.9 million in the accrual of health benefits. The growth in expenses for contractual services of \$6.1 million, or 5.2%, is due mainly to increased security costs at LAX from the City of Los Angeles, added surveillance equipment, and other third-party sources. Except for a slight decrease in materials and supplies, other categories of operating expenses at LAX have also increased an aggregate of \$3.3 million, or 12.7%.

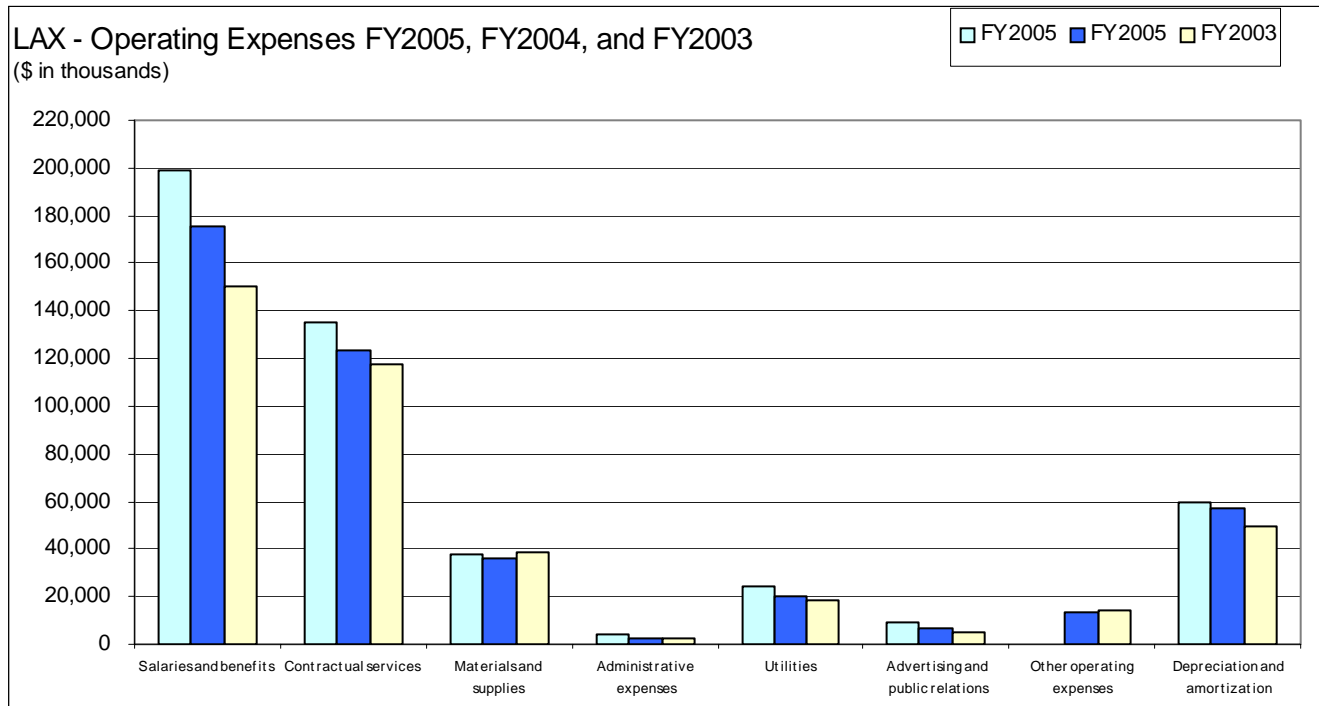
During fiscal year 2004 incremental security amounted to \$45.5 million. This amount is \$4.4 million more than prior fiscal year's restated amount of \$41.1 million.

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The following chart illustrates comparative growth in LAX's operating expenses by category for fiscal years 2005, 2004, and 2003:



Nonoperating revenue and expense

Nonoperating revenue and expense consist of transactions that are not normally associated with ongoing operations of LAX, but can be significant to the total change in net assets for the fiscal year. A substantial impact comes from collecting FAA approved Passenger Facilities Charges (PFC), the payment of debt-related interest, and the receipt of interest from the investment of cash.

Fiscal Year 2005 Compared to 2004. For fiscal year 2005, LAX recorded net nonoperating revenues of \$132.4 million, compared to \$101.5 million for the prior fiscal period. Of the total amount recorded, \$113.7 million came from PFC revenue, which is an increase of \$6.8 million, or 6.3%, from the prior fiscal year amount of \$107.0 million. The increase was primarily due to the increase in the passenger traffic.

During fiscal year 2005, the fair value of LAX's investments decreased by \$3.0 million. Also, interest income declined by \$1.2 million, or 3.9%, to \$28.7 million.

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Fiscal Year 2004 Compared to 2003. Nonoperating revenue and expense consist of transactions that are not normally associated with ongoing operations of LAX, but can be significant to the total change in net assets for the fiscal year. A substantial impact comes from collecting FAA-approved Passenger Facilities Charges (PFCs), payment of debt service interest, and receipt of interest from cash investment. For fiscal year 2004, LAX showed net nonoperating revenues of \$101.5 million, compared to \$85.3 million for the prior fiscal period. Of the total amount recorded, \$107.0 million came from PFC revenue, which is an increase of \$42.6 million, or 66.1%, from the prior fiscal year amount of \$64.4 million. During fiscal year 2004, the fair value of LAX investments decreased by \$21.7 million. Also during fiscal year 2004, interest income declined by \$4.0 million, or 11.7%, to \$29.8 million.

Income before Capital Grant Contributions

Fiscal Year 2005 Compared to 2004. Income before capital grant contributions and interagency transfers is \$147.4 million for the fiscal year 2005, 16.1% higher than the prior fiscal year's amount of \$127.0 million. During fiscal year 2005, LAX accrued \$1.0 million in capital grants for approved projects, which is \$3.6 million, or 82.0%, lower than the \$4.4 million earned in fiscal year 2004. LAX had a change in net assets of \$144.8 million. This is an increase of \$13.0 million, or 9.9%, over the prior fiscal year's amount of \$131.8 million. Net assets increased by 7.7% to \$2,024.5 million as a result of this change.

Fiscal Year 2004 Compared to 2003. Income before capital grant contributions and interagency transfers is \$127.0 million, 13.8% higher than the prior fiscal year amount of \$111.5 million. During fiscal year 2004, LAX accrued \$4.4 million in grant contributions for approved capital grant projects, which is \$7.9 million, or 64.3%, lower than the \$12.3 million earned in fiscal year 2003. LAX had a change in net assets of \$131.8 million. This is an increase of \$7.9 million, or 6.4%, over the prior fiscal year amount of \$123.8 million. Net assets increased by 7.5% to \$1,879.8 million as a result of this change.

Additional Information

As of the date of the auditors' report, there are no known facts, decisions, or conditions that are expected to have a significant effect on LAX's financial statements.

Further information on the results of LAX is provided in the accompanying audited financial statements and footnotes thereto for the fiscal years ended June 30, 2005 and 2004. This financial report is designed to provide LAWA and LAX customers, investors, and creditors with a general overview of LAX's financial condition and to present information about the money that it receives and spends for the fiscal years reported. If you have questions about this report, or need additional financial information, please contact the Los Angeles World Airports Financial Reporting Division at 7301 World Way West, 6th Floor, Los Angeles, California 90045. Also, you may find historical and other useful information regarding LAX and the other LAWA airports from our website at www.lawa.org.

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Statements of Net Assets

June 30, 2005 and 2004

(Dollars in thousands)

Assets	2005	2004
Current assets:		
Cash and pooled investments held by the City Treasurer (note 3)	\$ 552,847	473,404
Accounts receivable, net of allowance for uncollectible accounts of \$3,779 and \$2,327 in 2005 and 2004, respectively	23,782	31,526
Unbilled receivables	23,263	42,580
Federal grants receivable	—	6,363
Accrued interest receivable	5,466	4,938
Due from other agencies	110,460	77,376
Prepaid expenses and inventories	2,377	1,880
Total current assets	718,195	638,067
Noncurrent assets:		
Restricted assets:		
Cash and pooled investments held by the City Treasurer (note 3)	456,978	480,663
Investments with fiscal agents (note 3)	28,148	30,034
Federal grants receivable	—	4,390
Accrued interest receivable	3,119	2,792
Passenger facility charges receivable (note 12)	14,730	14,427
Total restricted assets	502,975	532,306
Capital assets (note 4):		
Land, land clearance, and air easements	597,755	479,353
Buildings, improvements, and equipment	1,308,432	1,272,219
Leased property	184,423	184,423
Less accumulated depreciation and amortization	(829,995)	(770,285)
Construction work in process	143,294	140,809
Net capital assets	1,403,909	1,306,519
Deferred bond issuance expenses	3,139	3,440
Total noncurrent assets	1,910,023	1,842,265
Total assets	2,628,218	2,480,332

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Statements of Net Assets

June 30, 2005 and 2004

(Dollars in thousands)

Liabilities	2005	2004
Current liabilities:		
Contracts and accounts payable	\$ 36,501	23,751
Employee benefits (notes 6 and 9)	9,117	8,854
Salaries payable	2,267	1,305
Commercial paper notes payable (note 5)	15,500	15,500
Current obligations under capital leases (notes 6 and 11)	912	855
Other liabilities (note 6)	8,431	7,677
	<u>72,728</u>	<u>57,942</u>
Current liabilities payable from unrestricted assets		
Current liabilities payable from restricted assets:		
Obligations under securities lending transactions	143,649	147,318
Bonds payable, plus net deferred credits and charges of \$850 in both 2005 and 2004 (note 5)	22,090	23,240
Contracts and accounts payable	37,410	18,685
Accrued bond interest payable	1,171	2,087
	<u>204,320</u>	<u>191,330</u>
Current liabilities payable from restricted assets		
Total current liabilities	<u>277,048</u>	<u>249,272</u>
Long-term liabilities:		
Bonds payable, plus net deferred credits and charges of \$8,152 and \$9,002 in 2005 and 2004, respectively (note 5)	238,022	260,112
Obligations under capital leases – less current portion (notes 6 and 11)	52,881	53,793
Employee benefits (notes 6 and 9)	17,365	19,037
Other liabilities (note 6)	18,366	18,366
	<u>326,634</u>	<u>351,308</u>
Total long-term liabilities		
Total liabilities	<u>603,682</u>	<u>600,580</u>
Net assets:		
Invested in capital assets, net of related debt	1,090,005	988,222
Restricted:		
Capital projects	153	147
Debt service	27,071	28,041
Special purpose	227,849	252,132
Unrestricted	679,458	611,210
	<u>679,458</u>	<u>611,210</u>
Total net assets	<u>\$ 2,024,536</u>	<u>1,879,752</u>

See accompanying notes to financial statements.

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Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2005 and 2004

(Dollars in thousands)

	2005	2004
Operating revenues:		
Aviation revenue:		
Landing fees	\$ 134,015	139,890
Building rentals	101,153	92,206
Other aviation revenue	49,876	54,875
Concession revenue	194,386	171,192
Airports sales and services	1,978	2,389
Miscellaneous revenue	1,234	3,585
Total operating revenues	482,642	464,137
Less operating expenses:		
Salaries and benefits	199,238	175,493
Contractual services (note 7)	135,313	123,692
Administrative expense	3,970	2,909
Materials and supplies	37,692	36,178
Utilities	24,378	19,799
Advertising and public relations	8,820	6,527
Other operating expenses, net	(1,458)	13,636
Total operating expenses before depreciation and amortization	407,953	378,234
Income from operations before depreciation and amortization	74,689	85,903
Less depreciation and amortization	(59,710)	(60,432)
Operating income	14,979	25,471
Nonoperating revenue (expenses):		
Passenger facility charges (note 12)	113,739	106,958
Interest income	28,668	29,825
Change in fair value of investments	(2,978)	(15,107)
Interest expense	(16,998)	(18,980)
Bond expense	(302)	(328)
Gain on sale of securities	3,867	988
Other nonoperating expenses	(29)	(2,159)
Other nonoperating revenues	6,457	293
Total nonoperating revenue, net	132,424	101,490
Income before capital grants	147,403	126,961
Capital grant contributions	791	4,390
Inter-agency transfer, net	(3,410)	406
Change in net assets	144,784	131,757
Net assets, beginning of year	1,879,752	1,747,995
Net assets, end of year	\$ 2,024,536	1,879,752

See accompanying notes to financial statements.

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Statements of Cash Flows

Years ended June 30, 2005 and 2004

(Dollars in thousands)

	2005	2004
Cash flows from operating activities:		
Receipts from customers	\$ 508,251	426,791
Payments for goods and services	(177,231)	(191,381)
Payments to employees	(199,685)	(180,355)
Other payments, net	(18,593)	(15,825)
	<u>112,742</u>	<u>39,230</u>
Net cash provided by operating activities		
Cash flows from noncapital financing activities:		
Inter-agency transfer in (out)	(3,410)	406
	<u>(3,410)</u>	<u>406</u>
Net cash provided by (used in) noncapital financing activities		
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(157,100)	(72,123)
Receipts from passenger facility charges	113,435	99,283
Principal paid on bonds	(22,390)	(23,160)
Interest paid on bonds	(17,552)	(18,510)
Principal paid on capital leases	(855)	(798)
Interest paid on capital leases	(1,212)	(812)
Cash transferred from fiscal agents	1,886	14,022
Payments for commercial paper issuance costs	—	(99)
Federal grants received	5,181	—
	<u>(78,607)</u>	<u>(2,197)</u>
Net cash used in capital and related financing activities		
Cash flows from investing activities:		
Decrease in fair value of investments	(2,978)	(15,107)
Interest received	31,680	32,846
Securities lending cash collateral received (paid)	(3,669)	21,085
	<u>25,033</u>	<u>38,824</u>
Net cash provided by investing activities		
Net increase in cash and cash equivalents	<u>55,758</u>	<u>76,263</u>
Cash and cash equivalents, beginning of year	<u>954,067</u>	<u>877,804</u>
Cash and cash equivalents, end of year	<u>\$ 1,009,825</u>	<u>954,067</u>
Cash and pooled investments held by the City Treasurer – unrestricted	\$ 552,847	473,404
Cash and pooled investments held by the City Treasurer – restricted	<u>456,978</u>	<u>480,663</u>
	<u>\$ 1,009,825</u>	<u>954,067</u>

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Statements of Cash Flows

Years ended June 30, 2005 and 2004

(Dollars in thousands)

	2005	2004
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 14,979	25,471
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	59,710	60,432
Change in provision for uncollectible accounts	1,452	428
Other noncash expenses, net	6,428	(1,868)
Changes in operating assets and liabilities:		
Accounts receivable	6,292	(5,032)
Unbilled receivables	19,317	(32,314)
Federal grants receivable – current	6,363	(6,363)
Prepaid expenses and inventories	(497)	(170)
Contracts and accounts payable	31,475	11,360
Employee benefits	(1,409)	(1,114)
Salaries payable	962	(3,748)
Other liabilities	754	2,831
Due to other agencies	(33,084)	(10,683)
	97,763	13,759
Net cash provided by operating activities	\$ 112,742	39,230

See accompanying notes to financial statements.

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(1) Organization and Reporting Entity

The financial statements of the Los Angeles International Airport (LAX) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP), as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The Los Angeles World Airports (Department of Airports of the City of Los Angeles, California) (LAWA) operates Los Angeles International Airport (LAX) as an independent, financially self-sufficient departmental component of the City of Los Angeles (the City). LAWA also operates Ontario International Airport (ONT), Van Nuys Airport, and Palmdale Regional Airport (collectively, the Airport System).

LAWA is under the management and control of a seven-member Board of Airport Commissioners (the Board) appointed by the City Mayor and approved by the City Council. Under the City Charter, the Board has the general power to, among other things: (a) acquire, develop, and operate all property, plant, and equipment as it may deem necessary or convenient for the promotion and accommodation of air commerce; (b) borrow money to finance the development of airports owned, operated, or controlled by the City; and (c) fix, regulate, and collect rates and charges for use of the Airport System. An executive director administers LAWA and reports to the Board.

The financial statements presented herein represent the financial position, changes in financial position, and cash flows of LAX only and are not intended to present fairly the financial position, changes in financial position, or the cash flows of LAWA or the City in conformity with accounting principles generally accepted in the United States of America.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

LAX is reported as an enterprise fund and maintains its records on the accrual basis of accounting. Under this method, revenues are recorded when earned, and expenses are recorded when the related liability is incurred. LAX applies all applicable Governmental Accounting Standards Board (GASB) pronouncements as well as Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins issued on or before November 30, 1989, unless such pronouncements conflict with or contradict GASB pronouncements.

(b) Cash and Pooled Investments

All cash collections are deposited with and all payments are withdrawn from the City Treasurer, with the exception of certain bond financing activity of LAX's outstanding bonds. In order to maximize investment return, LAX pools its available cash with that of the City, which is invested by the City Treasurer (see note 3).

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LAX's investments, including its share of the City's pooled investments, are stated at fair value. Fair value is determined based upon market closing prices or bid/asked prices for regularly traded securities. The fair value of mutual funds, government-sponsored investment pools, and other similar investments are stated at share value or appropriate allocation of fair value of the pool, if separately reported. Certain money market investments with initial maturities at the time of purchase of less than one year are recorded at cost, as the cost approximates market value.

Interest income arising from such cash and pooled investments is apportioned to LAX based on the relationship of LAX's respective daily cash balances to aggregate cash and pooled investments.

(c) *Accounts Receivable and Unbilled Receivable*

LAX recognizes revenue in the period earned. Receivables aged beyond 90 days are put into the collection process and then referred after 120 days to LAX's resident City Attorneys for collection and/or possible write-off. An allowance for uncollectible accounts is set as a reserve by LAX policy. This policy requires that 2% of outstanding receivables plus all referrals to City Attorney be reserved as uncollectible through a provisional month-end charge to operating expense. Accounts that are written-off get charged to the allowance account. Unbilled receivable balances are the result of revenue accrued for services that exceed \$5,000 each, but not yet billed.

(d) *Contracts Payable, Accounts Payable, and Other Liabilities*

All transactions for goods and services obtained by LAX from City approved contractors and vendors get processed for payment via its automated payment system. This procedure results in the recognition of expense in the period that an invoice for payment is processed through the system, or when a vendor first provided the goods and/or services. When LAX makes agreements that require customers to make cash deposits, these amounts are then reflected as other current liabilities. Reserves for claims and litigation are recorded as other long-term liabilities.

(e) *Securities Lending*

The City Treasurer engages in securities lending activities. LAX's share of assets and liabilities arising from the reinvested cash collateral has been recognized in the accompanying financial statements (see note 3).

(f) *Investments with Fiscal Agents*

LAX has funds that are held by fiscal agents and pledged to the payment or security of the 1995, 2002, and 2003 bonds (see note 3).

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(g) Federal Grants

Receipts from the federal government for approved grants are recorded as Capital Grant Contribution or Federal Grant Revenue, as appropriate, in the statements of revenues, expenses, and changes in net assets. Additionally, federal grant receipts from the Transportation Security Administration (TSA) are recorded in Aviation Revenue as part of Other Aviation Revenue.

(h) Capital Assets

Capital assets are carried at cost, or at estimated fair value on the date received in the case of properties acquired by donation or by termination of leases, less an allowance for accumulated depreciation. Such cost includes, when appropriate, interest capitalized as part of the cost of construction of fixed assets. Maintenance and repairs are charged to operations in the period incurred. Renewals and betterments are capitalized in the asset accounts. LAX has a capitalization threshold of \$5,000 for all capital assets.

(i) Landing Fees

Landing fee rates are used to determine what fees are to be charged to the airlines each time that a qualified aircraft lands at LAX. These fees are calculated using complex and unique allocation methods of relevant operating costs attributable to operational activities approved by the airlines. The type of landing fee method applied by LAX is compensatory. Under this fee methodology, the fees charged by LAX for a facility or service are based on costs attributable only to that facility, or service. For example, the landing fees charged for using the airfield and apron are based on LAX's actual costs of operating the airfield and apron. For control purposes, the landing fees are calculated twice each fiscal year.

(j) Concession Revenues

Concession revenue is generated through LAX concessionaires, or tenants, who pay monthly fees for using airport facilities to offer their goods and services to the general public and air traveling community. Payments to LAX are based on negotiated agreements with concessionaires to remit amounts based on either a Minimum Annual Guarantee (MAG), or on gross receipts. Amounts recorded to concession revenue are determined by the type of revenue category set up in the general ledger system and integrated with the monthly accounts receivable billing process. Concession revenue is recorded as it is earned. Some tenant agreements require self-reporting of concession operations and/or sales. The tenant's operations report and payment are due to LAX in the month following the activity. The timing of concessionaire reporting and when revenue earned is recorded will determine when accruals are required for each tenant.

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(k) *Bond Premiums, Discounts, and Issuance Costs*

Bond premiums and discounts, issuance costs, as well as gains and losses on extinguishments are deferred and amortized over the life of the bonds. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

(l) *Depreciation and Amortization*

Depreciation expense includes amortization of assets under capital leases. Depreciation and amortization are computed on the straight-line basis. The estimated useful lives of the major property classifications are as follows: buildings and facilities, 10 to 40 years; landplane ports, 10 to 35 years; and equipment, 5 to 20 years. No depreciation is provided for construction work in process until construction is completed and/or the asset is placed in service.

(m) *Preliminary Costs of Capital Projects*

Preliminary costs of capital projects incurred prior to the finalization of formal construction contracts are capitalized. In the event the proposed capital projects are abandoned, the associated preliminary costs are charged to expense in the year of abandonment.

(n) *Operating and Nonoperating Revenues and Expenses*

Operating revenues and expenses generally result from providing services, and producing and delivering goods in connection with LAX's principal ongoing operations. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. LAX derives operating revenues primarily from landing fees, terminal space rental, auto parking, and concessions. LAX's major operating expenses include salaries and employee benefits, fees for contractual services related to security and parking management, and other expenses such as maintenance, insurance, and utilities.

(o) *Interest Expense*

LAX capitalizes interest expense (net of interest earnings) for capital projects during construction. Interest expense for the years ended June 30, 2005 and 2004 was \$16,998,000 and \$18,980,000, respectively. There was no capitalized interest in 2005 and 2004.

(p) *Deferred Revenue*

Deferred revenue consists of concessionaire rentals and payments received in advance, which will be amortized to revenue on the straight-line basis over the applicable period.

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(q) *Employee Benefits*

LAX employees accumulate annual vacation and sick leave in varying amounts based on length of service. Vacation and sick leave are recorded as earned. Upon termination or retirement, employees are paid the cash value of their accumulated leave.

(r) *Allocation of Administrative Expenses*

A portion of administrative expenses incurred by LAWA has been allocated to LAX based on LAX's relative share of total operating expenses.

(s) *Statements of Cash Flows*

Cash and cash equivalents as reported in the statements of cash flows include short-term, highly liquid investments that are both readily convertible to known amounts of cash and have maturities of three months or less at the time of purchase. Cash and investments (both restricted and unrestricted) held by the City Treasurer are, in effect, demand deposits and are, therefore, considered to be cash equivalents.

(t) *Use of Estimates*

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

(u) *Reclassifications*

Certain reclassifications have been made to fiscal year 2004 amounts in order to conform to the fiscal year 2005 presentation.

(v) *Inventory*

LAX's inventory consists primarily of general office supplies and is recorded at cost on a first-in, first-out basis.

(w) *Inter-Departmental Transfers*

Amounts shown on the financial statements as inter-agency transfers reflect operational and other expenses incurred by Ontario, Palmdale, or Van Nuys airports but paid for by LAX. Generally, LAX does not receive reimbursement for these expenses from the other airports, and accordingly, records a transfer in an amount equal to the expenses incurred.

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(x) *Net Assets*

The accompanying financial statements utilize a net assets presentation. Net assets are categorized as follows:

- *Invested in Capital Assets, Net of Related Debt* – This category groups all capital assets into one component of net assets. Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction, or improvement of these assets reduce the balance in this category.
- *Restricted Net Assets* – This category presents external restrictions imposed by creditors, grantors, contributors, or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.
- *Unrestricted Net Assets* – This category represents net assets of LAX not restricted for any project or other purpose.

(y) *Accounting Change*

GASB Statement No. 40

On July 1, 2004, LAX adopted GASB Statement No. 40 (GASB 40), *Deposit and Risk Investment Disclosures an Amendment of GASB Statement No. 3*. GASB 40 requires specific disclosures if applicable for credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. It also modifies GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Purchase Agreements*, related to required disclosures of custodial credit risk of deposits and investments. See note 3 for disclosures.

(3) **Cash and Investments**

(a) *Cash and Pooled Investments*

Cash is deposited with the City Treasurer and generally invested in short-term investments under the City Treasurer's pooled investment program. The Los Angeles City Treasury Investment Procedures and Guidelines, established pursuant to the California Government Code and Los Angeles City Council action, govern the City's investment practices. The primary objectives of the City's investment policy are the safety of capital, the liquidity of the portfolio, and the yield on the investments. Investments permitted by the City's investment policy include obligations of the U.S. Government and agencies, certain commercial paper, bankers' acceptances, medium-term corporate notes, negotiable certificate of deposits, repurchase agreements, and state and local government pools (e.g., State Local Agency Investment Fund) up to certain specified allowable percentages.

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LAX's equity in the City Treasurer's pooled investment and securities lending programs consists of the following cash and investments, based on the relative percentages of such equity to the total of the City Treasurer's pooled funds (in thousands):

Description	2005	2004
Deposits	\$ 21,206	54,382
U.S. Treasury securities	100,982	113,534
Federal agency securities	563,482	502,793
Commercial paper	147,435	101,131
Medium-term corporate notes	168,641	148,835
State Local Agency Investment Fund	8,079	33,392
Total	1,009,825	954,067
Restricted portion	(456,978)	(480,663)
Unrestricted portion	\$ 552,847	473,404

The restricted portion represents cash and investments that are restricted as to use either by bond indenture requirements, actions of the Board, or the Federal Aviation Administration.

LAX's proportionate share of cash deposits was collateralized entirely with collateral held in the pledging bank's trust department or another financial institution. As defined in the California Government Code, all collateral other than mortgage collateral must have a fair value at all times of not less than 110% of the amount of deposit, while mortgage collateral must have a fair value of not less than 150% of the deposit. Such collateral is considered held in the City's name.

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(b) Investments Authorized by the City's Investment Policy

The table below identifies the investment types that are authorized for LAX by the City's investment policy. The table also identifies certain provisions of the City's investment policy that address interest rate risk, credit risk, and concentration of credit risk.

	<u>Maximum maturities</u>	<u>Maximum concentration</u>
U.S. Treasury and federal agency securities	5 years	100%
Bonds issued by local agencies	5 years	100
Registered state warrants and municipal notes	5 years	100
Bankers' acceptances	180 days	40
Commercial paper	270 days	40
Negotiable certificates of deposit or time deposits		
Yankee certificates of deposit		
CRA certificates of deposit or time deposits	180 days	30
Repurchase agreements	32 days	15
Reverse repurchase agreements	92 days	5*
Medium-term corporate notes	5 years	30
Shares of a money market mutual fund	N/A	20
Securities lending program	N/A	20
Asset-backed securities	5 years	20**
Collateralized mortgage obligations	5 years	20**
Local Agency Investment Fund (LAIF)		(per state limit)***

* The total of reverse repurchase agreements and the securities subject to a securities lending agreement may not exceed 20% of the total portfolio.

** Combined total for mortgage-backed and asset-backed securities.

*** Current account limit is \$40 million.

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(c) *City of Los Angeles Investment Pool*

At June 30, 2005, the investments held in the City Treasury's General and Special Investment Pool Programs and their maturities are as follows (in thousands):

Type of investments	Amount	Investment maturities			
		1 to 30 days	31 to 60 days	61 to 365 days	366 days to 5 years
U.S. Treasury notes	\$ 526,446	—	25,102	50,690	450,654
U.S. agencies	3,446,885	244,830	113,766	373,801	2,714,488
Medium-term notes	878,328	5,004	24,974	121,815	726,535
Commercial paper	861,293	844,318	16,500	475	—
State of California LAIF	40,703	40,703	—	—	—
Short-Term Investment Funds	9	9	—	—	—
Securities lending cash collateral:					
U.S. Treasury notes	478,756	—	26,219	52,812	399,725
U.S.	395,396	—	—	—	395,396
Total general and special pools	\$ 6,627,816	1,134,864	206,561	599,593	4,686,798

At June 30, 2005, LAX has \$1,009,825 invested in the City's Pool which represents approximately 17.51% of the City Treasury's General and Special Investment Pool.

Interest Rate Risk. The City's investment policy limits the maturity of its investments to a maximum of five years for U.S. Treasury and federal agency securities, medium-term corporate notes, and bonds issued by local agencies; 270 days for commercial paper; and 32 days for repurchase agreements.

Credit Risk. The City's investment policy requires that for all classes of investments, except linked banking certificates of deposits, the issuers must have minimum credit ratings as follows: Standard and Poor's Corporation (S&P) A-1/A; Moody's Investor Services (Moody's) P-1/A2; Fitch Ratings (Fitch), if available, F1/A. The City's investments in medium-term notes were rated A+ or better by S&P and A1 or better by Moody's, while investments in commercial paper were rated A-1+ by S&P, and P-1 by Moody's. As further required by the City's investment policy, all investments in medium-term notes and commercial paper were made with corporations that (a) operate within the United States, (b) have total assets in excess of \$500 million, (c) are organized in the United States as special purpose corporations, trust or limited liability companies, and (d) have program-wide credit enhancements. The State of California Local Agency Investment Fund is not rated.

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Concentration of Credit Risk. The City's investment policy does not allow more than 10% of its investment portfolio, except U.S. Treasury and federal agencies, to be invested in securities of a single issuer, including its related entities. The City's investment policy further provides for a maximum concentration limit of 30% on any individual federal agency or government-sponsored entity. The City's pooled investments comply with these requirements. GAAP requires disclosure of certain investments in any one issuer that represent 5% or more of total investments, the City does not have such investment.

(d) *City of Los Angeles Securities Lending Program*

LAX participates in the City of Los Angeles securities lending program. Under this program, the City lends investment securities to broker/dealers for collateral that will be returned for the same securities in the future. These activities are governed by a contractual agreement with the City's bank limiting the nature and amount of transactions subject to full collateralization. Collateral securities are initially pledged at 102% of the fair value of the securities lent, and additional collateral has to be provided by the next business day if its value falls to less than 101.5% of the fair value of the securities lent. Under the City's program, no more than 20% of the par value of the City's General Investment Pool shall be available for lending. Total cash collateral received by the City was \$874,152,310 and \$746,110,601 at June 30, 2005 and 2004, respectively. No noncash collateral was received by the City at June 30, 2005. Net revenues earned by the City on its securities lending program totaled \$1,160,093 and \$720,158 for the years ended June 30, 2005 and 2004, respectively. LAX's share of cash collateral received and corresponding liability aggregated approximately \$143,649,000 and \$147,318,000 at June 30, 2005 and 2004, respectively.

(e) *Investments with Fiscal Agents*

LAX also maintains investments with fiscal agents that are pledged to the payment or security of its 1995, 2002, and 2003 bonds. These investments are also generally invested in short-term investments under the control of the fiscal agents.

The investment practices of the fiscal agents are similar to those of the City Treasurer, with similar investment objectives. These investments are restricted as to their use and have maturities designed to coincide with required bond retirement payments.

These investments are uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in LAX's name.

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LAX's investments with fiscal agents are as follows (in thousands):

<u>Description</u>	<u>2005</u>	<u>2004</u>
Money market funds	\$ 4,689	4,240
U.S. Treasury securities	23,459	25,794
Total	<u>\$ 28,148</u>	<u>30,034</u>

(4) Changes in Capital Assets

Capital asset activity for the years ended June 30, 2005 is as follows (in thousands):

	<u>Balance at July 1, 2004</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance at June 30, 2005</u>
Capital assets, not depreciated:				
Land and land clearance	\$ 435,008	118,402	—	553,410
Air easements	44,345	—	—	44,345
Construction in progress	140,809	131,433	(128,948)	143,294
Total capital assets, not depreciated	<u>620,162</u>	<u>249,835</u>	<u>(128,948)</u>	<u>741,049</u>
Capital assets, depreciated:				
Buildings	512,693	—	—	512,693
Improvements	643,639	29,041	—	672,680
Equipment and vehicles	115,887	7,172	—	123,059
Leased property	184,423	—	—	184,423
Total capital assets, depreciated	<u>1,456,642</u>	<u>36,213</u>	<u>—</u>	<u>1,492,855</u>
Less accumulated depreciation:				
Buildings	(249,596)	(12,664)	—	(262,260)
Improvements	(349,126)	(32,079)	—	(381,205)
Equipment and vehicles	(95,653)	(5,095)	—	(100,748)
Leased property	(75,910)	(9,872)	—	(85,782)
Total accumulated depreciation	<u>(770,285)</u>	<u>(59,710)</u>	<u>—</u>	<u>(829,995)</u>
Total capital assets depreciated, net	<u>686,357</u>	<u>(23,497)</u>	<u>—</u>	<u>662,860</u>
Total capital assets, net	<u>\$ 1,306,519</u>	<u>226,338</u>	<u>(128,948)</u>	<u>1,403,909</u>

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Capital asset activity for the years ended June 30, 2004 is as follows (in thousands):

	<u>Balance at July 1, 2003</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance at June 30, 2004</u>
Capital assets, not depreciated:				
Land and land clearance	\$ 368,812	66,196	—	435,008
Air easements	44,345	—	—	44,345
Construction in progress	194,416	70,132	(123,739)	140,809
Total capital assets, not depreciated	<u>607,573</u>	<u>136,328</u>	<u>(123,739)</u>	<u>620,162</u>
Capital assets, depreciated:				
Buildings	511,473	1,220	—	512,693
Improvements	587,077	56,562	—	643,639
Equipment and vehicles	114,133	1,756	(2)	115,887
Leased property	184,423	—	—	184,423
Total capital assets, depreciated	<u>1,397,106</u>	<u>59,538</u>	<u>(2)</u>	<u>1,456,642</u>
Less accumulated depreciation:				
Buildings	(236,336)	(13,260)	—	(249,596)
Improvements	(310,475)	(38,651)	—	(349,126)
Equipment and vehicles	(89,957)	(5,696)	—	(95,653)
Leased property	(73,085)	(2,825)	—	(75,910)
Total accumulated depreciation	<u>(709,853)</u>	<u>(60,432)</u>	<u>—</u>	<u>(770,285)</u>
Total capital assets depreciated, net	<u>687,253</u>	<u>(894)</u>	<u>(2)</u>	<u>686,357</u>
Total capital assets, net	<u>\$ 1,294,826</u>	<u>135,434</u>	<u>(123,741)</u>	<u>1,306,519</u>

(5) Bonds and Commercial Paper Notes Payable

LAX issued revenue bonds in 1995, 2002, and 2003 for various airport improvement projects and to advance refund certain bonds. LAX's revenues are pledged as security for the bonds. In fiscal year 2003, LAWA issued \$217,175,000 of revenue bonds to fund LAX airport improvement projects and advance refund a portion of the 1995 bonds.

The 1995 Revenue Bonds were issued in the amount of \$365,855,000 to finance capital improvements and repay certain indebtedness. The bonds are limited obligations of the Department payable from and secured by a pledge of LAX revenues.

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The 2002 Series A Revenue Bonds, totaling \$32,450,000, were issued on December 19, 2002 to finance capital improvements. The bonds are limited obligations of the Department payable from and secured by a pledge of LAX revenues.

The 2002 Subseries C-1 and Subseries C-2 Subordinate Revenue Bonds, totaling \$57,400,000, were issued on December 19, 2002 to finance capital improvements. The bonds are limited obligations of the Department payable from and secured by a pledge of LAX revenues. The bonds are also secured by an irrevocable direct pay letter of credit from Landesbank Baden-Wuerttemberg, JP Morgan Chase Bank, and Bayerische Landesbank.

The 2003 Series A Subordinate Revenue Bonds, totaling \$23,700,000, were issued on February 26, 2003 to finance capital improvements. The bonds are limited obligations of the Department payable from and secured by a pledge of LAX revenues. The bonds are also secured by an irrevocable direct pay letter of credit from Landesbank Baden-Wuerttemberg, JP Morgan Chase Bank, and Bayerische Landesbank.

The 2003 Series B Revenue Bonds, totaling \$103,625,000, were issued on May 7, 2003 to advance refund a portion of the 1995 Revenue Bonds. The bonds are limited obligations of the Department payable from and secured by a pledge of LAX revenues. The difference in cash flows between the issued and the refunded bond was \$772,000, with an economic gain on the refunding of \$3,881,000. The amount of outstanding LAX revenue bonds at June 30, 2005 is \$251,110,000.

In fiscal year 2002, the Department implemented a commercial paper program to finance a portion of LAX's short-term borrowing needs as well as pay all or a portion of the principal of and interest on the notes when due, with a program authorization of \$300,000,000. The Commercial Paper Notes are secured by irrevocable direct pay letters of credit in the amount of \$163,500,000 from Landesbank Baden-Wuerttemberg, JP Morgan Chase, West LB, and Bayerische Landesbank. As of June 30, 2005, LAX issued \$15,500,000 in commercial paper notes. The commercial paper notes bear interest at a market rate at the date issued not to exceed 12% per annum.

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LAX revenue bonds mature in varying amounts through 2020. Bonds and commercial paper notes activity for the fiscal year ended June 30, 2005 is as follows (in thousands):

Debt issue	Interest rate%	Principal balance, July 1, 2004	Additions	Deductions	Principal balance, June 30, 2005	Due in one year
1995 Bonds	5.00% to 8.38% \$	56,325	—	(22,390)	33,935	21,240
2002 Series A	4.10 to 5.25	32,450	—	—	32,450	—
2002 Series C	1.75*	57,400	—	—	57,400	—
2003 Series A	1.77*	23,700	—	—	23,700	—
2002 Series B	4.00 to 5.00	103,625	—	—	103,625	—
Subtotal		273,500	—	(22,390)	251,110	21,240
Commercial paper	1.80*	15,500	—	—	15,500	15,500
Deferred charges and credits, net		9,865	—	(863)	9,002	850
Total		\$ 298,865	—	(23,253)	275,612	37,590

* Average variable rate.

Bonds and commercial paper notes activity for the fiscal year ended June 30, 2004 is as follows (in thousands):

Debt issue	Interest rate %	balance, July 1, 2003	Additions	Deductions	balance, June 30, 2004	Due in one year
1995 Bonds	5.00% to 8.38% \$	79,485	—	(23,160)	56,325	22,390
2002 Series A	4.10 to 5.25	32,450	—	—	32,450	—
2002 Series C	3.50	57,400	—	—	57,400	—
2003 Series A	3.60	23,700	—	—	23,700	—
2002 Series B	4.00 to 5.00	103,625	—	—	103,625	—
Subtotal		296,660	—	(23,160)	273,500	22,390
Commercial paper	Variable	15,500	—	—	15,500	15,500
Deferred charges and credits, net		10,719	—	(854)	9,865	850
Total		\$ 322,879	—	(24,014)	298,865	38,740

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Future annual debt service requirements, excluding commercial paper, are as follows (in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Fiscal year ending June 30:			
2006	\$ 21,240	11,192	32,432
2007	11,820	10,351	22,171
2008	12,415	9,750	22,165
2009	13,050	9,124	22,174
2010	13,705	8,465	22,170
2011 – 2015	79,625	31,227	110,852
2016 – 2020	99,255	11,859	111,114
Total	<u>\$ 251,110</u>	<u>91,968</u>	<u>343,078</u>

(6) Other Long-Term Liabilities

Other long-term liabilities activity for the year ended June 30, 2005 is as follows (in thousands):

	<u>Balance at July 1, 2004</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance at June 30, 2005</u>	<u>Due in one year</u>
Employee benefits	\$ 27,891	5,750	(7,159)	26,482	9,117
Capital lease obligation (note 11)	54,648	—	(855)	53,793	912
Other liabilities	26,043	11,888	(11,134)	26,797	8,431
Total	<u>\$ 108,582</u>	<u>17,638</u>	<u>(19,148)</u>	<u>107,072</u>	<u>18,460</u>

Other long-term liabilities activity for the year ended June 30, 2004 is as follows (in thousands):

	<u>Balance at July 1, 2003</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance at June 30, 2004</u>	<u>Due in one year</u>
Employee benefits	\$ 29,005	14,987	(16,101)	27,891	8,854
Capital lease obligation (note 11)	55,446	—	(798)	54,648	855
Other liabilities	23,211	9,063	(6,231)	26,043	7,677
Total	<u>\$ 107,662</u>	<u>24,050</u>	<u>(23,130)</u>	<u>108,582</u>	<u>17,386</u>

(7) Related Party Services

The City provides certain administrative, emergency response, and police services, as well as water and power service to LAX. The payments for these services, included in operating expenses for the years ended June 30, 2005 and 2004, were \$42,330,000 and \$50,059,000, respectively. The amount of \$1,018,000, which was accrued for City services, was due and payable at June 30, 2005, while none at June 30, 2004.

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In addition, LAX collects parking taxes on behalf of the City. Parking taxes collected and remitted to the City were \$6,781,000 and \$5,971,000 for the years ended June 30, 2005 and 2004, respectively.

The amounts reported as due from other agencies of \$110,460,000 and \$77,376,000 as of June 30, 2005 and 2004, respectively, represent cash advanced to Van Nuys Airport and Palmdale Regional Airport for their operations.

(8) Retirement System

(a) Retirement Plan Description

All full-time employees of LAX are eligible to participate in the City Employees' Retirement System of the City of Los Angeles, California (the System), a single employer defined benefit pension plan. The System serves as a common investment and administrative agent for various City departments and agencies that participate in the System. LAX makes contributions to the System for its pro rata share of retirement costs attributable to its employees.

The System provides retirement, disability, and death benefits based on the employees' years of service, age, and final compensation. Employees with ten or more years of service may retire if they are at least 55 years old. Normal retirement allowances are reduced for employees under age 60 at the time of retirement, unless they have 30 or more years of service and are age 55 or older. Employees age 70 or above may retire at any time with no required minimum period of service. The System does not have a mandatory retirement age and none of the LAX's employees are required to contribute to the System under state statute.

Covered employees contribute to the System at a rate established through the collective bargaining process for those whose membership began prior to February 1, 1983 and at a fixed rate of 6% of salary for those who entered membership on or after February 1, 1983. The City contributes the remaining amounts necessary to pay benefits when due, as determined by the actuarial consultant of the System. LAX's share of such contributions, based on LAX's salaries relative to total salaries for LAWA as a whole, was \$18,998,000, \$10,180,000, and \$6,072,000 for the years ended June 30, 2005, 2004, and 2003, respectively.

(b) Funding Status and Progress

The "pension benefit obligation" is a standardized disclosure measure that results from applying actuarial assumptions to estimate the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, to be payable in the future as a result of employee service to date. The measure is intended to help users assess the funding status of the fund to which contributions are made on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among employers. The measure is the actuarial present value of credited projected benefits and is independent of the funding method used.

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The System does not make separate measurements of assets and pension benefit obligation for individual entities of the City. Using the most recent available data from the City, the following information is provided:

The pension benefit obligation has been computed for the System as a whole as part of an actuarial valuation performed as of June 30, 2001, the date of the latest actuarial valuation of System pension benefits, but reflects all plan amendments adopted through June 30, 2005. The valuation was performed using the projected-unit-credit-cost method using the following significant actuarial assumptions:

- A rate of return on the investment of present and future assets of 8% per year compounded annually
- Annual cost-of-living increases of 3% for retirees
- Total annual payroll increases of 4%
- Annual salary increases for individuals that vary by age averaging 4% per year over a full 30-year career.

The total unfunded pension benefit obligation applicable to the System as a whole was \$1,492,000 at June 30, 2004 as follows (in thousands):

Total pension benefit obligation	\$	8,534,000
Actuarial value of available plan assets		(7,042,000)
		<u>1,492,000</u>
Unfunded pension benefit obligation	\$	<u>1,492,000</u>

(c) Actuarially Determined Contribution Requirements and Contributions Made

The System's funding policy provides for actuarially determined periodic contributions at rates such that sufficient assets will be available to pay benefits when due. The contribution rate for normal cost is determined primarily by using the projected-unit-credit-cost method to amortize the unfunded actuarial accrued liability over the period ending June 30, 2010. The significant actuarial assumptions used to compute the actuarially determined contribution requirement are essentially the same as those used to compute the pension benefit obligation. Using the most recent available data from the City, the following information is provided:

Total annual pension costs for the City were \$159,083,000, \$51,604,000, and \$32,296,000 for the years ended June 30, 2004, 2003, and 2002, respectively, representing 100% of annual required contributions for each year.

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Other contribution information and ten-year historical trend information can be found in the System's Comprehensive Annual Financial Report (CAFR). This CAFR can be obtained from the Los Angeles City Employees' Retirement System (LACERS), 360 E. Second Street, 8th Floor, Los Angeles, California 90012.

(d) Required Supplemental Information (Unaudited)

The following represents the Los Angeles City Employees' Retirement System Schedule of Funding Progress, separate information for LAX was not available (in thousands):

Valuation date (June 30)	Actuarial accrued liability (AAL)*	Actuarial value of assets	Unfunded (over funded) AAL	Funded ratio	Covered payroll	AAL as a % of covered payroll
2004	\$ 8,533,864	7,042,108	1,491,756	82.5%	\$ 1,575,285	94.7%
2003	7,659,846	6,999,647	660,199	91.4	1,405,058	47.0
2002	7,252,118	7,060,188	191,930	97.4	1,334,335	14.4

* Actuarial accrued liability (AAL).

(e) Other Postemployment Benefits

LAX, as a participant in the System, also provides a Retiree Health Insurance Premium Subsidy. Under Division 4, Chapter 11 of the City's Administrative Code, certain retired employees are eligible for this health insurance premium subsidy. This subsidy is to be funded entirely by the City. Employees with ten or more years of service who retire after age 55, or employees who retire at age 70 with no minimum service requirement, are eligible for a health premium subsidy with a City-approved health carrier. The System is advance funding the retiree health benefits on an actuarial determined basis. Amounts contributed specifically to the Retiree Health Insurance Premium Subsidy by LAX alone are not available.

From the data made available by the City at June 30, 2004, the total active plan participants were 27,092 for LACERS and 24,431 for pensions. As of June 30, 2005, the date of the latest actuarial valuation of the City's Retiree Health Insurance Premium Subsidy, the total unfunded health benefit subsidy applicable to the System as a whole was approximately \$561,000,000 as follows (in thousands):

Total health benefit liability	\$ 1,420,000
Reserve for health benefits	<u>(859,000)</u>
Unfunded benefit liability	<u><u>\$ 561,000</u></u>

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(9) Self-Insurance

LAX is part of the City's self-administered and self-funded workers' compensation system. Claims and judgments are recorded when it is probable that an asset has been impaired or a liability has been incurred and the amount of loss can be reasonably estimated. The liability for workers' compensation claims includes a provision for incurred but not reported claims and loss adjustment expenses.

Payments to the Workers' Compensation Division of the City Personnel Department have been made based on cash payments for workers' compensation claims. LAX's estimated liability for workers' compensation claims is based on the results of an independent actuarial study and has been allocated to LAX based on a ratio of LAX salaries to total LAWA salaries.

A rollforward of the accrued workers' compensation liability (included in employee benefits liability within note 6) is as follows (in thousands):

Liability at June 30, 2003	\$	14,604
Provisions for claims		14,133
Claim payments		<u>(5,309)</u>
Liability at June 30, 2004		23,428
Provisions for claims		5,001
Claim payments		<u>(4,778)</u>
Liability at June 30, 2005		23,651
Current portion		<u>(6,393)</u>
Long-term liability at June 30, 2005, net of current portion	\$	<u><u>17,258</u></u>

The LAWA Risk Management Division oversees a self-administered Risk and Claims Management program. Claims are administered in-house by a dedicated team of Analysts who will manage and direct a claim/lawsuit until resolved. LAWA Risk Management (in cooperation with its contracted broker of record) is responsible for placing General Liability insurance policies (including a War and Terrorism policy) up to the policy limits of \$1.0 billion. Additional lines of insurance include General Property Insurance, with policy limits of \$1.7 billion, Boiler and Machinery coverage and Earthquake insurance. These insurance limits are excess of LAWA's self-insured retention (deductible) which for liability insurance is \$10,000 per claim and a \$300,000 aggregate and \$100,000 per occurrence and aggregate retention on Property insurance. The self-insured retention for both Property and Liability insurance as well as the purchase of all insurance policies is budgeted and funded annually by the Risk Management Division. Historically, no liability or property claims have reached or exceeded the stated policy limits.

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LAWA also continues to maintain a catastrophic loss fund that is held in reserve to fund claims or losses that may conceivably breach insurance policy limits. The transference of risk exposure through the procurement of liability and property insurance has proven to be a very effective program for LAWA.

(10) Commitments and Contingencies

As of June 30, 2005, a number of claims and lawsuits are pending against LAX that arose in the normal course of operations. LAX recognizes a liability for claims and judgments when it is probable that an asset has been impaired or a liability has been incurred and the amount of loss can be reasonably estimated. The following is a summary of certain matters related to LAX's operations.

(a) Services and Reimbursements

Air Transport Association of America v. City of Los Angeles. City of Los Angeles Department of Airports, and Los Angeles Board of Airport Commissioners, Formal Complaint No. 13-95-05 (Federal Aviation Administration); and *Aircraft Owners and Pilots Association v. City of Los Angeles*, City of Los Angeles Department of Airports, and Los Angeles Board of Airport Commissioners, Formal Complaint No. 13-95-09 (Federal Aviation Administration) – two nearly identical administrative proceedings involving formal complaints filed in March and June 1995 are pending before the Secretary. These proceedings concern a transfer to the City's General Fund in the amount of approximately \$58 million (plus any accrued interest). The actions challenge the transfer of funds related to a condemnation award received from the state of California in connection with real estate acquired by the state for the Century Freeway Project. The complainants, the ATA, and Aircraft Owners and Pilots Association, allege that the transfer is a violation of the Airport and Airways Improvement Act of 1982 (AAIA) governing the use of airport revenues and certain grant assurances executed pursuant to AAIA.

The complainants seek an order barring the City from expending the funds for nonairport uses, directing the City to repay to LAWA amounts already transferred, suspending LAX's eligibility for grant funds pending compliance with its grant assurances and imposing a civil penalty of \$50,000. The Federal Aviation Administration (the FAA) failed to act on the complainants' request for a preliminary ruling that the City be barred from using the funds while proceedings are pending. Answers to both complaints have been filed. In December 1995, the FAA denied respondents' motion to dismiss the complaints. There has been no decision by the FAA as to whether or not to institute an investigation on the complaints or to hold full hearings.

(b) Environmental Issues

Through the normal course of operations, LAWA and its facilities are subject to potential environmental contamination and other environmental concerns. Accordingly, LAWA has established a comprehensive hazardous materials management plan for all facilities under its control. This plan calls for the evaluation of all property utilized by LAWA and the environmental cleanup of any sites found to be contaminated. This evaluation has not been completed to date.

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LAWA bears the financial responsibility for the cleanup of environmental contamination on property owned by it. However, LAWA believes that if the contamination originated based on contractual arrangements, the primary responsibility for any such cleanup would be borne by the tenants, even if they declare bankruptcy. LAWA, as property owner, however, assumes the ultimate responsibility for cleanup of such contamination in the event that the tenant is unable to make restitution. As a result of the hazardous materials management plan noted above, LAWA has already begun cleanup on several sites, is in the process of implementing additional safeguards to prevent additional hazardous substance contamination, and is completing the environmental evaluation of LAWA's facilities. However, the extent of the cleanup and/or the ability of the original tenants to reimburse LAWA for such cleanup cannot be determined at the present time. Therefore, it is reasonably possible that losses could be incurred; however, until such matters are resolved, the range of loss, if any, cannot be reasonably estimated.

(c) ***Other***

Commitments for construction, the purchase of real property, equipment, and materials and supplies amounted to \$24,179,000 and \$34,621,000 as of June 30, 2005 and 2004, respectively.

(d) ***Terrorist Activities***

LAX, like the rest of the North American air transportation system, has been adversely affected by the terrorist attacks that occurred in the United States on September 11, 2001 (the September 11 Events). As a result of the September 11 Events, there was a temporary suspension of air carrier operations in the United States, including operations at LAX. Since the September 11 Events, due in part to the September 11 Events and in part to the slowdown in the national economy, significant declines have been experienced in aviation activity and enplaned passenger traffic, as well as in activity-based revenues consisting primarily of landing fees, passenger facility charges, concession revenues, and parking revenue. For the calendar year ended December 31, 2005, LAX experienced a 9.1% reduction in passenger levels and a 20.2% reduction in air traffic movements compared to the 12 months preceding September 11 events. Aviation activity was also affected by the hostilities in Iraq and the outbreak of Severe Acute Respiratory Syndrome (SARS).

As part of its program of proactively addressing heightened security concerns and requirements, LAX has engaged in a review of its rates and charges, and has implemented revenue enhancements and expenditure controls that affect a variety of operating expenses. LAX's capital improvement program was also reevaluated and many such expenditures were suspended, except where the affected projects were near completion or essential from a security or safety standpoint.

Reductions in operating levels at LAX from those which existed prior to the September 11 Events may continue for a period of time and to a degree that is uncertain. The future level of aviation activity and enplaned passenger traffic at LAX will depend upon several factors directly and indirectly related to the September 11 Events, including, among others, the financial condition of individual airlines and the viability of continued service. A number of airlines were experiencing economic difficulties prior to the September 11 Events.

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The financial situation for most airlines has improved in fiscal year 2005 due to modest increase in passenger volume. However, several airlines still filed for bankruptcy during the fiscal year, including U.S. Airways, Varig Airlines, and Aloha Airlines. The bankruptcy case against United Airlines (UA) is still pending with the court. UA is the largest revenue provider for LAX, which accounted for 8.3% of revenues and 15.8% of total passengers.

LAWA is unable to predict (i) the duration of current reduced air traffic volume, (ii) the long-term impact of the above-described events on costs and revenues of LAWA, (iii) the future financial condition of the airlines using LAWA's airports, or (iv) the likelihood of future incidents of terrorism or other air transportation disruptions.

(11) Capital Leases Payable

During the prior years, LAX entered into various lease agreements with certain airlines. These agreements are classified as capital leases and are for certain public areas at LAX. The agreements generally provide for the payment of amounts over various terms between 27 and 35 years, with interest at the rate incurred by the lessor on their related borrowings, which include improvement bonds. Property capitalized under these lease agreements amounted to \$184,423,000 at June 30, 2005 and 2004. Accumulated depreciation with respect to such property for the respective years aggregated to \$85,781,000 and \$75,910,000.

Estimated future minimum lease payments under these agreements are as follows (in thousands):

Fiscal year ending June 30:		
2006	\$	2,905
2007		2,985
2008		3,061
2009		3,076
2010		3,146
2011 – 2015		17,166
2016 – 2020		20,376
2021 – 2025		25,172
2026 – 2027		3,604
Total minimum lease payments		81,491
Less interest portion		(27,628)
Present value of minimum lease payments	\$	53,863

LAX currently uses rental credits to finance its obligations on capital leases with LAX TWO Corporation. These rental credits are applied as an offset of amounts owed to LAX by the corporation for terminal leases and landing fees.

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(12) Passenger Facility Charges

In 1990, Congress approved the Aviation Safety and Capacity Expansion Act, which authorized domestic airports to impose a Passenger Facility Charge (PFC) on enplaning passengers. In May 1991, the FAA issued the regulations for the use and reporting of PFCs. PFCs may be used for airport projects that must meet at least one of the following criteria: (1) preserve or enhance safety, security, or capacity of the national air transportation system, (2) reduce noise or mitigate noise impacts resulting from an airport, or (3) furnish opportunities for enhanced competition between or among carriers.

In April 1993, the FAA approved LAWA's application to collect PFCs at LAX for specifically approved airport improvement projects. The collection authority was for \$360,000,000 for five years. Effective July 1, 1993, LAWA began collecting PFCs in the amount of \$3 per passenger. In 1996, LAWA received approval to transfer a portion of PFC revenue collected at LAX to fund projects at Ontario. Effective January 1, 1996, the FAA approved LAWA's amended application to cease PFC collections at LAX after collecting approximately \$152,600,000.

In May 1996, the FAA approved LAWA's request to transfer a portion of PFC revenues collected at LAX to fund approved projects at Ontario. Accordingly, PFC charges totaling \$126,090,000 imposed and collected at LAX have been transferred for Ontario's project expenditures as of June 30, 2002. There were no additional collections at LAX transferred to ONT for the years ended June 30, 2005 and 2004.

In November 1997 and April 1998, the FAA approved LAWA's application to impose PFCs at LAX and Ontario, respectively, for noise mitigation projects. LAWA began collecting PFCs in the amount of \$3 per passenger effective February 1, 1998 and July 1, 1998 at LAX and Ontario, respectively. Approved collections at LAX of \$150,000,000 are to be used for the soundproofing of City of Los Angeles residences and sound insulation of nearby residences. Approved collections of \$45,680,000 at Ontario are to be used for land acquisition and sound insulation of the City of Ontario residences. Of the Ontario-approved PFC, an estimated \$33,680,000 will be used to reimburse LAX for funds previously utilized to acquire land for Ontario.

In October 2, 1998, the FAA approved LAWA's application to amend PFCs at LAX for noise mitigation projects. The amendment increased the total approved PFC revenue from \$150,000,000 to \$440,000,000. The noise mitigation project was modified to decrease residential soundproofing in the City of Los Angeles and to increase the amount of land to be acquired for noise mitigation purposes.

Effective August 1, 2003, the FAA approved an increase to the PFC charge at LAX from \$3.00 to \$4.50.

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The PFC funds are recognized on the accrual basis of accounting and the funds collected are restricted and may be used on specifically approved projects. Due to their restricted use, PFCs are categorized as nonoperating revenues. All funds collected must be maintained in an interest-bearing account with the City Treasurer prior to disbursement. Cumulative PFC collections and the related interest received as reported to the FAA as of June 30, 2005 and 2004 were as follows (in thousands):

	2005	2004
Amount collected	\$ 756,402	642,967
Interest received	68,062	60,827
Cumulative PFC collections	\$ 824,464	703,794

Collected but unexpended PFC revenue is included on the statement of net assets as restricted cash and pooled investments held by the City Treasurer. Related accrued interest income and PFC receivables are also reported as restricted assets.

(13) Subsequent Events

Bankruptcy Filing of Delta and Northwest Airlines

On September 14, 2005, Delta, the nation's No. 3 airline, and Northwest, the No. 4 carrier, filed for bankruptcy. Both cited the spike in jet fuel costs at that time, which had soared nearly 20% since June 1, 2005, as prime reasons for seeking protection from creditors under Chapter 11 of federal bankruptcy laws.

Delta and Northwest provided 7.6% and 3.6%, respectively, of passenger activity at LAX during fiscal year 2005. A reserve has been established to account for potential losses on prepetition accounts receivable outstanding as of June 30, 2005. Management believes that their bankruptcy filing will not have a significant impact on LAWA's financial statements.

COMPLIANCE SECTION



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**Independent Auditors' Report on Internal Control
over Financial Reporting and on Compliance and Other Matters Based on an
Audit of Financial Statements Performed in Accordance
with *Government Auditing Standards***

The Members
Board of Airport Commissioners
City of Los Angeles, California:

We have audited the accompanying financial statements of Los Angeles International Airport (LAX), a proprietary fund of the City of Los Angeles and a part of Los Angeles World Airports (Department of Airports of the City of Los Angeles, California) (LAWA), as of and for the year ended June 30, 2005 and have issued our report thereon, dated November 10, 2005. 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered LAX's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether LAX's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain matters that we reported to the management of LAX in a separate letter dated November 10, 2005.

This report is intended solely for the information and use of LAWA's board of airport commissioners, management, and federal or pass-through grantor agencies and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

Los Angeles, California
November 10, 2005