Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies

Principles of consolidation

Our consolidated financial statements include the accounts of all majority-owned subsidiaries and variable interest entities that are required to be consolidated. Investments in joint ventures for which we do not have control or are not the primary beneficiary, but have the ability to exercise significant influence over the operating and financial policies, are accounted for under the equity method. Accordingly, our share of net earnings and losses from these ventures is included in the Consolidated Statements of Operations. Intracompany profits, transactions and balances have been eliminated in consolidation. Certain reclassifications have been made to prior periods to conform with current reporting. As discussed in Note 26, the presentation of our Consolidated Statements of Cash Flows has been adjusted for the reclassification of customer financing transactions associated with Boeing Capital Corporation (BCC). The origination and subsequent principal collections for these transactions were previously presented as investing activities in our Consolidated Statements of Cash Flows, consistent with the presentation by BCC in their stand-alone financial statements. The amounts for prior periods have been reclassified to be consistent with current year presentation.

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 assumptions and estimates that directly affect the amounts reported in the consolidated financial statements. Significant estimates for which changes in the near term are considered reasonably possible and that may have a material impact on the financial statements are addressed in these notes to the consolidated financial statements.

Operating Cycle

For classification of current assets and liabilities, we elected to use the duration of the related contract as our operating cycle which is generally longer than one year.

Revenue Recognition

Contract accounting Contract accounting is used for development and production activities predominately by the Aircraft and Weapons Systems (A&WS), Network Systems, Support Systems, and Launch and Orbital Systems (L&OS) segments within Integrated Defense Systems (IDS). These activities include the following products and systems: military aircraft, helicopters, missiles, space systems, missile defense systems, satellites, rocket engines, and information and battle management systems. The majority of business conducted in these segments is performed under contracts with the U.S. Government and foreign governments that extend over a number of years. Contract accounting involves a judgmental process of estimating the total sales and costs for each contract, which results in the development of estimated cost of sales percentages. For each sale contract, the amount reported as cost of sales is determined by applying the estimated cost of sales percentage to the amount of revenue recognized.

Sales related to contracts with fixed prices are recognized as deliveries are made, except for certain fixed-price contracts that require substantial performance over an extended period before deliveries begin, for which sales are recorded based on the attainment of performance milestones. Sales related to contracts in which we are reimbursed for costs incurred plus an agreed upon profit are recorded as costs are incurred. The majority of these contracts are with the U.S. Government. The Federal Acquisition regulations provide guidance on the types of cost that will be reimbursed in establishing contract price. Contracts may contain provisions to earn incentive and award fees if targets are achieved. Incentive and award fees that can be reasonably estimated are recorded over the performance period of the contract. Incentive and award fees that cannot be reasonably estimated are recorded when awarded.

Program accounting We use program accounting to account for sales and cost of sales related to all our commercial airplane programs by the Commercial Airplanes segment. Program accounting is a method of accounting applicable to products manufactured for delivery under production-type contracts where profitability is realized over multiple contracts and years. Under program accounting, inventoriable production costs, program tooling costs and warranty costs are accumulated and charged as cost of sales by program instead of by individual units or contracts. A program consists of the estimated number of units (accounting quantity) of a product to be produced in a continuing, long-term production effort for delivery under existing and anticipated contracts. To establish the relationship of sales to cost of sales, program accounting requires estimates of (a) the number of units to be produced and sold in a program, (b) the period over which the units can reasonably be expected to be produced, and (c) the units' expected sales prices, production costs, program tooling, and warranty costs for the total program.

We recognize sales for commercial airplane deliveries as each unit is completed and accepted by the customer. Sales recognized represent the price negotiated with the customer, adjusted by an escalation formula. The amount reported as cost of sales is determined by applying the estimated cost of sales percentage for the total remaining program to the amount of sales recognized for airplanes delivered and accepted by the customer.

Service revenue Service revenue is recognized when the service is performed. This method is predominately used by our Support Systems, L&OS and Commercial Airplanes segments. Service activities include the following: Delta launches, ongoing maintenance of International Space Station, Space Shuttle and explosive detection systems, support agreements associated with military aircraft and helicopter contracts and technical and

flight operation services for commercial aircraft. BCC lease and financing revenue is also included in 'Service revenue' on the Consolidated Statements of Operations. See the 'Lease and financing arrangements' section below for a discussion of BCC's revenue recognition policies.

Lease and financing arrangements Lease and financing arrangements are used predominately by BCC, our wholly-owned subsidiary, and consist of sales-type/financing leases, operating leases and notes receivable. Revenue and interest income are recognized for our various types of leases and notes receivable as follows:

Sales-type/financing leases At lease inception, we record an asset ("net investment") representing the aggregate future minimum lease payments, estimated residual value of the leased equipment and unearned income. Income is recognized over the life of the lease to approximate a level rate of return on the net investment. Residual values, which are reviewed periodically, represent the estimated amount we expect to receive at lease termination from the disposition of leased equipment. Actual residual values realized could differ from these estimates.

Operating leases Revenue on the leased aircraft and equipment representing rental fees and financing charges is recorded on a straight-line basis over the term of the lease.

Notes receivable At commencement of a note receivable issued for the purchase of aircraft or equipment, we record the note and any unamortized discounts. Interest income and amortization of any discounts are recorded ratably over the related term of the note.

Research and development

Research and development includes costs incurred for experimentation, design and testing and are expensed as incurred unless the costs are related to certain contractual arrangements. Costs that are incurred pursuant to such contractual arrangements are recorded over the period that revenue is recognized, consistent with our contract accounting policy.

During the year ended December 31, 2004, we have established cost sharing arrangements with some suppliers for the 787 that will enhance our internal development capabilities and offset a substantial portion of the financial risk of developing the 787 product. Our cost sharing arrangements explicitly state that the supplier contributions are for reimbursements of costs we incur for experimentation, basic design and testing activities during the development of the 787. In each arrangement, we will retain substantial rights to the 787 part or component covered by the arrangement.

Pursuant to Statement of Financial Accounting Standards (SFAS) No. 68, *Research and Development Arrangements*, we have recorded the amounts received from these cost sharing arrangements as a reduction to research and development expenses. Specifically, under the terms of each agreement, payments received from suppliers for their share of the costs will be typically based on milestones and will be recognized as earned when we achieve the milestone events and no ongoing obligation on our part exists. In the event we receive a milestone payment prior to the completion of the milestone the amount will be classified as liability until earned.

Share-based compensation

We use a fair value based method of accounting for share-based compensation provided to our employees in accordance with SFAS No. 123, *Accounting for Stock-Based Compensation*, as described in Note 17. Our primary types of share-based compensation consist of stock options, ShareValue Trust distributions and Performance Shares. We value stock options issued based upon an option-pricing model and recognize this fair value as an expense over the period in which the options service period. Potential distributions from the ShareValue Trust have been valued based upon an option-pricing model, with the related expense recognized over the life of the trust. Share-based expense associated with Performance Shares is determined based on the market value of our stock at the time of the award applied to the maximum number of shares contingently issuable based on stock price, and is amortized over a five-year period.

Income taxes

Provisions for federal, state and foreign income taxes are calculated on reported pre-tax earnings based on current tax law and also include, in the current period, the cumulative effect of any changes in tax rates from those used previously in determining deferred tax assets and liabilities. Such provisions differ from the amounts currently receivable or payable because certain items of income and expense are recognized in different time periods for financial reporting purposes than for income tax purposes. Significant judgment is required in determining income tax provisions and evaluating tax positions. We establish reserves for income tax when, despite the belief that our tax positions are fully supportable, there remain certain positions that are probable to be challenged and possibly disallowed by various authorities. The consolidated tax provision and related accruals include the impact of such reasonably estimable losses and related interest as deemed appropriate. To the extent that the probable tax outcome of these matters changes, such changes in estimate will impact the income tax provision in the period in which such determination is made.

Postretirement plans

We sponsor various pension plans covering substantially all employees. We also provide postretirement benefit plans other than pensions, consisting principally of health care coverage to eligible retirees and qualifying dependents. Benefits under the pension and other postretirement benefit plans are generally based on age at retirement and years of service and for some pension plans benefits are also based on the employee's annual earnings. The net periodic cost of our pension and other post-retirement plans is determined using the projected unit credit method and several actuarial assumptions, the most

significant of which are the discount rate, the long-term rate of asset return, and medical trend (rate of growth for medical costs). Not all net periodic pension income or expense is recognized in net earnings in the year incurred because it is allocated to production as product costs, and a portion remains in inventory at the end of a reporting period. We amortize gains and losses, which occur when actual experience differs from actuarial assumptions, over the average future service period of employees. Our funding policy for pension plans is to contribute, at a minimum, the statutorily required amount.

Cash and cash equivalents

Cash and cash equivalents consist of highly liquid instruments, such as certificates of deposit, time deposits, and other money market instruments, which have original maturities of less than three months. We aggregate our cash balances by bank, and reclassify any negative balances to a liability account presented as a component of accounts payable.

Inventories

Inventoried costs on commercial aircraft programs and long-term contracts include direct engineering, production and tooling costs, and applicable overhead, which includes fringe benefits, production related indirect and plant management salaries and plant services, not in excess of estimated net realizable value. In accordance with industry practice, inventoried costs include amounts relating to programs and contracts with long production cycles, a portion of which is not expected to be realized within one year.

Because of the higher unit production costs experienced at the beginning of a new airplane program (known as the "learning curve effect"), the actual costs incurred for production of the early units in the program will exceed the amount reported as cost of sales for those units. The excess or actual costs over the amount reported as cost of sales is presented as "deferred production costs," which are included in inventory along with unamortized tooling costs.

Used aircraft purchased by the Commercial Airplanes segment, commercial spare parts, and general stock materials are stated at cost not in excess of net realizable value.

Assets of discontinued operations

Assets to be disposed of that meet all of the criteria to be classified as held for sale as set forth in SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, are reported at the lower of their carrying amounts or fair values less cost to sell. Assets are not depreciated while they are classified as held for sale. Assets held for sale that have operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of our assets are reported in discontinued operations when (a) it is determined that the operations and cash flows of the assets will be eliminated from our on-going operations and (b) we will not have any significant continuing involvement in the operations of the assets after the disposal transaction.

Property, plant and equipment (including operating lease equipment)

Property, plant and equipment are recorded at cost, including applicable construction-period interest, less accumulated depreciation and are depreciated principally over the following estimated useful lives: new buildings and land improvements, from 10 to 40 years; and new machinery and equipment, from 3 to 20 years. The principal methods of depreciation are as follows: buildings and land improvements, 150% declining balance; and machinery and equipment, sum-of-the-years' digits. We periodically evaluate the appropriateness of remaining depreciable lives assigned to long-lived assets subject to a management plan for disposition. Aircraft financing operating lease equipment is recorded at cost and depreciated over the term of the lease or projected economic life of the equipment, primarily on a straight-line basis, to an estimated residual or salvage value.

We review long-lived assets, which includes property, plant and equipment and operating lease equipment, for impairments in accordance with SFAS No. 144. Long-lived assets held for sale are stated at the lower of cost or fair value less cost to sell. Long-lived assets held for use are subject to an impairment assessment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the carrying value is no longer recoverable based upon the undiscounted future cash flows of the asset, the amount of the impairment is the difference between the carrying amount and the fair value of the asset.

Investments

We classify investments as either operating or non-operating. Operating investments are strategic in nature, which means they are integral components of our operations. Non-operating investments are those we hold for non-strategic purposes. Earnings from operating investments, including our share of income or loss from certain equity method investments, income from cost method investments, and any gain/loss on the disposition of investments, are recorded in 'Income/(loss) from operating investments, net'. Earnings from non-operating investments, including marketable debt and equity securities, are recorded in 'Other income, net' on the Consolidated Statements of Operations.

Certain investments are accounted for under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Available-for-sale securities include debt and equity securities and enhanced equipment trust certificates (EETCs). Available-for-sale securities are recorded at their fair values and unrealized gains and losses are reported as part of 'Accumulated other comprehensive income' on the Consolidated Statements of Financial Position. As discussed in Note 12, prior to the

fourth quarter of 2004, held-to-maturity securities included EETCs and debentures for which we had the positive intent and ability to hold to maturity. Held-to-maturity securities were reported at amortized cost. We may transfer held-to-maturity securities to available-for-sale securities when there are changes in certain circumstances, as permitted by SFAS No. 115, or when other events that are isolated, nonrecurring and unusual occur without requiring our entire portfolio of held-to-maturity securities to be transferred to available-for-sale. However, if we do not meet the circumstances permitted by SFAS No. 115, our entire portfolio of held-to-maturity securities are transferred to available-for-sale. Debt and equity securities are continually assessed for impairment. To determine if an impairment is other than temporary we consider the duration of the loss position, the strength of the underlying collateral, the duration to maturity, credit reviews and analyses of the counterparties. Other than temporary losses on operating investments are recorded in 'Cost of products and services' and other than temporary losses on non-operating investments are recorded in 'Other income, net'.

Goodwill and acquired intangibles

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, which we adopted on January 1, 2002, the accounting for goodwill and indefinite-lived intangible assets changed from an amortization approach to an impairment-only approach. The SFAS No. 142 goodwill impairment model is a two-step process. First, it requires a comparison of the book value of net assets to the fair value of the related operations that have goodwill assigned to them. We estimate the fair values of the related operations using discounted cash flows. The cash flow forecasts are adjusted by an appropriate discount rate derived from our market capitalization plus a suitable control premium at the date of evaluation. If the fair value is determined to be less than book value, a second step is performed to compute the amount of the impairment. In this process, a fair value for goodwill is estimated, based in part on the fair value of the operations used in the first step, and is compared to its carrying value. The shortfall of the fair value below carrying value represents the amount of goodwill impairment. SFAS No. 142 requires goodwill to be tested for impairment annually at the same date every year, and when an event occurs or circumstances change such that it is reasonably possible that an impairment may exist. Our annual testing date is April 1.

Our finite-lived acquired intangible assets are amortized on a straight-line method and include the following: developed technology, 5 to 12 years; product know-how, 30 years; customer base, 10 to 15 years; and other, 5 to 17 years. In accordance with SFAS No. 144, we evaluate the potential impairment of finite-lived acquired intangible assets when appropriate. If the carrying value is no longer recoverable based upon the undiscounted future cash flows of the asset, the amount of the impairment is the difference between the carrying amount and the fair value of the asset.

Derivatives

We account for derivatives pursuant to SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. All derivative instruments are recognized in the financial statements and measured at fair value regardless of the purpose or intent for holding them. We record our interest rate and foreign currency swaps at fair value based on discounted cash flow analysis and for warrants and other option type instruments based on option pricing models. For derivatives designated as hedges of the exposure to changes in the fair value of a recognized asset or liability or a firm commitment (referred to as fair value hedges), the gain or loss is recognized in earnings in the period of change together with the offsetting loss or gain on the hedged item attributable to the risk being hedged. The effect of that accounting is to reflect in earnings the extent to which the hedge is not effective in achieving offsetting changes in fair value. For our cash flow hedges, the effective portion of the derivative's gain or loss is initially reported in shareholders' equity (as a component of accumulated other comprehensive income/loss) and is subsequently reclassified into earnings. The ineffective portion of the gain or loss is reported in earnings immediately. We also hold certain instruments for economic purposes that do not qualify for hedge accounting treatment. For these derivative instruments as well as other derivatives not receiving hedge treatment the changes in fair value are recorded in earnings.

Aircraft valuation

Used aircraft under trade-in commitments and aircraft under repurchase commitments In conjunction with signing a definitive agreement for the sale of new aircraft (Sale Aircraft), we have entered into specified-price trade-in commitments with certain customers that give them the right to trade in used aircraft upon the purchase of Sale Aircraft. Additionally, we have entered into contingent repurchase commitments with certain customers wherein we agree to repurchase the Sale Aircraft at a specified price, generally ten years after delivery of the Sale Aircraft. Our repurchase of the Sale Aircraft is contingent upon a future, mutually acceptable agreement for the sale of additional new aircraft. If, in the future, we execute an agreement for the sale of additional new aircraft, and if the customer exercises its right to sell the Sale Aircraft to us, a contingent repurchase commitment would become a trade-in commitment. Based on our historical experience, we believe that very few, if any, of our outstanding contingent repurchase commitments will ultimately become trade-in commitments. Exposure related to the trade-in of used aircraft resulting from trade-in commitments may take the form of: (1) adjustments to revenue related to the sale of new aircraft determined at the signing of a definitive agreement, and/or (2) charges to cost of products and services related to adverse changes in the fair value of trade-in aircraft that occur subsequent to signing of a definitive agreement for new aircraft but prior to the purchase of the used trade-in aircraft. The trade-in aircraft exposure related to item (2) is included in 'Accounts payable and other liabilities' on the Consolidated Statements of Financial Position.

Obligations related to probable trade-in commitments are measured as the difference between gross amounts payable to customers and the estimated fair value of the collateral. The fair value of collateral is determined using aircraft specific data such as, model, age and condition, market conditions for specific aircraft and similar models, and multiple valuation sources. This process uses our assessment of the market for each trade-in aircraft, which in most instances begins years before the return of the aircraft. There are several possible markets in which we continually pursue opportunities to place used aircraft. These markets include, but are not limited to, (1) the resale market, which could potentially include the cost of long-term storage, (2) the leasing market, with the potential for refurbishment costs to meet the leasing customer's requirements, or (3) the scrap market. Collateral valuation varies significantly depending on which market we determine is most likely for each aircraft. On a quarterly basis, we update our valuation analysis based on the actual activities associated with placing each aircraft into a market. This quarterly collateral valuation process yields results that are typically lower than residual value estimates by independent sources and tends to more accurately reflect results upon the actual placement of the aircraft.

Used aircraft acquired by the Commercial Airplanes segment are included in 'Inventories' at the lower of cost or market as it is our intent to sell these assets. To mitigate costs and enhance marketability, aircraft may be placed on operating lease. While on operating lease, the assets are included in 'Customer financing,' however, the valuation continues to be based on the lower of cost or market. The lower of cost or market assessment is performed quarterly using the process described above.

Asset valuation for equipment under operating lease, assets held for sale or re-lease and collateral underlying receivables Included in 'Customer financing' are operating lease equipment, notes receivables and sales-type/financing leases. Sales-type/financing leases are treated as receivables, and allowances are established in accordance with SFAS No. 13, Accounting for Leases and SFAS No. 118, *Accounting by Creditors for Impairment of a Loan*, as amended.

We periodically assess the fair value of the assets we own, including equipment under operating leases, assets held for sale or re-lease and collateral underlying receivables, to determine if their fair values are less than the related assets' carrying values. Differences between carrying values and fair values of finance leases and notes and other receivables, as determined by collateral value, are considered in determining the allowance for losses on receivables.

We use a median calculated from published collateral values from multiple external equipment appraisers based on the type and age of the aircraft to determine the fair value of aircraft. Under certain circumstances, we apply judgment based on the attributes of the specific aircraft or equipment, usually when the features or use of the aircraft vary significantly from the more generic aircraft attributes covered by outside publications.

Impairment review for equipment under operating leases and held for sale or re-lease When events or circumstances indicate (and no less than annually), we review the carrying value of all aircraft and equipment under operating lease and held for sale or re-lease for potential impairment. In 2004, we reviewed all aircraft and equipment under operating lease and held for sale or re-lease. We evaluate assets under operating lease or held for re-lease for impairment when the expected undiscounted cash flow over the remaining useful life is less than the carrying value. We use various assumptions when determining the expected undiscounted cash flow. These assumptions include expected future lease rates, lease terms, end of economic life value of the aircraft or equipment, periods in which the asset may be held in preparation for a follow-on lease, maintenance costs, remarketing costs and the remaining economic life of the asset. We state assets held for sale at the lower of carrying value or fair value less costs to sell.

When we determine that impairment is indicated for an asset, the amount of asset impairment expense recorded is the excess of the carrying value less asset value guarantees, if applicable, over the fair value of the asset. For aircraft assets, we use a median calculated from the published fair values from multiple external equipment appraisers based on the type and age of the asset to determine the fair value. However, if the features or use of the aircraft varies significantly from the generic aircraft attributes covered by outside publications, we apply judgment based on the attributes of the specific aircraft to determine fair value.

Allowance for losses on receivables The allowance for losses on receivables is a valuation account used to provide for potential impairment of receivables in our portfolio. The balance is an accounting estimate of probable but unconfirmed losses in the receivables portfolio. The allowance for losses on receivables relates to two components of receivables: (a) specifically identified receivables that are evaluated individually for impairment and (b) pools of receivables that are evaluated for impairment.

We determine a receivable is impaired when, based on current information and events, it is probable that we will be unable to collect amounts due according to the original contractual terms of the receivable agreement, without regard to any subsequent restructurings. Factors considered in assessing collectibility include, but are not limited to, a customer's extended delinquency, requests for restructuring and filings for bankruptcy. We determine a specific impairment allowance based on the difference between the carrying value of the receivable and the estimated fair value of the related collateral. Each quarter, we review customer credit ratings, published historical credit default rates for different rating categories, third-party guarantees (if applicable) and third-party aircraft valuations as a basis to validate the reasonableness of the allowance for losses on receivables. There can be no assurance that actual results will not differ from estimates and values or that the consideration of these factors in the future will not result in an increase/decrease to the allowance for losses on receivables.

The allocation for general purposes represents our best estimate of losses existing in the remaining receivables considering delinquencies, loss experience, collateral values, guarantees, risk of individual customer credits, published historical default rates for different rating categories, results of periodic credit reviews and the general state of the economy and airline industry.

We review the adequacy of the general allowance attributable to the remaining pool of receivables (after excluding the receivables subject to a specific allowance) by assessing both the collateral exposure and the applicable cumulative default rate. Collateral exposure for a particular receivable is the excess of the carrying value of the receivable over the fair value of the related collateral. A receivable with an estimated fair value in excess of the carrying value is considered to have no collateral exposure.

Prior to the third quarter of 2004, the collateral value was determined by averaging collateral values obtained from third-party equipment appraisers' industry data. In the third quarter of 2004, we began determining the collateral value by calculating the median of those appraised values. The median value method provides a better weighted measure of aircraft collateral values. The applicable cumulative default rate is determined using two components: customer credit ratings and weighted-average remaining contract term. Internal credit ratings are identified for each customer in the portfolio. Those ratings are updated based on public information and information obtained directly from our customers. Prior to the third quarter of 2004, we based the cumulative default rate on the weighted-average remaining life of the entire portfolio. In the third quarter of 2004, we began determining the cumulative default rate for each receivable based on its weighted-average remaining life. By measuring each receivable's weighted-average remaining life as opposed to using a portfolio average, we have increased the overall accuracy of this measurement.

We have entered into agreements with certain customers that would entitle us to look beyond the specific collateral underlying the receivable for purposes of determining the collateral exposure as described above. Should the proceeds from the sale of the underlying collateral asset resulting from a default condition be insufficient to cover the carrying value of our receivable (creating a shortfall condition), these agreements, would for example permit us to take the actions necessary to sell or retain certain other assets in which the customer has an equity interest and use the proceeds to cover the shortfall.

Postemployment plans

We account for postemployment benefits, such as severance or job training, under SFAS No.112, *Employer's Accounting for Postemployment Benefits*. A liability for postemployment benefits is recorded when payment is probable, the amount is reasonably estimable, and the obligation relates to rights that have vested or accumulated.

Asset retirement obligations

SFAS No. 143, *Accounting for Asset Retirement Obligations*, became effective on January 1, 2003. Under SFAS No. 143, obligations associated with the retirement of long-lived assets are recorded when there is a legal obligation to incur such costs. Upon initial recognition of a liability, the cost is capitalized as part of the related long-lived asset and depreciated over the corresponding asset's useful life. SFAS No. 143 did not have a significant impact on our financial position or results of operations upon adoption. The Financial Accounting Standards Board (FASB) is now considering an exposure draft clarifying that a legal obligation to perform an asset retirement activity that is conditional on a future event is within the scope of SFAS No. 143 and would be recognized if the liability's fair value can be reasonably estimated. Uncertainty surrounding the timing and method of settlement that may be conditional on events occurring in the future would be factored into the measurement of the liability rather than the recognition of the liability.

Any known asset retirement obligation for which the liability's fair value can be reasonably estimated has been recorded in the consolidated financial statements. We have certain known conditional asset retirement obligations, such as asbestos remediation activities to be performed in the future, that are not reasonably estimable due to insufficient information about the timing and method of settlement of the obligation. These obligations have not been recorded in the consolidated financial statements per SFAS No. 143. A liability for these obligations will be recorded in the period when sufficient information regarding timing and method of settlement becomes available to make a reasonable estimate of the liability's fair value. In addition, there may be conditional asset retirement obligations that we have not yet discovered (e.g. asbestos may exist in certain buildings but we have not become aware of it through the normal course of business), and therefore, these obligations also have not been included in the consolidated financial statements.

Note 2 – Standards Issued and Not Yet Implemented

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs – an amendment of ARB No. 43*. This Standard requires abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) to be recognized as current period charges. Additionally, it requires that allocation of fixed production overhead costs be allocated to inventory based on the normal capacity of the production facility. The provisions of this Standard apply prospectively and are effective for us for inventory costs incurred after January 1, 2006. While we believe this Standard will not have a material effect on our financial statements, the impact of adopting these new rules is dependent on events that could occur in future periods, and as such, an estimate of the impact cannot be determined until the event occurs in future periods.

In December 2004, the FASB issued SFAS No. 123 (revised 2004) (SFAS No. 123R), *Shared-Based Payment*. This Standard requires companies to measure share-based payments at

grant-date fair value and recognize the compensation expense in their financial statements. While we previously adopted the fair value based method of accounting pursuant to SFAS No. 123, *Accounting for Stock-Based Compensation*, SFAS No. 123R changes our method of measuring compensation expense for our Performance Shares from market price to fair value at grant date and requires a forfeiture assumption for our unvested awards. Additionally, SFAS No. 123R amends the presentation of the statement of cash flows and requires additional annual disclosures. We will early adopt the provisions of SFAS No. 123R as of January 1, 2005 using the modified prospective method. We believe the impact of applying an estimated forfeiture assumption to our uvested awards will not have a material effect on our financial statements.

Note 3 – 717 Program Completion

On January 12, 2005 we decided to conclude production of the 717 commercial airplane in 2006 due to the lack of overall market demand for the airplane. The decision is expected to result in total pre-tax charges of approximately $385, of which $280 is incorporated in the 2004 fourth quarter and year end results.

Of the $280 charge that was incorporated in the 2004 fourth quarter and year end results, supplier termination charges were $171; production disruption and related charges were $36; pension/post-retirement curtailment charges were $43; and severance charges were $30. Of the $105 charge that is expected to be recorded in periods subsequent to 2004, pension settlement charges are estimated to be $60 and plant shutdown charges are estimated to be $45. The termination of the 717 line will result in $385 of cash expenditures that are expected to occur during 2005 through 2007. This charge is determined based on current facts and information and we will revise our estimates accordingly as new facts and information become available.

Note 4 – Goodwill and Acquired Intangibles

During the fourth quarter of 2004, a developed technology within IDS in our other acquired intangible assets was no longer needed and we were unable to use this technology within any other program; therefore, we recognized an impairment loss of $4 for other acquired intangible assets.

On May 4, 2004, we acquired a developer of unmanned aerial vehicles into our A&WS segment which is reported within IDS. This resulted in $11 of goodwill. During the third and fourth quarter of 2004 we had a purchase adjustment of $24 and $1 related to contractual reach forward losses.

On March 3, 2004, we announced that effective April 1, 2004, Air Traffic Management (ATM) was absorbed into Phantom Works advanced researched and development division which is included within Boeing Technology and is reported in our ‘Other’ segment. On April 1, 2004, we performed annual impairment testing on our goodwill and indefinite-lived intangible assets which resulted in an impairment of the $3 of goodwill previously assigned to ATM.

We reorganized our Military Aircraft and Missile Systems and Space and Communications segments into IDS. This reorganization triggered a goodwill impairment analysis as of January 1, 2003. Our analysis took into consideration the lower stock price as of April 1, 2003, to include the impact of the required annual impairment test. As a result of this impairment analysis, we recorded a goodwill impairment charge during the three months ended March 31, 2003 of $913 ($818 net of tax). This charge related to our segments as follows: L&OS $572 and Commercial Airplanes $341.

This impairment charge related to L&OS resulted during an internal reorganization, when the SFAS No. 142 reportable segments, operating segments, and reporting unit designations changed, causing significantly different relationships between reporting unit carrying values and fair values. Specifically, the new L&OS reporting unit was created by combining six preexisting reporting units: Boeing Satellite Systems, Human Space Flight & Exploration, Expendable Launch Systems, USA joint venture, Rocketdyne Propulsion & Power, and Sea Launch joint venture. The carrying value of one of these reporting units, Boeing Satellite Systems, exceeded its fair value resulting in the goodwill balances at this reporting unit being fully impaired during calendar year 2002. However, the carrying values of the other five reporting units were less than their fair values, so the goodwill balances at these reporting units were not impaired during calendar year 2002. In addition, the Board of Directors approved in early 2003 our long range business plan which included downward revisions to cash flow projections for the L&OS reporting unit. The combination of these factors resulted in the newly created L&OS reporting unit having a carrying value that exceeded its fair value, prompting recognition of the goodwill impairment charge of $572.

The impairment charge related to our Commercial Airplanes segment was due to the reductions in the cash flow prospects and computed fair values of certain reporting units within Commercial Aviation Services.

As a result of adopting SFAS No. 142 on January 1, 2002, we recorded a transitional goodwill impairment charge during the first quarter of 2002 of $2,410 ($1,827 net of tax), presented as a cumulative effect of accounting change. This charge related to our segments as follows: L&OS $1,586; Commercial Airplanes $430; and Other $394. The Other segment charge related to Connexion by Boeing℠ and ATM.

The changes in the carrying amount of goodwill by reportable segment for the year ended December 31, 2004, were as follows:

	December 31, 2003	Goodwill Adjustments[1]	New Acquisitions	Impairment Losses	December 31, 2004
Commercial Airplanes	$282				**$282**
Aircraft and Weapon Systems	317	$25	$11		**353**
Network Systems	1,194	2			**1,196**
Support Systems	117				**117**
Other	3			$(3)	
	$1,913	$27	$11	$(3)	**$1,948**

[1]The Goodwill Adjustments represents purchase price adjustments.

Our finite-lived acquired intangible assets are being amortized on a straight-line basis over the following weighted-average useful lives:

	Weighted-Average Useful Life
Product know-how	30
Customer base	14
Developed technology	10
Other	12

The gross carrying amounts and accumulated amortization of our other acquired intangible assets were as follows at December 31:

	2004		2003	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Developed technology	**$578**	**$256**	$566	$195
Product know-how	**308**	**44**	308	33
Customer base	**106**	**29**	106	22
Other	**150**	**55**	144	36
	$1,142	**$384**	$1,124	$286

Amortization expense for acquired finite-lived intangible assets for the years ended December 31, 2004 and 2003 was $97 and $94. Estimated amortization expense for the five succeeding years are as follows:

	Estimated Amortization Expense
2005	$88
2006	82
2007	82
2008	82
2009	81

As of December 31, 2004 and 2003, we had one indefinite-lived intangible asset, a trademark, with a carrying amount of $197.

Note 5 – Earnings Per Share

During the second quarter of 2004, we adopted Emerging Issues Task Force Issue No. 03-6, *Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings Per Share*, which did not have a material effect on our earnings per share.

Basic earnings per share is calculated by the sum of (1) net income less dividends paid divided by the basic weighted-average shares outstanding and (2) dividends paid divided by the weighted-average shares outstanding. Basic weighted-average shares outstanding is based on the weighted-average number of shares outstanding as well as participating securities that reduce basic earnings per share and excludes treasury shares and the outstanding shares held by the ShareValue Trust not committed for distribution. Participating securities consist of vested stock units associated with our deferred compensation plans.

Diluted earnings per share is calculated by dividing net income by the diluted weighted-average shares outstanding. Diluted weighted-average shares outstanding is based on that same number of basic weighted shares outstanding shares plus dilutive potential common shares. Dilutive potential common shares may include shares distributable under stock option, stock unit, Performance Shares and ShareValue Trust plans. These potential common shares are included in the computation of diluted shares outstanding if they would reduce earnings per share.

The weighted-average number of shares outstanding (in millions) for the years ended December 31, used to compute earnings per share are as follows:

	2004	2003	2002
Weighted-average shares outstanding	**800.2**	800.1	799.0
Participating securities	**6.8**	5.3	5.0
Basic weighted-average shares outstanding	**807.0**	805.4	804.0
Diluted potential common shares	**6.0**	3.5	4.4
Diluted weighted-average shares outstanding	**813.0**	808.9	808.4

The weighted-average number of shares outstanding for the year ended December 31 (in millions), included in the table below, is excluded from the computation of diluted earnings per share because the average market price did not exceed the exercise/threshold price. However, these shares may be dilutive potential common shares in the future.

	2004	2003	2002
Stock options	**10.9**	25.0	22.5
Stock units		0.2	0.1
Performance Shares	**28.6**	24.2	19.0
ShareValue Trust	**38.4**	41.2	40.4

Note 6 – Income Taxes

The (benefit)/expense for taxes on income consisted of the following:

Year ended December 31,	2004	2003	2002
U.S. Federal			
Taxes paid or currently payable	**$(435)**	$(1,923)	$432
Change in deferred taxes	**787**	1,707	449
	352	(216)	881
State			
Taxes paid or currently payable	**(58)**	(33)	(79)
Change in deferred taxes	**(154)**	64	45
	(212)	31	(34)
Income tax (benefit)/expense	**$140**	$(185)	$847

The following is a reconciliation of the tax derived by applying the U.S. federal statutory rate of 35% to the earnings before income taxes and comparing that to the recorded income tax (benefit)/expense:

Year ended December 31,	2004	2003	2002
U.S. federal statutory tax	**$ 686**	$ 175	$1,100
Foreign Sales Corporation/ Extraterritorial Income tax benefit	**(168)**	(115)	(195)
Research benefit	**(28)**	(37)	(28)
Non-deductibility of goodwill	**2**	229	
Federal audit settlement	**(147)**	(456)	
Charitable contributions	**(9)**	(13)	(15)
Tax-deductible dividends	**(17)**	(14)	
State income tax provision, net of effect on U.S. federal tax	**(138)**	21	(22)
Other provision adjustments	**(41)**	25	7
Income tax (benefit)/expense	**$ 140**	$(185)	$ 847

The 2004 effective income tax rate of 7.1% differed from the federal statutory tax rate of 35%, due to Foreign Sales Corporation (FSC) and Extraterritorial Income (ETI) exclusion tax benefits, tax credits, state income taxes, tax benefits from a settlement with the Internal Revenue Service (IRS) of the years 1986-1997, tax benefits associated with state tax audit settlements, and other provision adjustments.

The effective income tax rates for 2003 and 2002 also vary from the federal statutory tax rate due to FSC and ETI benefits, tax credits, state income taxes, and in 2003, favorable resolution of IRS audit issues and the non-deductibility for tax purposes of certain portions of goodwill impairment charges.

The components of net deferred tax assets at December 31 were as follows:

	2004	2003
Deferred tax assets	**$ 8,583**	$10,084
Deferred tax liabilities	**(7,516)**	(7,110)
Valuation allowance	**(12)**	(16)
Net deferred tax assets	**$ 1,055**	$ 2,958

Significant components of our deferred tax assets, net of deferred tax liabilities, at December 31 were as follows:

	2004	2003
Other comprehensive income (net of valuation allowances of $12 and $16)	**$ 1,150**	$2,415
Retiree health care accruals	**2,212**	2,073
Inventory and long-term contract methods of income recognition	**1,188**	1,693
Other employee benefits accruals	**1,276**	842
In-process research and development related to acquisitions	**142**	156
Net operating loss, credit, and charitable contribution carryovers	**587**	118
Pension benefit accruals	**(4,332)**	(2,826)
Customer and commercial financing	**(1,168)**	(1,513)
Net deferred tax assets	**$ 1,055**	$2,958

Of the deferred tax asset for net operating loss, credit, and charitable contribution carryovers, $435 expires in years ending from December 31, 2005 through December 31, 2024 and $152 may be carried over indefinitely.

Deferred U.S. income taxes and foreign withholding taxes are not provided on the undistributed cumulative earnings of foreign subsidiaries because such earnings are considered to be permanently reinvested in those operations. It is not practicable to estimate the amount of additional taxes that may be payable upon distribution.

Within the Consolidated Statements of Operations is Other income/expense which consists primarily of interest income received from tax refunds.

IRS Audit Overview

IRS examinations have been completed through 1997 and income taxes have been settled with the IRS for all years through 1996 and for McDonnell Douglas Corporation for all years through 1992. We have filed appeals with the IRS for 1993 through 1997 for McDonnell Douglas Corporation.

During 2004 we received $896 relating to federal income tax refunds for which estimated accruals had primarily been recorded in prior periods. Of this amount, $681 related to the 2003 federal tax return. $104 related to a settlement of the 1996 tax year and the 1997 partial tax year for McDonnell Douglas Corporation, $69 related to a settlement of the 1983 through 1987 tax years, and $1 related to the 1985 tax year. The balance of $41 relates to a partial settlement of the 1986 through 1997 Boeing Company audit and was recorded in the year ended December 31, 2004. In addition, $217 of interest

income associated with the tax refunds was received and recorded in the Consolidated Statements of Operations. Of the $217 of interest income received, $40 was recorded in 2003 and the balance was recorded during 2004. In addition to the cash received above, we are awaiting the receipt of an additional $124 of federal net income tax refund and $42 of interest for the settlement of the years 1986 through 1997 which have already been accrued during the year ended December 31, 2004.

Net income tax (refunds)/payments were $(903), $(507) and $(49) in 2004, 2003 and 2002, respectively.

Tax Accruals

We are subject to income taxes in the U.S. and numerous foreign jurisdictions.

Amounts accrued for the potential tax assessments primarily recorded in current tax liabilities total $1,678 and $1,507 at December 31, 2004 and 2003, respectively. Accruals relate to tax issues for U.S. federal, domestic state, and taxation of foreign earnings as follows:

- The accruals associated with U.S. federal tax issues such as the tax benefits from the FSC and ETI tax rules, the amount of research and development tax credits claimed, deductions associated with employee benefit plans, U.S. taxation of foreign earnings, and valuation issues regarding charitable contributions claimed were $1,412 at December 31, 2004, and $1,229 at December 31, 2003.
- The accruals for domestic state tax issues such as the allocation of income among various state tax jurisdictions and the amount of state tax credits claimed were $214 at December 31, 2004, and $226 at December 31, 2003, net of federal benefit.
- The accruals associated with taxation of foreign earnings were $52 at December 31, 2004, and $52 at December 31, 2003.

Legislative Update

On October 22, 2004, the President signed the American Jobs Creation Act of 2004 (the Act). The Act provides a deduction for income from qualified domestic production activities, which will be phased in from 2005 through 2010. In return, the Act also provides for a two-year phase-out (except for certain preexisting binding contracts) of the existing ETI exclusion tax benefit for foreign sales which the World Trade Organization (WTO) ruled was an illegal export subsidy. The European Union (EU) believes that the Act fails to adequately repeal the illegal export subsidies because of the transitional provisions and has asked the WTO to review whether these transitional provisions are in compliance with their prior ruling. It is not possible to predict what impact this issue will have on future earnings pending the final resolution of this matter. Additionally, the Act creates a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85% dividend received deduction for certain dividends from controlled foreign corporations.

On December 21, 2004, FASB Staff Position (FSP) No. FAS 109-1, *Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004*, was issued. FSP No. FAS 109-1 clarifies that this tax deduction should be accounted for as a special deduction in accordance with SFAS No. 109, *Accounting for Income Taxes*. As such, the special deduction has no effect on deferred tax assets and liabilities existing at the date of enactment. Rather, the impact of this deduction will be reported in the period in which the deduction is claimed on our tax return beginning in 2005. As regulations are still pending, we have been unable to quantify this impact.

On December 21, 2004, FSP No. FAS 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004*, was issued. FSP No. FAS 109-2 provides companies additional time, beyond the financial reporting period during which the Act took effect, to evaluate the Act's impact on a company's plan for reinvestment or repatriation of certain foreign earnings for purposes of applying SFAS No. 109. FSP No. FAS 109-2 was effective upon issuance. As of December 31, 2004, management had not decided on whether, and to what extent we might repatriate foreign earnings under the Act, and accordingly, the financial statements do not reflect any provisions for taxes on unremitted foreign earnings. Based on our analysis of the Act, although not yet finalized, it is possible that under the repatriation provision of the Act we may repatriate some amount of earnings between $0 to $350 with the respective tax liability ranging from $0 to $26. We expect to be in a position to finalize our assessment by June 30, 2005.

Note 7 – Accounts Receivable

Accounts receivable at December 31 consisted of the following:

	2004	2003
U.S. Government contracts	$2,701	$2,493
Commercial and customers	985	866
Other	1,075	1,202
Less valuation allowance	(108)	(95)
	$4,653	$4,466

The following table summarizes our accounts receivable under U.S. Government contracts that were not billable or related to outstanding claims as of December 31:

	2004	2003
Unbillable		
Current	$366	$505
Expected to be collected after one year	399	147
	$765	$652
Claims		
Current	$ 8	$ 14
Expected to be collected after one year	23	21
	$ 31	$ 35

Unbillable receivables on U.S. Government contracts arise when the sales or revenues based on performance attainment, though appropriately recognized, cannot be billed yet under terms of the contract as of the balance sheet date. Accounts receivable related to claims are items that we believe are earned, but are subject to uncertainty concerning their determination or ultimate realization.

As of December 31, 2004 and 2003, other accounts receivable included $671 and $553 of reinsurance receivables relating to Astro Ltd., a wholly-owned subsidiary, that operates as a captive insurance company. Currently, Astro Ltd. insures aviation liability, workers compensation, general liability, property, as well as various other smaller risk liability insurances.

Note 8 – Inventories

Inventories at December 31 consisted of the following:

	2004	2003
Long-term contracts in progress	$ 11,258	$ 10,228
Commercial aircraft programs	6,049	6,448
Commercial spare parts, used aircraft, general stock materials and other, net of reserves	1,884	2,596
	19,191	19,272
Less advances and progress billings	(14,944)	(13,934)
	$ 4,247	$ 5,338

As a normal course of our Commercial Airplanes segment production process, our inventory may include a small quantity of airplanes that are completed but unsold. As of December 31, 2004 and 2003, the value of completed but unsold aircraft in inventory was insignificant. Inventory balances included $233 subject to claims or other uncertainties primarily relating to the A-12 program as of December 31, 2004 and 2003.

Included in commercial aircraft program inventory and directly related to the sales contracts for the production of aircraft are amounts paid or credited in cash or other consideration, to airline customers totaling $665 and $543 as of December 31, 2004 and 2003. These amounts are referred to as early issue sales consideration. Early issue sales consideration is recognized as a reduction to revenue when the delivery of the aircraft under contract occurs. In the unlikely situation that an airline customer was not able to perform and take delivery of the contracted aircraft we believe that we would have the ability to recover amounts paid through retaining amounts secured by advances received on aircraft to be delivered. However to the extent early issue sales consideration exceeds advances these amounts may not be recoverable and would be recognized as a current period expense. As of December 31, 2004 and 2003, the amount of early issue sales consideration net of advance of deposits included in commercial aircraft program inventory amounted to $123 and $154.

Commercial aircraft inventory production costs incurred on in-process and delivered units in excess of the estimated average cost of such units determined as described in Note 1 represent deferred production costs. As of December 31, 2004 and 2003, there were no significant excess deferred production costs or unamortized tooling costs not recoverable from existing firm orders for the 777 program. The deferred production costs and unamortized tooling included in the 777 program's inventory at December 31 are summarized in the following table:

	2004	2003
Deferred production costs	$703	$794
Unamortized tooling	485	582

During the years ended December 31, 2004 and 2003, we purchased $298 and $746 of used aircraft. Used aircraft in inventory totaled $162 and $819 as of December 31, 2004 and 2003.

When we are unable to immediately sell used aircraft held by Commercial Airplanes, we may place the aircraft on operating leases, or finance the sale of new aircraft with a short-term note receivable. The carrying amount of aircraft on operating lease, or sales financed under a note receivable, totaled $958 and $447 as of December 31, 2004 and 2003 and resulted in a decrease to Inventory and an offsetting increase to Customer financing. These transactions were previously identified as non-cash transactions and excluded from the Consolidated Statements of Cash Flows. However we changed the classification of the cash flow effects of customer financing transactions which are currently presented as operating activities. As such these transactions are now recorded in the Consolidated Statements of Cash Flows. (See Note 26.)

During 2002 we were selected by the US Air Force (USAF) to supply 100 767 Tankers and entered into a preliminary agreement with the USAF for the procurement of the 100 Tankers. On January 14, 2005 we announced our plan to recognize pre-tax charges totaling $275 related to the USAF 767 Tanker program. The charge, which is a result of our quarter and year-end reviews, reflects our updated assessment of securing the specific USAF 767 Tanker contract that was being negotiated, given the continued delay and now likely re-competition of the contract. As of December 31, 2004, we expensed $179 (Commercial Airplanes) and $47 (IDS) related to the USAF 767 Tanker contract for Commercial aircraft programs and Long-term contracts in progress within the categories above. As of December 31, 2003, the Commercial aircraft programs and Long-term contracts in progress categories above contained $113 (Commercial Airplanes) and $28 (IDS) related to the USAF 767 Tanker inventoriable pre-contract costs. These charges were included in the Consolidated Statement of Cash Flows in the 'Other charges and credits, net' which is consistent with the treatment of our inventory write-offs.

Note 9 – Discontinued Operations – Commercial Financial Services

On May 2, 2004, our Board of Directors approved a plan to sell all of the assets and business operations of BCC's Commercial Financial Services business. This plan was approved by BCC's Board of Directors on May 21, 2004. On May 24, 2004, BCC entered into a purchase and sale agreement with General Electric Capital Corporation (GECC) to sell substantially all of the assets related to its Commercial Financial Services business. The purchase agreement, as amended, called for the sale of the assets to take place in a series of closings, commencing on May 31, 2004 and ending no later than December 31, 2004. The final asset sale closed on December 27, 2004. BCC intends to dispose of the remaining assets identified to the Commercial Financial Services business that are not subject to the purchase and sale agreement with GECC by the end of the second quarter of 2005.

Notes to Consolidated Financial Statements

Our consolidated financial statements and related footnote disclosures reflect the Commercial Financial Services business as discontinued operations. Income associated with the Commercial Financial Services business, net of applicable income taxes, is shown as income from discontinued operations for all periods presented in accordance with SFAS No. 144. In addition, the assets of this business have been reclassified and presented as assets of discontinued operations. There are no liabilities related to the Commercial Financial Services business that are expected to be assumed by GECC or other buyers, other than those specific liabilities associated with the portfolio assets sold, such as security deposits and maintenance reserves.

The assets sold to GECC consisted of leases and financing arrangements having a carrying value of $1,872 as of May 31, 2004. The purchase price paid for the assets transferred at each closing was determined based on the carrying value of the assets, plus a total premium of $140 that was paid as of June 30, 2004. As of December 31, 2004, BCC had received $2,017 in cash proceeds from this sale.

As part of the purchase and sale agreement with GECC, BCC agreed to a sharing arrangement for losses that may be incurred at the end of the initial financing terms of the transferred portfolio assets, or, in some instances, prior to the end of the financing term, such as certain events of default and repossession. The loss sharing arrangement provides that cumulative net losses (if any) are to be shared between BCC and GECC in accordance with the following formula: (i) with respect to the first $150 of cumulative net losses, BCC will be liable to GECC for 80% of the amount thereof (in such event GECC will bear 20% of such losses); (ii) with respect to cumulative net losses between $150 and $275, BCC will be liable to GECC for 100% of such additional cumulative net losses; and (iii) if cumulative losses exceed $275, GECC will bear 100% of the loss risk above $275. These provisions effectively "cap" BCC's exposure to any losses as referred to herein at $245. In the event there are cumulative net gains on the portfolio, GECC is required to make an earn-out payment to BCC in an amount equal to 80% of such cumulative net gain. Gains and losses on the portfolio are to be measured on a cumulative basis over the remaining life of the portfolio assets. The amount of the gain or loss on any particular portfolio asset is the difference between the fair market value of the equipment asset securing the portfolio asset and the carrying value of the portfolio asset. BCC has the right in certain circumstances to participate in a refinancing or other redeployment of a portfolio asset for the purpose of minimizing any loss on such asset.

In 2004, BCC recorded a gain of $72 ($46 net of tax) due to the sale of the Commercial Financial Services assets to GECC. The gain was calculated as the $140 premium less the increase in BCC's reserve for future portfolio losses, estimated sales and excise taxes, and investment banking, transaction and legal fees. Based upon an analysis that considered collateral values and the creditworthiness of the counterparties, BCC had established a liability of $90 at December 31, 2004, to reserve for probable future portfolio losses, which included $54 previously reported as an allowance for losses on receivables transferred to GECC. BCC determined its expected losses of $90 based on the customer credit ratings, published historical default rates for various rating categories and the collateral exposure for each customer based on the difference between the book carrying value and the estimated fair market value of the assets. Future adjustments may be made as circumstances dictate and will be recorded as part of BCC's continuing operations.

Since substantially all of the operating activities of BCC's former Commercial Financial Services business were included in the sale of the Commercial Financial Services portfolio assets and operations to GECC, BCC elected not to allocate any interest expense or general and administrative expense to its discontinued operations following May 2004, the month in which the sale to GECC was announced. For the five months ended May 31, 2004, BCC allocated $31 of interest expense and $3 of general administrative expense to the Commercial Financial Services business which is reflected in income from discontinued operations.

During 2004, the net gain on the disposal of discontinued operations of $66 ($42 net of tax), which included a gain of $72 ($46 net of tax) related to the sale of assets to GECC and a loss of $6 ($4 net of tax) related to the revaluation of the remaining Commercial Financial Services assets to the lower of carrying value or fair value less costs to sell. This revaluation loss related principally to one 737 Boeing Business Jet (BBJ).

During the third quarter of 2004, we reassessed our near term fleet requirements and that resulted in one BBJ being retained in our executive fleet. As a result of this decision, BCC recorded asset impairment expense of $11 as part of our continuing operations and reclassified the asset from discontinued operations.

Operating results of the discontinued operations for the years ended December 31 were as follows:

	2004	2003	2002
Revenues	$ 96	$229	$230
Income from discontinued operations	16	51	37
Provision for income taxes	(6)	(18)	(14)
Income from discontinued operations, net of taxes	$ 10	$ 33	$ 23
Net gain on disposal of discontinued operations	$ 66		
Provision for income taxes	(24)		
Net gain on disposal of discontinued operations, net of taxes	$ 42		

The major classes of assets related to discontinued operations, all of which were held for sale, were as follows as of December 31:

	2004	2003
Investment in sale-type/financing leases	$10	$ 724
Notes receivable	1	727
Valuation allowance of receivables		(48)
Operating lease equipment, at cost, less accumulated depreciation	59	634
Property, plant and equipment, net		45
Assets of discontinued operations	$70	$2,082

Note 10 – Customer Financing

Customer financing does not include assets associated with commercial financing due to BCC's agreement to sell substantially all of the assets related to its Commercial Financial Services business to GECC, as discussed in Note 9.

Customer financing at December 31 consisted of the following:

	2004	2003
Aircraft financing		
Notes receivable	$ 2,155	$ 2,289
Investment in sales-type/financing leases	3,799	4,022
Operating lease equipment, at cost, less accumulated depreciation of $823 and $647	5,112	4,628
Other equipment financing		
Notes receivable	44	97
Operating lease equipment, at cost, less accumulated depreciation of $72 and $51	294	282
Less valuation allowance of receivables	(403)	(404)
	$11,001	$10,914

Interest rates on fixed-rate notes ranged from 5.99% to 11.42%, and effective interest rates on variable-rate notes ranged from 4.56% to 8.78%.

The operating lease aircraft category primarily includes new and used jet and commuter aircraft. At December 31, 2004 and 2003, aircraft financing operating lease equipment included $73 and $270 of equipment available for re-lease. At December 31, 2004 and 2003, we had firm lease commitments for $25 and $141 of this equipment.

The change in the valuation allowance of receivables for the years ended December 31, 2004, 2003 and 2002, consisted of the following:

	Valuation Allowance
Beginning balance – January 1, 2002	$(114)
Charge to costs and expenses	(190)
Reduction in customer financing assets	3
Ending balance – December 31, 2002	(301)
Charge to costs and expenses	(214)
Reduction in customer financing assets	111
Ending balance – December 31, 2003	(404)
Charge to costs and expenses	(45)
Reduction in customer financing assets	46
Ending balance – December 31, 2004	**$(403)**

The components of investment in sales-type/financing leases at December 31 were as follows:

	2004	2003
Minimum lease payments receivable	$ 5,998	$ 5,204
Estimated residual value of leased assets	833	747
Unearned income	(3,032)	(1,929)
	$ 3,799	$ 4,022

Aircraft financing is collateralized by security in the related asset; we have not experienced problems in accessing such collateral. However, the value of the collateral is closely tied to commercial airline performance and may be subject to reduced valuation with market decline. Our financing portfolio has a concentration of 757, 717 and MD-11 model aircraft that have valuation exposure. As of December 31, 2004 and 2003, notes receivable, sales-type/financing leases and operating leases attributable to aircraft financing included $1,457 and $1,378 attributable to 757 model aircraft ($475 and $511 accounted for as operating leases) and $2,308 and $2,109 attributable to 717 model aircraft ($596 and $467 accounted for as operating leases) and $833 and $895 attributable to MD-11 model aircraft ($687 and $732 accounted for as operating leases).

Certain customers have filed for bankruptcy protection or requested lease or loan restructurings; these negotiations were in various stages as of December 31, 2004.

- During 2003, BCC completed a restructuring of United Airlines, Inc. (United) aircraft loans and leases. United accounted for $1,131 and $1,159 (10% and 11%) of our aircraft financing portfolio at December 31, 2004 and 2003. The terms of the restructured loans and leases resulted in a charge to the valuation allowance of $50.
- During 2003, BCC agreed to restructure certain outstanding leases with ATA Holdings Corp. (ATA). ATA accounted for $705 and $707 (6% and 6%) of our aircraft financing portfolio at December 31, 2004 and 2003. The terms of the restructured leases did not result in a charge to the valuation allowance.
- During 2004, BCC completed a restructuring of its leases with Hawaiian Airlines, Inc. (Hawaiian). As a result of the approval of the restructured lease terms, BCC recorded a provision for losses of $13 due to the difference between the approved bankruptcy claim and the amount it received when it sold the claim. Hawaiian accounted for $456 and $506 (4% and 5%) of our aircraft financing portfolio at December 31, 2004 and 2003.

In addition to the customers discussed above, some other customers have requested a restructuring of their transactions. BCC has not reached agreement on any other restructuring requests that we believe would have a material adverse effect on our earnings, cash flows and/or financial position.

See Note 21 for a discussion regarding the creditworthiness of counterparties in customer financing arrangements.

Scheduled payments on customer financing are as follows:

Year	Principal Payments on Notes Receivable	Sales-Type/ Financing Lease Payments Receivable	Operating Lease Payments Receivable
2005	$ 192	$ 483	$ 550
2006	166	434	469
2007	183	503	397
2008	183	392	335
2009	150	373	274
Beyond 2009	1,354	3,813	1,227

Customer financing assets we leased under capital leases and have been subleased to others totaled $298 and $325 at December 31, 2004 and 2003.

During the year ended December 31, 2004, we recorded $18 ($17 recognized at BCC) to increase the valuation allowance due to the normal provision for losses in the customer financing portfolio. Additionally, during the year ended 2004, we increased the provision for losses by $27 ($82 recognized at the Other segment offset by a reduction of $55 recognized at BCC). The increase was due to deteriorated airline credit ratings and depressed aircraft values based on our quarterly assessment of the adequacy of customer financing reserves as well as the additional factors that impacted the year ended December 31, 2004. The primary factors attributing to the $27 increase in the valuation allowance in 2004 were: an increase of $87 in the requirement in the allowance account resulting from the determination that receivables from ATA were subject to a specific impairment offset by $53 of benefit from the mitigation of collateral exposure from agreements with certain customers. During the year ended December 31, 2003, we recorded $23 ($21 recognized at BCC) to increase the valuation allowance due to normal provision for losses in the customer financing portfolio and recorded a charge of $191 ($130 recognized at BCC) to increase the valuation allowance due to deteriorated airline credit ratings and depressed aircraft values based on our quarterly assessment of the adequacy of customer financing reserves. During the year ended December 31, 2002, we recorded $10 ($8 recognized at BCC) to increase the valuation allowance due to normal provision for losses in the customer financing portfolio and recorded a charge of $180 ($100 recognized at BCC) to increase the valuation allowance due to deteriorated airline credit ratings and depressed aircraft values based on our quarterly assessment of the adequacy of customer financing reserves.

The valuation allowance includes amounts recorded either as specific impairment allowances on receivables or general valuation allowances. As of December 31, 2004 and 2003, carrying amounts of impaired receivables were $2,232 and $1,605. Specific impairment allowances for losses of $295 and $123 were allocated to $1,179 and $483 of impaired receivables as of December 31, 2004 and 2003. Remaining allowance balances of $108 and $281 were recorded as general valuation allowances as of December 31, 2004 and 2003.

The average recorded investment in impaired receivables as of December 31, 2004, 2003 and 2002, was $1,940, $1,688 and $211. Income recognition is generally suspended for receivables at the date when full recovery of income and principal becomes doubtful. Income recognition is resumed when receivables become contractually current and performance is demonstrated by the customer. The amount of interest income recognized on such receivables during the period in which they were considered impaired was $30, $106 and $18 for the years ended December 31, 2004, 2003 and 2002, of which $35, $115 and $12 was recognized on a cash basis, respectively.

During 2004, we recorded charges related to customer financing activities of $42 in operating earnings, which included impairment charges of $29 ($27 recorded by BCC) and a charge of $13 recorded in the Other segment relating to the reduction of anticipated lease rates on specific aircraft. During 2003, we recorded charges related to customer financing activities of $126 in operating earnings, which includes impairment charges of $105 ($100 recorded by BCC) and $21 of charges related to the write-off of forward-starting interest rate swaps related to Hawaiian. During 2002, we recorded charges of $110 related to customer financing activities, of which $66 related to the return of 24 717s by AMR Corporation. The impairments resulted from the deteriorated aircraft values and reduced estimated cash flows for operating leases.

Note 11 – Property, Plant and Equipment

Property, plant and equipment at December 31 consisted of the following:

	2004	2003
Land	$ 470	$ 457
Buildings	9,677	9,381
Machinery and equipment	10,318	10,767
Construction in progress	940	943
	21,405	21,548
Less accumulated depreciation	(12,962)	(12,951)
	$ 8,443	$ 8,597

Depreciation expense was $1,028, $1,005 and $1,094 for the years ended December 31, 2004, 2003 and 2002, respectively. Interest capitalized as construction-period property, plant and equipment costs amounted to $71, $61 and $71 for the years ended December 31, 2004, 2003 and 2002, respectively.

Rental expense for leased properties was $372, $429 and $519 for the years ended December 31, 2004, 2003 and 2002, respectively. These expenses, substantially all minimum rentals, are net of sublease income. Minimum rental payments under operating and capital leases with initial or remaining terms of one year or more aggregated $2,284 and $98 for the

year ended December 31, 2004. Payments, net of sublease amounts, due during the next five years are as follows:

	2005	2006	2007	2008	2009
Operating leases	$389	$371	$293	$191	$171
Capital leases	31	19	17	8	6

Note 12 – Investments

Joint ventures and other investments

All investments are recorded in Short-term investments and Investments. At December 31, 2004 and 2003, Investments included $67 and $98 attributable to investments in joint ventures. Investments also included other non-marketable securities of $73 and $63 at December 31, 2004 and 2003.

The principal joint venture arrangements are United Space Alliance; HRL Laboratories, LLC; APB Winglets Company, LLC; BATA Leasing, LLC (BATA); and Sea Launch. We have a 50% partnership with Lockheed Martin in United Space Alliance, which is responsible for all ground processing of the Space Shuttle fleet and for space-related operations with the USAF. United Space Alliance also performs modifications, testing and checkout operations that are required to ready the Space Shuttle for launch. We are entitled to 33% of the earnings from HRL Laboratories, LLC, which conducts applied research in the electronics and information sciences; and creates new products and services for space, telecommunications, defense and automotive applications. We have a 45% ownership of APB Winglets Company, LLC, which was established for the purposes of designing, developing, manufacturing, installing, certifying, retrofitting, marketing, selling, and providing after-sales support with respect to winglets for retrofit aircraft.

We have a 50% partnership with ATA in BATA, which was established to acquire aircraft and market and lease the aircraft to third-parties. During 2003, we finalized an amendment to the partnership, which gave us majority control in the management of the business and affairs of BATA. As a result, BATA is now consolidated in our financial statements.

The Sea Launch venture, in which we are a 40% partner with RSC Energia (25%) of Russia, Kvaerner ASA (20%) of Norway, and KB Yuzhnoye/PO Yuzhmash (15%) of Ukraine, provides ocean-based launch services to commercial satellite customers. For the year ended December 31, 2004, the venture conducted three launches. The venture also conducted three launches in 2003. Our investment in this venture as of December 31, 2004, reflects the recognition of our share of losses reported by Sea Launch in prior years. The venture incurred losses in 2004, 2003 and 2002, due to the relatively low volume of launches, driven by a depressed commercial satellite market. We have financial exposure with respect to the venture, which relates to guarantees by us provided to certain Sea Launch creditors, performance guarantees provided by us to a Sea Launch customer and financial exposure related to advances and other assets reflected in the consolidated financial statements.

We have consistently applied the requirements set forth in paragraph 19(i) of Accounting Principle Bulletin (APB) 18, *The Equity Method of Accounting for Investments in Common Stock*, to account for our investment in the Sea Launch venture. Accordingly, we suspended recording equity losses after writing our investment in and direct loans to Sea Launch down to zero and accruing our obligation for third-party guarantees on Sea Launch indebtedness. We are not committed to provide any further financial support to the Sea Launch venture. However, in the event that we do extend additional financial support to Sea Launch in the future, we will recognize suspended losses as appropriate.

During 2003, we recorded a charge of $55 related to Resource 21, a partnership entered into with three other parties several years ago to develop commercial remote sensing and ground monitoring. The charge resulted from a decision by NASA to not award an imagery contract to Resource 21. During 2003, we also recorded adjustments to equity investments in Ellipso, SkyBridge and Teledesic resulting in the net write down of $27.

During 2002, a $100 impairment charge was recorded to write off a cost-method investment in Teledesic, LLC, which stopped work on its satellite constellation and announced its intent to reduce staff. In addition, we recorded a $48 impairment charge related to our BATA Leasing, LLC, joint venture investment. This charge was our share of the adjustment to estimated fair market value for the joint venture's 727 aircraft.

Investments in debt and equity securities

Investments consisted of the following at December 31:

	2004				2003			
	Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value	Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value
Available-for-Sale								
Equity	**$4**	**$9**		**$13**	$4	$7		$11
Debt [2]	**3,267**		**$51**	**3,216**	20	1		21
Held-to-Maturity [1]								
Debt [3]					453		$57	396
	$3,271	**$9**	**$51**	**$3,229**	$477	$8	$57	$428

(1) The unrealized gains/losses of held-to-maturity securities are not recorded in the consolidated financial statements.
(2) At December 31, 2004, $325 of these debt securities have been in a continuous unrealized loss position for 12 months or longer.
(3) At December 31, 2003, these debt securities have been in a continuous unrealized loss position for 12 months or longer.

During 2004, we invested $3,011 of cash in an externally managed portfolio of investment grade fixed income instruments. The portfolio is diversified and highly liquid and primarily consists of U.S. dollar debt obligations of the United States Treasury, other government agencies, corporations, mortgage-backed and asset-backed securities. The portfolio has an average duration of 1.5 years. Debt securities with maturities less than one year are short-term investments and the remaining securities are long term investments (except cash equivalents with maturities less than 90 days). As of December 31, 2004, amounts invested with a fair value of $2,718 were classified as available-for-sale Investments on the Consolidated Statements of Financial Position. We do not intend to hold these investments to maturity, nor do we intend to actively and frequently buy and sell these securities with the objective of generating profits on short-term differences in price. In addition, amounts totaling $108 were classified as Cash and cash equivalents and $173 were classified as available-for-sale and recorded in Short-term investments. During 2004, realized gains and losses on these investments were not material.

In November 2004, we signed a term sheet whereby we agreed to exchange a D tranche investment issued by a trust sponsored by Delta Air Lines, Inc. (Delta) for two C tranche investments owned by Delta and certain other rights. As of December 31, 2004, we adjusted the carrying value of the D tranche investment to the fair value of the consideration to be received upon completion of the exchange with Delta of $146, with the assistance of independent valuations. Although we recorded a pre-tax non-cash charge to asset impairment expense of $32 as a result of this adjustment, we have substantially mitigated further risk of a realized loss by improving the collateral package available to secure the investments while maintaining an expected return equal to the original D tranche investment.

As a result of our decision to participate in an exchange of assets with Delta, we determined that we did not intend to hold our investment in the D tranche until maturity. As a result of this decision, we determined that our entire portfolio of held-to-maturity securities would have to be accounted for as available-for-sale securities. Since our economic commitment to the exchange of assets occurred in mid-December 2004, we elected to reclassify our held-to-maturity investments totaling $354 as available-for-sale securities effective December 31, 2004. We reduced the carrying value of our investments by $37 and recorded an equal charge to accumulated other comprehensive income/loss. We do not expect that we will be able to account for any of our investments as held-to-maturity investments for at least two years in accordance with specific accounting literature. We will record the quarterly changes in the fair values of our available-for-sale securities as changes to the carrying value of the securities with a corresponding change to accumulated other comprehensive income/loss.

On an ongoing basis, we will perform an impairment test on our investment securities to determine if the fair value decline of a security is other-than-temporary. If the impairment is other-than-temporary, we reset the cost basis for the impaired security and record the charge in the Consolidated Statements of Operations.

At December 31, 2004, our available-for-sale investments included $312 of subordinated debt investments in several EETCs, which includes our debt security in Delta. EETCs are secured by aircraft on lease to commercial airlines. EETCs provide investors with tranched rights to cash flows from a financial instrument, as well as a collateral position in the related asset. While the underlying classes of equipment notes vary by maturity and/or coupon depending upon tenor or level of subordination of the specific equipment notes and their corresponding claim on the aircraft, the basic function of an EETC remains to passively hold separate debt investments to enhance liquidity for investors, who in turn pass this liquidity benefit directly to the airline in the form of lower coupon and/or greater debt capacity. We participate in several EETCs as an investor. Our EETC investments are related to customers that have less than investment-grade credit. Approximately $287 of the above amounts relates to investments that were acquired in 2002. Due to the commercial aviation market downturn, these securities have been in a continuous unrealized loss position for 12 months or longer. Despite the unrealized loss position of these securities, we have concluded that these EETC investments are not other-than-temporarily impaired. This assessment was based on the value of the underlying collateral to the securities, the term of the securities, and both internal and third-party credit reviews and analyses of the counterparties, principally major domestic airlines. Accordingly, we have concluded that it is probable that we will be able to collect all amounts due according to the contractual terms of these debt securities.

At December 31, 2004, our available-for-sale investments included an investment in mandatorily redeemable preferred stock of ATA that had been in a continuous unrealized loss position since 2001. During the second quarter of 2004, our assessment of ATA's continued financial difficulties led us to conclude that the unsecured preferred stock investment maturing in 2015 was other-than-temporarily impaired. Accordingly, we lowered the carrying value of this investment to its fair value, resulting in a pre-tax non-cash charge to asset impairment expense of $29. Of this amount, $17 of pre-tax unrealized loss ($11 net of tax) was reclassified from accumulated other comprehensive income/loss to asset impairment expense. During the third quarter of 2004, we reassessed the fair value of this investment, resulting in an additional pre-tax non-cash charge to asset impairment expense of $18, which reduced the carrying value of the investment to zero.

There were no other-than-temporary impairments recognized in 2003. However, during 2002, we recorded an impairment of $79 related to one of BCC's long-held investments in equipment trust certificates (ETCs) secured by aircraft on lease to United, which is recorded in cost of products and services. This debt investment was classified as held-to-maturity and had declined in value for a period that was determined to be other-than-temporary. Additionally, during 2002, $40 ($25 net of tax) of unrealized loss was reclassified from accumulated other comprehensive income/loss to other income due to other than temporary impairments of available-for-sale investments.

At December 31, 2004, there was no unrealized loss recorded in accumulated other comprehensive income/loss related to debt securities that were reclassified from available-for-sale to held-to-maturity at their fair values compared with $14 at December 31, 2003.

Maturities of available-for-sale debt securities at December 31, 2004, were as follows:

	Available-for-Sale	
	Amortized Cost	Estimated Fair Value
Due in 1 year or less	$ 320	$ 319
Due from 1 to 5 years	1,959	1,926
Due from 5 to 10 years	203	194
Due after 10 years	785	777
	$3,267	$3,216

Note 13 – Accounts Payable and Other Liabilities

Accounts payable and other liabilities at December 31 consisted of the following:

	2004	2003
Accounts payable	**$ 4,563**	$ 3,822
Accrued compensation and employee benefit costs	**3,360**	2,804
Pension liabilities	**744**	1,138
Product warranty liabilities	**781**	825
Lease and other deposits	**362**	316
Dividends payable	**210**	143
Other	**4,849**	4,466
	$14,869	$13,514

Accounts payable included $344 and $289 at December 31, 2004 and 2003, attributable to checks written but not yet cleared by the bank.

At December 31, 2004 and 2003, the Other category in the table above included $666 and $799 of accrued insurance liability relating to our wholly-owned captive insurance agencies, Astro Inc. and Astro Ltd. Also included in the Other category is $1,774 and $1,233 at December 31, 2004 and 2003, attributable to liabilities we have established for legal, environmental, and other contingencies we deem probable and estimable as discussed in Note 23. Payments associated with these liabilities may occur in periods significantly beyond the next twelve months. The Other category included forward loss recognition related primarily to launch and satellite contracts of $1,218 and $1,164 at December 31, 2004 and 2003. In addition, the Other category included $171 as of December 31, 2004 as a result of our decision in 2004 to end production of the 717 program, described in Note 3 and $121 for the 757 program.

Note 14 – Deferred Lease Income

During 2004, we delivered one 767 aircraft to a joint venture named TRM Aircraft Leasing Co. Ltd (TRM). During 2003, we delivered four 767 aircraft to TRM. TRM was established in the second quarter of 2003 in order to provide financing and arrange for a total of five 767 aircraft to be leased to Japan Airlines. The leases are accounted for as operating leases each with a term of seven years. We have provided financing of approximately $42 related to the five aircraft, which in combination with our partial ownership of TRM, has caused us to retain substantial risk of ownership in the aircraft. As a result, we recognize rental income over the term of the lease. As of December 31, 2004 and 2003, the present value of the remaining deferred lease income was $379 and $318, discounted at a rate of 5.0%.

During 2001, we delivered four C-17 transport aircraft to the United Kingdom Royal Air Force (UKRAF), which were accounted for as operating leases. The lease term is seven years, at the end of which the UKRAF has the right to purchase the aircraft for a stipulated value, continue the lease for two additional years or return the aircraft. Concurrent with the negotiation of this lease, we, along with UKRAF, arranged to assign the contractual lease payments to an independent financial institution. We received proceeds from the financial institution in consideration of the assignment of the future lease receivables from the UKRAF. The assignment of lease receivables is non-recourse to us. The initial proceeds represented the present value of the assigned total lease receivables discounted at a rate of 6.6%. As of December 31, 2004 and 2003, the balance of $366 and $457 represented the present value of the remaining deferred lease income.

Notes to Consolidated Financial Statements

Note 15 – Debt

Debt consisted of the following:

	December 31, 2004	December 31, 2003
Boeing Capital Corporation debt:		
Non-recourse debt and notes		
3.410%–5.790% notes due through 2013	**$ 84**	$ 88
Senior debt securities		
4.750%–7.375% due through 2013	**4,441**	5,476
Senior medium-term notes		
2.550%–7.640% due through 2023	**1,345**	2,240
Euro medium-term notes		
3.440% due in 2004		61
Subordinated notes		
8.310% due through 2004		20
Capital lease obligations		
1.670%–7.350% due through 2015	**280**	329
Retail notes		
3.150%–6.750% due through 2017	**874**	874
Commercial paper securitized due 2009		89
Subtotal Boeing Capital Corporation debt	**$ 7,024**	$ 9,177
Other Boeing debt:		
Non-recourse debt and notes		
Enhanced equipment trust	**$ 509**	$ 538
Unsecured debentures and notes		
200, 7.875% due Feb. 15, 2005	**200**	202
199, 0.000% due May 31, 2005*	**195**	185
300, 6.625% due Jun. 1, 2005	**299**	298
250, 6.875% due Nov. 1, 2006	**250**	249
175, 8.100% due Nov. 15, 2006	**175**	175
350, 9.750% due Apr. 1, 2012	**349**	349
600, 5.125% due Feb. 15, 2013	**597**	597
400, 8.750% due Aug. 15, 2021	**398**	398
300, 7.950% due Aug. 15, 2024**	**300**	300
250, 7.250% due Jun. 15, 2025	**247**	247
250, 8.750% due Sep. 15, 2031	**248**	249
175, 8.625% due Nov. 15, 2031	**173**	173
400, 6.125% due Feb. 15, 2033	**393**	393
300, 6.625% due Feb. 15, 2038	**300**	300
100, 7.500% due Aug. 15, 2042	**100**	100
175, 7.875% due Apr. 15, 2043	**173**	173
125, 6.875% due Oct. 15, 2043	**125**	125
Senior medium-term notes		
7.060%–7.460% due through 2006	**20**	45
Capital lease obligations due through 2009	**36**	70
Other notes	**89**	100
Subtotal other Boeing debt	**$ 5,176**	$ 5,266
Total debt	**$12,200**	$14,443

*The $199 note due May 31, 2005, is a promissory note to FlightSafety International for the purchase of its 50% interest in Alteon, formerly FlightSafety Boeing Training International (FSBTI). The promissory note carries a zero percent interest rate.

**The $300 debentures due August 15, 2024, are puttable at the holder's option on August 15, 2012. All other debentures and notes are not puttable prior to maturity.

Additional disclosure information

Maturities of long-term debt for the next five years are as follows:

	2005	2006	2007	2008	2009
BCC	$ 556	$ 712	$1,343	$714	$527
Other Boeing	765	492	46	26	19
	$1,321	$1,204	$1,389	$740	$546

We have $3,500 currently available under credit line agreements with a group of commercial banks. BCC is named a subsidiary borrower for up to $2,000 under these arrangements. Total debt interest, including amounts capitalized, was $790, $873 and $801 for the years ended December 31, 2004, 2003 and 2002, respectively. Interest expense recorded by BCC is reflected as a separate line item on our Consolidated Statements of Operations, and is included in earnings from operations. Total company interest payments were $722, $775 and $727 for the years ended December 31, 2004, 2003 and 2002, respectively. We continue to be in full compliance with all covenants contained in our debt agreements.

Short-term debt, and current portion of long-term debt, consisted of the following:

	At December 31, 2004		At December 31, 2003	
	Consolidated Total	BCC Only	Consolidated Total	BCC Only
Commercial Paper conduit			$ 15	$ 15
Senior medium-term notes	**$ 437**	**$437**	921	896
Unsecured debentures and notes	**694**			
Subordinated notes			20	20
Capital lease obligations	**71**	**53**	88	49
Non-recourse debt and notes	**36**	**4**	34	4
Euro medium-term notes			61	61
Retail notes	**62**	**62**		
Other notes	**21**		5	
	$1,321	**$556**	$1,144	$1,045

In 2004, BCC redeemed $1,000 face value of its outstanding senior notes, which had a carrying value of $999. This redemption included the entire principal amount, equal to $500 face value, of its 7.10% Senior debt securities due 2005 at a redemption price equal to 105.30% of the principal amount of the notes together with interest accrued to the redemption date. BCC redeemed $500 face value of its 5.65% Senior debt securities due 2006 at a redemption price equal to 104.81% of the principal amount of the notes together with interest accrued to the redemption date. BCC recognized a loss of $42 related to this early debt redemption which consisted of a $52 prepayment penalty for early redemption offset by $10 related to the amount by which the fair value of BCC's hedged redeemed debt exceeded the carrying value of its hedged redeemed debt.

Financing activities

On December 23, 2003, we put in place a support agreement in which we commit to maintain certain financial metrics at BCC. BCC is currently in compliance with these metrics. As of December 31, 2004, we were in compliance with the covenants for the 364-day and the 5-year revolving credit facilities.

On March 23, 2004, we filed a shelf registration with the SEC for $1,000 for the issuance of debt securities and underlying

common stock. The entire amount remains available for potential debt issuance. BCC has $3,421 that remains available from shelf registrations filed with the SEC.

At December 31, 2004, $183 of BCC debt was collateralized by portfolio assets and underlying equipment totaling $300. The debt consists of the 1.67% to 5.79% notes due through 2015.

Note 16 – Postretirement Plans

We have various pension plans covering substantially all employees. We fund all our major pension plans through trusts. The key objective of holding pension funds in a trust is to satisfy the retirement benefit obligations of the pension plans. Pension assets are placed in trust solely for the benefit of the pension plans' participants, and are structured to maintain liquidity that is sufficient to pay benefit obligations as well as to keep pace over the long term with the growth of obligations for future benefit payments.

We also have postretirement benefits other than pensions which consist principally of health care coverage for eligible retirees and qualifying dependents, and to a lesser extent, life insurance to certain groups of retirees. Retiree health care is provided principally until age 65 for approximately half those retirees who are eligible for health care coverage. Certain employee groups, including employees covered by most United Auto Workers bargaining agreements, are provided lifetime health care coverage.

Obligations and funded status

The following table reconciles the funded status of both pensions and the other postretirement benefits (OPB), principally retiree health care, to the balance on the Consolidated Statements of Financial Position. Benefit obligation balances presented in the table reflect the projected benefit obligation (PBO) for our pension plans, and accumulated postretirement benefit obligations (APBO) for our OPB plans. Both the PBO and APBO include the estimated present value of future benefits that will be paid to plan participants, based on expected future salary growth and employee services rendered through the measurement date. We use a measurement date of September 30 for our pension and OPB plans.

	Pensions		Other Postretirement Benefits	
At September 30,	**2004**	2003	**2004**	2003
Change in benefit obligation				
Beginning balance	**$39,931**	$35,971	**$ 8,617**	$ 8,308
Service cost	**831**	753	**162**	162
Interest cost	**2,378**	2,319	**492**	533
Impact of Medicare Prescription Drug, Improvement and Modernization Act of 2003			**(439)**	
Plan participants' contributions	**13**	12		
Amendments	**190**	114	**(119)**	(470)
Actuarial (gain)/loss	**1,656**	2,937	**(57)**	583
Acquisitions/dispositions, net		(34)		
Settlement/curtailment	**(14)**	(2)	**(8)**	(9)
Benefits paid	**(2,204)**	(2,139)	**(513)**	(490)
Ending balance	**$42,781**	$39,931	**$ 8,135**	$ 8,617
Change in plan assets				
Beginning balance at fair value	**$33,209**	$28,834	**$ 58**	$48
Acquisitions/dispositions, net		(34)		
Actual return on plan assets	**4,296**	4,728	**6**	5
Company contribution	**3,645**	1,728	**16**	16
Plan participants' contributions	**13**	12	**1**	
Settlement/curtailment	**(43)**			
Benefits paid	**(2,163)**	(2,100)	**(9)**	(11)
Exchange rate adjustment	**20**	41		
Ending balance at fair value	**$38,977**	$33,209	**$ 72**	$ 58
Reconciliation of funded status to net amounts recognized				
Funded status-plan assets less than projected benefit obligation	**$ (3,804)**	$ (6,722)	**$(8,063)**	$(8,559)
Unrecognized net actuarial loss	**13,756**	13,430	**2,676**	3,373
Unrecognized prior service costs	**1,365**	1,376	**(762)**	(745)
Adjustment for fourth quarter contributions	**752**	12	**135**	126
Net amount recognized	**$12,069**	$ 8,096	**$(6,014)**	$(5,805)
Amounts recognized in statement of financial position consist of:				
Prepaid benefit cost	**$12,588**	$ 8,542		
Intangible asset	**225**	692		
Accumulated other comprehensive (income)/loss	**3,169**	6,629		
Accounts payable and other liabilities	**(744)**	(1,138)	**$ (55)**	$ (60)
Accrued retiree health care			**(5,959)**	(5,745)
Accrued pension plan liability	**(3,169)**	(6,629)		
Net amount recognized	**$12,069**	$ 8,096	**$(6,014)**	$(5,805)

Claims payable estimates include a liability for claims that were incurred during the reporting period, including those that have been reported by participants, as well as those that have not yet been reported by participants by the end of the period. The decrease in the minimum pension liability included in other comprehensive income/loss was ($3,460) at December 31, 2004 and the increase was $358 at December 31, 2003.

The accumulated benefit obligation (ABO) for all pension plans was $38,590 and $36,145 at September 30, 2004 and 2003. Only three of nine major pension plans have ABOs that exceed plan assets at September 30, 2004. The following table shows the key information for plans with ABO in excess of plan assets.

At September 30,	**2004**	2003
Projected benefit obligation	**$11,405**	$26,318
Accumulated benefit obligation	**11,162**	25,060
Fair value of plan assets	**10,293**	21,549

Components of net periodic benefit (income)/cost were as follows:

Year ended December 31,	**2004**	2003	2002
Components of net periodic benefit income – pensions			
Service cost	**$ 831**	$ 753	$ 703
Interest cost	**2,378**	2,319	2,261
Expected return on plan assets	**(3,378)**	(3,403)	(3,558)
Amortization of net transition asset		(1)	(3)
Amortization of prior service costs	**180**	169	160
Recognized net actuarial (gain)/loss	**379**	83	(35)
Settlement/curtailment	**61**	13	68
Net periodic benefit cost/(income) – pensions	**$ 451**	$ (67)	$ (404)

Year ended December 31,	**2004**	2003	2002
Components of net periodic benefit cost – OPB			
Service cost	**$ 162**	$ 162	$ 133
Interest cost	**492**	533	472
Expected return on plan assets	**(6)**	(5)	(4)
Amortization of prior service costs	**(102)**	(61)	(57)
Recognized net actuarial loss	**188**	175	82
Settlement/curtailment		2	(27)
Net periodic benefit cost – OPB	**$ 734**	$ 806	$ 599

In the second quarter of 2004, we adopted Financial Accounting Standards Board Staff Position (FSP) No. FAS 106-2, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003* (which superceded FSP No. FAS 106-1). This FSP provides authoritative guidance on the accounting for the federal subsidy and other provisions of the Medicare Prescription Drug, Improvement and Modernization Act of 2003. The effects of these provisions resulted in a reduction of $439 in our accumulated postretirement obligation with an offset to unrecognized net actuarial loss for our other postretirement benefits. In addition, the effects of these provisions resulted in our net periodic benefit cost for our other postretirement benefits decreasing by $37. The federal government will begin making the subsidy payments to employers in 2006. On January 21, 2005, the Centers for Medicare and Medicaid Services released final regulations implementing the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. These regulations are effective for the quarter ending March 31, 2005. We are currently evaluating the regulations but have not completed our assessment of the possible effects.

Assumptions

At September 30,	**2004**	2003	2002	2001
Discount rate: pension and OPB	**5.75%**	6.00%	6.50%	7.00%
Expected return on plan assets	**8.50%**	8.75%	9.00%	9.25%
Rate of compensation increase	**5.50%**	5.50%	5.50%	5.50%

We determine the discount rate each year as of the measurement date, based on a review of interest rates associated with long-term high quality corporate bonds. The discount rate determined on each measurement date is used to calculate the benefit obligation as of that date, and is also used to calculate the net periodic benefit (income)/cost for the upcoming plan year. The pension and OPB plans have the same discount rate for all periods presented.

The pension fund's expected return on assets assumption is derived from an extensive study conducted by our trust investments group and its actuaries on a periodic basis. The study includes a review of actual historical returns achieved by the pension trust and anticipated future long-term performance of individual asset classes with consideration given to the appropriate investment strategy. While the study gives appropriate consideration to recent trust performance and historical returns, the assumption represents a long-term prospective return. The expected return on plan assets determined on each measurement date is used to calculate the net periodic benefit (income)/cost for the upcoming plan year.

At September 30,	**2004**	2003
Assumed health care cost trend rates		
Health care cost trend rate assumed next year	**9.00%**	10.00%
Ultimate trend rate	**5.00%**	5.00%
Year that trend reached ultimate rate	**2009**	2009

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. To determine the healthcare cost trend rates we look at a combination of information including ongoing claims cost monitoring, annual statistical analyses of claims data, reconciliation of forecast claims against actual claims, review of trend assumptions of other plan sponsors and national health trends, and adjustments for plan design changes, workforce changes, and changes in plan participant behavior. A one-percentage-point change in assumed health care cost trend rates would have the following effect:

	1-Percentage Point Increase	1-Percentage Point Decrease
Effect on postretirement benefit obligation	$727	$(628)
Effect on total of service and interest cost	71	(61)

Plan Assets

Pension assets totaled $38,977 and $33,209 at September 30, 2004 and 2003. Pension assets are allocated with a goal to achieve diversification between and within various asset classes. Pension investment managers are retained with a specific investment role and corresponding investment guidelines. Investment managers have the ability to purchase securities on behalf of the pension trusts, and several of them have permission to invest in derivatives, such as equity or bond futures. Derivatives are sometimes used by the pension plans to achieve the equivalent market exposure of owning a security or to rebalance the total portfolio to the target asset allocation. Derivatives are more cost-effective investment alternatives when compared to owning the corresponding security. In the instances in which derivatives are used, cash balances must be maintained at a level equal to the notional exposure of the derivatives.

The actual allocations for the pension assets at September 30, 2004 and 2003, and target allocations by asset category, are as follows:

	Percentage of Plan Assets at September 30,		Target Allocations	
Asset Category	**2004**	2003	**2004**	2003
Equity	**60%**	55%	**50%**	56%
Debt	**32**	38	**31**	28
Real estate	**3**	3	**6**	7
Other	**5**	4	**13**	9
	100%	100%	**100%**	100%

During 2004 the investment strategy changed to decrease the Equity and Real estate allocations and increase the Debt and Other allocations. Real estate includes investments in private real estate investments. The Other category includes private equity investments and hedge funds. Actual investment allocations vary from target allocations due to periodic investment strategy changes and due to the nature of some asset classes, such as real estate and private equity where it could take a period of a few years to reach the targets. Additionally, actual and target allocations vary due to the timing of benefit payments or contributions made on or near the measurement date, September 30.

Equity includes domestic and international equity securities, such as common, preferred or other capital stock, as well as equity futures, currency forwards and residual cash allocated to the equity managers. Equity includes our common stock in the amounts of $1,613 (4.19% of plan assets) and $1,102 (3.3% of plan assets) at September 30, 2004 and 2003. Equity derivatives based on net notional amounts totaled 3.0% at September 30, 2004 and was insignificant at September 30, 2003.

Debt includes domestic and international debt securities, such as U.S. Treasury securities, U.S. Government agency securities, corporate bonds and commercial paper; cash equivalents; investments in bond derivatives such as bond futures, options, swaps and currency forwards; and redeemable preferred stock and convertible debt. Debt includes $1,175 in cash we contributed on September 30, 2003; subsequently, these funds were allocated to equity and debt in accordance with the asset allocation needs at the time. Bond derivatives based on net notional amounts totaled 4.6% and 1.9% of plan assets at September 30, 2004 and 2003.

Most of the trusts' investment managers, who invest in debt securities, invest in "To-Be-Announced" mortgage-backed securities (TBA). A TBA represents a contract to buy or sell mortgage-backed securities to be delivered at a future agreed upon date. TBAs are deemed economically equivalent to purchasing mortgage-backed securities outright, but are often more attractively priced in comparison to traditional mortgage-backed securities. If the investment manager wishes to maintain a certain level of investment in TBA securities, the manager will sell them prior to settlement and buy new TBAs for another future settlement; this approach is termed "rolling". Most of the TBA securities held were related to TBA roll strategies. Debt included $1,632 and $1,936 related to TBA securities at September 30, 2004 and 2003.

We held $72 and $58 in trust fund assets for other postretirement benefit plans at September 30, 2004 and 2003. Most of these funds are invested in a balanced index fund which is comprised of approximately 60% equities and 40% debt securities. The expected rate of return on these assets does not have a material effect on the net periodic benefit cost.

Cash Flows

Contributions Required pension contributions under Employee Retirement Income Security Act (ERISA) regulations are not expected to be material in 2005. However, we made a discretionary contribution to our plans of $450 (pre-tax) on February 4, 2005, and plan to make approximately $550 (pre-tax) in additional contributions later in the year. We expect to contribute approximately $17 to our other postretirement benefit plans in 2005.

Estimated Future Benefit Payments The table below reflects the total pension benefits expected to be paid from the plans or from our assets, including both our share of the benefit cost and the participants' share of the cost, which is funded by participant contributions. Other postretirement benefits payments reflect our portion only.

	Pensions	Other Postretirement Benefits
2005	$2,311	$537
2006	2,359	570
2007	2,421	604
2008	2,477	626
2009	2,523	648
2010 – 2014	13,986	3,471

Termination Provisions

Certain of the pension plans provide that, in the event there is a change in control of the Company which is not approved by the Board of Directors and the plans are terminated within five years thereafter, the assets in the plan first will be used to provide the level of retirement benefits required by ERISA, and then any surplus will be used to fund a trust to continue present

and future payments under the postretirement medical and life insurance benefits in our group insurance benefit programs.

We have an agreement with the U.S. Government with respect to certain pension plans. Under the agreement, should we terminate any of the plans under conditions in which the plan's assets exceed that plan's obligations, the U.S. Government will be entitled to a fair allocation of any of the plan's assets based on plan contributions that were reimbursed under U.S. Government contracts. Also, the Revenue Reconciliation Act of 1990 imposes a 20% non-deductible excise tax on the gross assets reverted if we establish a qualified replacement plan or amend the terminating plan to provide for benefit increases; otherwise, a 50% tax is applied. Any net amount we retain is treated as taxable income.

401(k)

We provide certain defined contribution plans to all eligible employees. The principal plans are the Company-sponsored 401(k) plans and an unfunded plan for unused sick leave. The provision for these defined contribution plans was $468, $464 and $448 in 2004, 2003 and 2002, respectively.

Note 17 – Share-Based Compensation

In December 2004, the FASB issued SFAS No. 123 (revised 2004) (SFAS No. 123R), *Shared-Based Payment*. We will early adopt the provisions of SFAS No. 123R as of January 1, 2005 using the modified prospective method. See Note 2 for further discussion.

The 'Share-based plans expense' caption on the Consolidated Statements of Operations represents the total expense we recognized for all our plans that are payable only in stock. These plans are described below.

The following summarizes share-based plans expense for the years ended December 31, 2004, 2003 and 2002, respectively:

	2004	2003	2002
Performance Shares	**$449**	$316	$295
ShareValue Trust	**74**	71	71
Stock options, other	**53**	69	81
	$576	$456	$447

Certain deferred stock compensation plans are reflected in general and administrative expense. We had issued 10,343,380 stock units as of December 31, 2004, that are convertible to either stock or a cash equivalent, of which 9,549,837 are vested, and the remainder vest with employee service. These stock units principally represent a method of deferring employee compensation by which a liability is established based upon the current stock price. An expense or reduction in expense is recognized associated with the change in that liability balance. The (increase)/reduction in expense related to deferred stock compensation was $(72), $(68) and $42 in 2004, 2003 and 2002, respectively.

Performance Shares

Performance Shares are stock units that are convertible to common stock contingent upon stock price performance. If, at any time up to five years after award, the stock price reaches and maintains a price equal to 161.0% of the stock issue price at the date of the award (representing a growth rate of 10% compounded annually for five years), 25% of the Performance Shares awarded are convertible to common stock. Likewise, at stock prices equal to 168.5%, 176.2%, 184.2%, 192.5% and 201.1% of the stock price at the date of award, the cumulative portion of awarded Performance Shares convertible to common stock are 40%, 55%, 75%, 100% and 125%, respectively. Performance Shares awards not converted to common stock expire five years after the date of the award; however, the Compensation Committee of the Board of Directors may, at its discretion, allow vesting of up to 100% of the target Performance Shares if our total shareholder return (stock price appreciation plus dividends) during the five-year performance period exceeds the average total shareholder return of the S&P 500 over the same period.

Beginning with our 2003 grants, all new Performance Shares awarded are subject to different terms and conditions from those previously reported. If at any time up to five years after award the stock price reaches and maintains for twenty consecutive days a price equal to a cumulative growth rate of 40% above the grant price, 15% of the Performance Shares awarded are convertible to common stock. Likewise, at cumulative growth rates above the grant price equal to 50%, 60%, 70%, 80%, 90%, 100%, 110%, 120% and 125%, the cumulative portion of awarded shares convertible to common stock are 30%, 45%, 60%, 75%, 90%, 100%, 110%, 120% and 125%, respectively. Performance Shares awards not converted to common stock expire five years after the date of the award. In the event all stock price hurdles have not been met, at the end of the performance period, unvested shares may vest based on our Total Shareholder Return (TSR) performance relative to the S&P 500. If less than 125% of the grant has vested at the end of the five-year performance period, an award formula will be applied to the initial grant based on the percentile rank of our TSR relative to the S&P 500. This can result in a vesting of the Performance Shares award up to a total of 125% and only applies if (1) our total shareholder return during the five-year performance period meets or exceeds the median total shareholder return of the S&P 500 over the same period and (2) total shareholder return is in excess of the five-year Treasury Bill rate at the start of the five-year period.

During the twelve months ended December 31, 2004, our stock price met the 70% cumulative growth rate level for performance share grants made in 2003. Accordingly, pursuant to the plan's terms, 60% of the 2003 Performance Shares awarded were converted to 5,316,363 shares of common stock. In addition, for the twelve months ended December 31, 2004, we recorded an additional $57 of compensation expense to reflect the cumulative expense for those Performance Shares converted to common stock.

The following table summarizes information about Performance Shares outstanding at December 31, 2004, 2003 and 2002, respectively.

(Shares in thousands)			Performance Shares Outstanding		
Grant Date	Expiration Date	Issue Price	**2004**	2003	2002
2/22/99	2/22/04	36.25		1,163	1,155
2/28/00	2/28/05	37.00	**2,635**	2,294	2,286
10/09/00	2/28/05	37.00	**266**	574	576
2/26/01	2/26/06	62.76	**5,826**	5,782	5,810
2/25/02	2/25/07	44.94	**5,564**	5,540	5,643
2/24/03	2/24/08	30.27	**3,540**	8,843	
2/23/04	2/23/09	43.53	**10,792**		

ShareValue Trust

The ShareValue Trust, established effective July 1, 1996, is a 14-year irrevocable trust that holds Boeing common stock, receives dividends and distributes to employees appreciation in value above a 3% per annum threshold rate of return. As of December 31, 2004, the Trust held 38,982,205 shares of our common stock, split between two funds, "fund 1" and "fund 2." On June 30, 2004, the market value of fund 2 exceeded $913 (the threshold representing a 3% per annum rate of return). Based on the average stock price of $50.825 as of June 30, 2004, the market value of fund 2 exceeded the threshold by $143 resulting in a distribution to participants. The distribution was paid in Boeing common stock, except for partial shares, distributions to foreign employees and beneficiaries of deceased participants, which were paid in cash. After employee withholding taxes, approximately 1.7 million shares of common stock were distributed to participants. These transactions were recorded as a deduction from additional paid-in capital.

If on June 30, 2006, the market value of fund 1 exceeds $1,004, the amount in excess of the threshold will be distributed to employees. Shares held by the Trust on June 30, 2010, after final distribution will revert back to us.

Similarly, if on June 30, 2008, the market value of fund 2 exceeds $1,028, the amount in excess of the threshold will be distributed to employees. Shares held by the Trust on June 30, 2010, after final distribution will revert back to us.

The ShareValue Trust is accounted for as a contra-equity account and stated at market value. Market value adjustments are offset to additional paid-in capital.

Stock options

Our 1997 Incentive Stock Plan (1997 Plan) permits the grant of stock options, stock appreciation rights (SARs) and restricted stock awards (denominated in stock or stock units) to any employee of ours or our subsidiaries and contract employees. Under the terms of the plan, 64 million shares are authorized for issuance upon exercise of options, as payment of SARs and as restricted stock awards, of which no more than an aggregate of 6,000,000 shares are available for issuance as restricted stock awards and no more than an aggregate of 3,000,000 shares are available for issuance as restricted stock that is subject to restrictions based on continuous employment for less than three years. This authorization for issuance under the 1997 Plan will terminate on April 30, 2007. As of December 31, 2004, no SARs have been granted under the 1997 Plan. The 1993 Incentive Stock Plan permitted the grant of options, SARs and stock to employees of ours or our subsidiaries. The 1988 and 1984 stock option plans permitted the grant of options or SARs to officers or other key employees of ours or our subsidiaries. No further grants may be awarded under these three plans.

On April 28, 2003, the shareholders approved The Boeing Company 2003 Incentive Stock Plan (2003 Plan). The 2003 Plan will permit awards of incentive stock options, nonqualified stock options, restricted stock, stock units, Performance Shares, performance units and other incentives. The aggregate number of shares of Boeing stock available for issuance under the 2003 Plan will not exceed 30 million and no participant may receive more than 2,000,000 shares in any one calendar year. Under the terms of the 2003 Plan, no more than an aggregate of 6,000,000 shares are available for issuance as restricted stock awards and no more than an aggregate of 1,500,000 shares are available for issuance as restricted stock that is subject to restrictions based on continuous employment for less than three years. A summary of the principal features is provided in our 2003 Proxy Statement.

Options have been granted with an exercise price equal to the fair market value of our stock on the date of grant and expire ten years after the date of grant. Vesting is generally over a five-year service period with portions of a grant becoming exercisable at one year, three years and five years after the date of grant.

Information concerning stock options issued to directors, officers and other employees is presented in the following table:

	2004		2003		2002	
(Shares in thousands)	**Shares**	**Weighted Average Exercise Price**	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Number of shares under option:						
Outstanding at beginning of year	**28,918**	**$43.68**	28,668	$44.01	28,186	$42.97
Granted	**74**	**43.97**	2,507	33.72	2,745	40.69
Exercised	**(2,973)**	**34.35**	(932)	32.64	(1,998)	24.47
Canceled or expired	**(1,292)**	**50.38**	(1,325)	55.20	(265)	46.17
Outstanding at end of year	**24,727**	**44.49**	28,918	43.68	28,668	44.01
Exercisable at end of year	**20,290**	**45.22**	21,803	44.19	20,384	42.75

As of December 31, 2004, 6,839,168 shares were available for grant under the 1997 Plan, 3,215,168 shares were available for grant under the Incentive Compensation Plan, and 18,604,375 shares were available for grant under the 2003 Plan.

The following table summarizes information about stock options outstanding at December 31, 2004 (shares in thousands):

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Shares	Weighted-Average Remaining Contractual Life (years)	Weighted-Average Price	Shares	Weighted-Average Price
$10 to $19	1,170	3.79	$14.21	1,170	$14.21
$20 to $29	930	2.93	25.19	724	24.19
$30 to $39	5,029	6.13	37.32	3,120	37.99
$40 to $49	7,408	4.7	42.11	5,845	42.44
$50 to $59	9,943	3.92	54.77	9,242	54.63
$60 to $69	247	6.2	63.78	189	63.66
	24,727			20,290	

We have determined the weighted-average fair values of stock-based arrangements granted during 2004, 2003 and 2002 to be $18.60, $13.76 and $16.78, respectively. The fair values of stock-based compensation awards granted were estimated using a binomial option-pricing model with the following assumptions:

	Grant Date	Option Term	Expected Volatility	Dividend Yield	Risk Free Interest Rate
2004	12/17/04	9 years	31%	1.1%	4.2%
2003	9/29/03	9 years	31%	1.1%	4.1%
2002	7/19/02	9 years	30%	1.1%	4.5%

Other stock unit awards

The total number of stock unit awards that are convertible only to common stock and not contingent upon stock price were 2,019,250, 1,910,293 and 1,823,591 as of December 31, 2004, 2003 and 2002, respectively.

Note 18 – Shareholders' Equity

In December 2000, a stock repurchase program was authorized by our Board of Directors, authorizing the repurchase of up to 85 million shares of our stock. We repurchased 14,708,856 shares during the year ended December 31, 2004. We did not repurchase any shares during the years ended December 31, 2003 and 2002.

20 million shares of authorized preferred stock remain unissued.

Note 19 – Derivative Financial Instruments

Derivative and hedging activities

We account for derivatives pursuant to SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. This standard requires that all derivative instruments be recognized in the financial statements and measured at fair value regardless of the purpose or intent for holding them.

We are exposed to a variety of market risks, including the effects of changes in interest rates, foreign currency exchange rates and commodity prices. These exposures are managed, in part, with the use of derivatives. The following is a summary of our risk management strategies and the effects of these strategies on the consolidated financial statements.

Cash flow hedges

Our cash flow hedges include certain interest rate swaps, cross currency swaps, foreign currency forward contracts, and commodity purchase contracts. Interest rate swap contracts under which we agree to pay fixed rates of interest are designated as cash flow hedges of variable-rate debt obligations. We use foreign currency forward contracts to manage currency risk associated with certain forecasted transactions, specifically sales and purchase commitments made in foreign currencies. Our foreign currency forward contracts hedge forecasted transactions principally occurring up to five years in the future. We use commodity derivatives, such as fixed-price purchase commitments, to hedge against potentially unfavorable price changes for items used in production. These include commitments to purchase electricity at fixed prices through December 2005. The changes in fair value of the percentage of the commodity derivatives that are not designated in a hedging relationship are recorded in earnings immediately. There were no significant changes in fair value reported in earnings for the years ended December 31, 2004, 2003 and 2002.

At December 31, 2004 and 2003, net gains of $35 and $5 (net of tax) were recorded in accumulated other comprehensive income/loss associated with our cash flow hedging transactions. Ineffectiveness for cash flow hedges was insignificant for the years ended December 31, 2004, 2003 and 2002. For the years ended December 31, 2004, 2003 and 2002, losses of $16, $20 and $46 (net of tax) were reclassified to cost of products and services. Based on our current portfolio of cash flow hedges, we expect to reclassify to cost of products and services a gain of $14 (net of tax) during the next year.

Fair value hedges

Interest rate swaps under which we agree to pay variable rates of interest are designated as fair value hedges of fixed-rate debt. The net change in fair value of the derivatives and the hedged items is reported in earnings. Ineffectiveness related to the interest rate swaps was insignificant for the years ended December 31, 2004, 2003 and 2002.

For the years ended December 31, 2004, 2003 and 2002, $24, $13 and $5 of gains related to the basis adjustment of certain terminated interest rate swaps and forward-starting interest rate swaps were amortized to earnings, respectively.

Derivative financial instruments not receiving hedge treatment

We also hold certain non-hedging instruments, such as interest exchange agreements, interest rate swaps, warrants, conversion feature of convertible debt and foreign currency forward contracts. The changes in fair value of these instruments are recorded in earnings. For the years ended December 31, 2004, 2003 and 2002, these non-hedging instruments resulted in gains of $19, $38 and $25.

We held forward-starting interest rate swap agreements to fix the cost of funding a firmly committed lease for which payment terms are determined in advance of funding. During the year ended December 31, 2003, the forward-starting interest rate swaps no longer qualified for fair value hedge accounting treatment. As a result, we recognized a pre-tax charge of $21. For the years ended December 31, 2003 and 2002, ineffectiveness losses of $1 and $8 were recorded in interest expense related to the forward-starting interest rate swaps.

Note 20 – Arrangements with Off-Balance Sheet Risk

We enter into arrangements with off-balance sheet risk in the normal course of business, as discussed below. These arrangements are primarily in the form of guarantees, ETC investments, and product warranties.

Guarantees

In November 2002, the FASB Interpretation No. 45 (FIN 45), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of the Indebtedness of Others*, which clarifies the requirements of SFAS No. 5, *Accounting for Contingencies*, relating to a guarantor's accounting for and disclosures of certain guarantees was issued. FIN 45 requires enhanced disclosures for certain guarantees. It also requires certain guarantees that are issued or modified after December 31, 2002, including third-party guarantees, to be initially recorded on the balance sheet at fair value. For guarantees issued on or before December 31, 2002, liabilities are recorded when and if payments become probable and estimable. FIN 45 has the general effect of delaying recognition for a portion of the revenue for product sales that are accompanied by certain third-party guarantees. The financial statement recognition provisions became effective prospectively beginning January 1, 2003. During 2004 and 2003, the fair value of guarantees we issued was not material.

Third-party guarantees

The following tables provide quantitative data regarding our third-party guarantees. The maximum potential payments represent a "worst-case scenario," and do not necessarily reflect our expected results. Estimated proceeds from collateral and recourse represent the anticipated values of assets we could liquidate or receive from other parties to offset our payments under guarantees. The carrying amount of liabilities recorded on the balance sheet reflects our best estimate of future payments we may incur as part of fulfilling our guarantee obligations.

As of December 31, 2004	Maximum Potential Payments	Estimated Proceeds from Collateral/ Recourse	Carrying Amount of Liabilities*
Contingent repurchase commitments	$3,751	$3,743	
Trade-in commitments	972	947	$25
Asset-related guarantees	408	296	12
Credit guarantees related to the Sea Launch venture	510	306	204
Other credit guarantees	60	19	10
Equipment trust certificates	28		
Performance guarantees	64	21	1

*Amounts included in Accounts payable and other liabilities

As of December 31, 2003	Maximum Potential Payments	Estimated Proceeds from Collateral/ Recourse	Carrying Amount of Liabilities*
Contingent repurchase commitments	$5,712	$5,712	
Trade-in commitments	1,279	1,214	$65
Asset-related guarantees	468	364	5
Credit guarantees related to the Sea Launch venture	519	311	208
Other credit guarantees	106	50	5
Equipment trust certificates	28		
Performance guarantees	56	18	

*Amounts included in Accounts payable and other liabilities

In conjunction with signing a definitive agreement for the sale of new aircraft (Sale Aircraft), we have entered into specified-price trade-in commitments with certain customers that give them the right to trade in used aircraft for the purchase of Sale Aircraft. Additionally, we have entered into contingent repurchase commitments with certain customers wherein we agree to repurchase the Sale Aircraft at a specified price, generally ten years after delivery of the Sale Aircraft. Our repurchase of the Sale Aircraft is contingent upon a future, mutually acceptable agreement for the sale of additional new aircraft. If, in the future, we execute an agreement for the sale of additional new aircraft, and if the customer exercises its right to sell the Sale Aircraft to us, a contingent repurchase commitment would become a trade-in commitment. Contingent repurchase commitments and trade-in commitments are now included in our guarantees discussion based on our current analysis of the underlying transactions. Based on our historical experience, we believe that very few, if any, of our outstanding contingent repurchase commitments will ultimately become trade-in commitments.

Exposure related to the trade-in of used aircraft resulting from trade-in commitments may take the form of: (1) adjustments to revenue related to the sale of new aircraft determined at the signing of a definitive agreement, and/or (2) charges to cost of products and services related to adverse changes in the fair value of trade-in aircraft that occur subsequent to signing of a definitive agreement for new aircraft but prior to the purchase of the used trade-in aircraft. The trade-in aircraft exposure included in Accounts payable and other liabilities in the tables above is related to item (2) above.

There is a high degree of uncertainty inherent in the assessment of the likelihood of trade-in commitments. The probability that trade-in commitments will be exercised is determined by using both quantitative information from valuation sources and qualitative information from other sources and is continually assessed by management. As disclosed in the above table, the maximum amounts payable under trade-in commitments were $972 and $1,279 as of December 31, 2004 and 2003. Based on the best market information available at the time, it was probable that we would be obligated to perform on trade-in commitments with gross amounts payable to customers totaling $116 and $582 as of December 31, 2004 and 2003. The estimated fair value of trade-in aircraft related to probable contractual trade-in commitments was $91 and $517 as of December 31, 2004 and 2003. Accounts payable and other liabilities included $25 and $65 as of December 31, 2004 and 2003, which represents the exposure related to these trade-in commitments.

We have issued various asset-related guarantees, principally to facilitate the sale of certain commercial aircraft. Under these arrangements, we are obligated to make payments to a guaranteed party in the event the related aircraft fair values fall below a specified amount at a future point in time. These obligations are collateralized principally by commercial aircraft, and expire within the next 14 years.

We have issued credit guarantees to creditors of the Sea Launch venture, of which we are a 40% partner, to assist the venture in obtaining financing. We have substantive guarantees from the other venture partners, who are obligated to reimburse us for their share (in proportion to their Sea Launch ownership percentages) of any guarantee payment we may make related to the Sea Launch obligations. Some of these guarantees are also collateralized by certain assets of the venture. In addition, we have issued credit guarantees, principally to facilitate the sale of commercial aircraft. Under these arrangements, we are obligated to make payments to a guaranteed party in the event that lease or loan payments are not made by the original debtor or lessee. Our commercial aircraft credit-related guarantees are collateralized by the underlying commercial aircraft. A substantial portion of these guarantees has been extended on behalf of original debtors or lessees with less than investment-grade credit. Current outstanding credit guarantees expire within the next 11 years.

Relating to our ETC investments, we have potential obligations relating to shortfall interest payments in the event that the interest rates in the underlying agreements are reset below levels specified in these agreements. These obligations would cease if United were to default on its interest payments to the trust. These guarantees will expire within the next 12 years.

We had certain obligations to investors in the trusts as a liquidity provider for ETC pass-through arrangements, which required funding to the trust to cover interest due to such investors in the event of default by United. In the event of funding, we are entitled to receive a first priority position in the ETC collateral in the amount of the funding. On February 7, 2003, we advanced $101 to the trust perfecting our collateral position and terminating our liquidity obligation. On August 9, 2004, The Bank of New York, acting as the collateral agent, reimbursed us for this advance with a total payment of $107. The payment included the original advanced amount, as well as interest income related to the advance.

We have outstanding performance guarantees issued in conjunction with joint venture investments. Pursuant to these guarantees, we would be required to make payments in the event a third-party fails to perform specified services. Current performance guarantees expire within the next 13 years.

Product warranties

We provide product warranties in conjunction with certain product sales. The majority of our warranties are issued by our Commercial Airplanes segment. Generally, aircraft sales are accompanied by a three- to four-year standard warranty for systems, accessories, equipment, parts and software manufactured by us or manufactured to certain standards under our authorization. Additionally, on occasion we have made commitments beyond the standard warranty obligation to correct fleet wide major warranty issues of a particular model. These costs are included in the program's estimate at completion (EAC) and expensed as aircraft are delivered. These warranties cover factors such as non-conformance to specifications and defects in material and design. Warranties issued by our IDS segment principally relate to sales of military aircraft and weapons hardware. These sales are generally accompanied by a six to twelve-month warranty period and cover systems, accessories, equipment, parts and software manufactured by us to certain contractual specifications. These warranties cover factors such as non-conformance to specifications and defects in material and workmanship.

Estimated costs related to standard warranties are recorded in the period in which the related product sales occur. The warranty liability recorded at each balance sheet date reflects the estimated number of months of warranty coverage outstanding for products delivered times the average of historical monthly warranty payments, as well as additional amounts for certain major warranty issues that exceed a normal claims level. The following table summarizes product warranty activity recorded during 2004 and 2003.

	Product Warranty Liabilities*
Beginning balance-January 1, 2003	$ 898
Additions for new warranties	155
Reductions for payments made	(250)
Changes in estimates	22
Ending balance–December 31, 2003	825
Additions for new warranties	114
Reductions for payments made	(252)
Changes in estimates	94
Ending balance – December 31, 2004	**$ 781**

*Amounts included in Accounts payable and other liabilities

Material variable interests in unconsolidated entities

Our investments in ETCs, EETCs and Special Purpose Entities (SPEs) continue to be included in the scope of Revised

Interpretation No. 46 (FIN 46(R)), *Consolidation of Variable Interest Entities*. All entities that were required to be consolidated under FIN 46(R) had been previously consolidated and therefore, the adoption of FIN 46(R) had no impact on our consolidated financial statements.

From 1999 through 2004, we invested in ETCs and EETCs, which are trusts that passively hold debt investments for a large number of aircraft to enhance liquidity for investors, who in turn pass this liquidity benefit directly to airlines in the form of lower coupon and/or greater debt capacity. ETCs and EETCs provide investors with tranched rights to cash flows from a financial instrument, as well as a collateral position in the related asset. Our investments in ETCs and EETCs do not require consolidation under FIN 46(R). We believe that our maximum exposure to economic loss from ETCs and EETCs is $349, comprised of our $321 investment balance and a maximum potential exposure of $28 relating to potential shortfall interest payments. Accounting losses, if any, from period to period could differ. As of December 31, 2004, the ETC and EETC transactions we participated in had total assets of $3,916 and total debt (which is non-recourse to us) of $3,595. During the year ended December 31, 2004, we recorded revenues of $28 and cash flows of $70.

From 1998 through 2004, we provided subordinated loans to certain SPEs that are utilized by the airlines, lenders and loan guarantors, including, for example, the Export-Import Bank of the United States. All of these SPEs are included in the scope of FIN 46(R); however, only certain SPEs require consolidation. SPE arrangements are utilized to isolate individual transactions for legal liability or tax purposes, or to perfect security interests from our perspective, as well as, in some cases, that of a third-party lender in certain leveraged lease transactions. We believe that our maximum exposure to economic loss from non-consolidated SPE arrangements that are Variable Interest Entities (VIEs) is $43, which represents our investment balance. Accounting losses, if any, from period to period could differ. As of December 31, 2004, these SPE arrangements had total assets of $451 and total debt (which is non-recourse to us) of $408. During the year ended December 31, 2004, we recorded revenues of $3 and cash flows of $28.

Industrial Revenue Bonds

We utilize Industrial Revenue Bonds (IRBs) issued by the City of Wichita to finance the purchase and/or construction of real and personal property at our Wichita site. Tax benefits associated with IRBs include a provision for a ten-year property tax abatement and a sales tax exemption from the Kansas Department of Revenue. We record the property on our Consolidated Statements of Financial Position, along with a capital lease obligation to repay the proceeds of the IRB. We have also purchased the IRBs and therefore are the Bondholder as well as the Borrower/Lessee of the property purchased with the IRB proceeds.

We also have a similar arrangement in place with the Development Authority of Fulton County, Georgia where we are both borrower and bondholder. Tax benefits associated with these IRBs are the provision of a ten-year partial property tax abatement. The capital lease obligation and IRB asset are recorded net in the Consolidated Statements of Financial Position pursuant to FIN 39, *Offsetting of Amounts Related to Certain Contracts*. As of December 31, 2004 and 2003, the assets and liabilities associated with the City of Wichita IRBs were $2,852 and $2,897, and the amounts associated with the Fulton County IRBs were $19.

Other commitments

Irrevocable financing commitments related to aircraft on order, including options, scheduled for delivery through 2007 totaled $6,661 and $1,495 as of December 31, 2004 and 2003. We anticipate that not all of these commitments will be utilized and that we will be able to arrange for third-party investors to assume a portion of the remaining commitments, if necessary. We had no significant commitments to arrange for equipment financing as of December 31, 2004 and 2003.

As of December 31, 2004 and 2003, future lease commitments on aircraft and other commitments not recorded on the Consolidated Statements of Financial Position totaled $483 and $524. These lease commitments extend through 2020, and our intent is to recover these lease commitments through sublease arrangements. As of December 31, 2004 and 2003, Accounts payable and other liabilities included $89 and $96 attributable to adverse commitments under these lease arrangements.

As of December 31, 2003, we had extended a $69 credit line agreement to one of our joint venture partners. As of December 30, 2004, this line of credit had been closed.

We insure our executives with Company Owned Life Insurance (COLI). We have the right to offset the loans against the cash surrender value with the cash surrender value and present the net liability or asset on the Consolidated Statements of Financial Position. At December 31, 2004 and 2003, the cash surrender value was $1,468 and $1,294 and the loans against the cash surrender value were $1,356 and $1,224, respectively. The cash surrender value net of these loans is recorded in Other assets on our Consolidated Statements of Financial Position at December 31, 2004 and 2003.

Note 21 – Significant Group Concentrations of Risk

Credit risk

Financial instruments involving potential credit risk are predominantly with commercial aircraft customers and the U.S. Government. Of the $15,654 in Accounts receivable and Customer financing included in the Consolidated Statements of Financial Position as of December 31, 2004, $10,750 related to commercial aircraft customers ($246 of Accounts receivable and $10,504 of Customer financing) and $2,701 related to the U.S. Government. Of the $10,504 of aircraft customer financing, $9,770 related to customers we believe have less than investment-grade credit. AirTran Airways, AMR Corporation, and United were associated with 14%, 12% and 11%, respectively, of our aircraft financing portfolio. Financing for aircraft is collateralized by security in the related asset, and historically we have not experienced a problem in accessing such collateral.

As of December 31, 2004, off-balance sheet financial instruments described in Note 20 predominantly related to commercial aircraft customers. Similarly, all of the $6,661 of irrevocable financing commitments related to aircraft on order including options related to customers we believe have less than investment-grade credit.

Other risk

The Commercial Airplanes segment is subject to both operational and external business environment risks. Operational risks that can disrupt its ability to make timely delivery of its commercial jet aircraft and meet its contractual commitments include execution of internal performance plans, product performance risks associated with regulatory certifications of its commercial aircraft by the U.S. Government and foreign governments, other regulatory uncertainties, collective bargaining labor disputes, performance issues with key suppliers and subcontractors and the cost and availability of energy resources, such as electrical power. Aircraft programs, particularly new aircraft models, face the additional risk of pricing pressures and cost management issues inherent in the design and production of complex products. Financing support may be provided by us to airlines, some of which are unable to obtain other financing. External business environment risks include adverse governmental export and import policies, factors that result in significant and prolonged disruption to air travel worldwide and other factors that affect the economic viability of the commercial airline industry. Examples of factors relating to external business environment risks include the volatility of aircraft fuel prices, global trade policies, worldwide political stability and economic growth, acts of aggression that impact the perceived safety of commercial flight, escalation trends inherent in pricing our aircraft and a competitive industry structure which results in market pressure to reduce product prices.

In addition to the foregoing risks associated with the Commercial Airplanes segment, the IDS businesses are subject to changing priorities or reductions in the U.S. Government defense and space budget, and termination of government contracts due to unilateral government action (termination for convenience) or failure to perform (termination for default). Civil, criminal or administrative proceedings involving fines, compensatory and treble damages, restitution, forfeiture and suspension or debarment from government contracts may result from violations of business and cost classification regulations on U.S. Government contracts.

The commercial launch and satellite service markets have some degree of uncertainty since global demand is driven in part by the launch customers' access to capital markets. Additionally, some of our competitors for launch services receive direct or indirect government funding. The satellite market includes some degree of risk and uncertainty relating to the attainment of technological specifications and performance requirements.

Risk associated with BCC includes interest rate risks, asset valuation risks, specifically, aircraft valuation risks, and credit and collectibility risks of counterparties.

As of December 31, 2004, our principal collective bargaining agreements were with the International Association of Machinists and Aerospace Workers (IAM) representing 17% of our employees (current agreements expiring in September and October 2005 and May 2007); the Society of Professional Engineering Employees in Aerospace (SPEEA) representing 14% of our employees (current agreements expiring in December 2005 and February 2008); and the United Automobile, Aerospace and Agricultural Implement Workers of America (UAW) representing 4% of our employees (current agreements expiring in September 2005, and May and October 2007).

Note 22 – Disclosures about Fair Value of Financial Instruments

The estimated fair value of our Accounts receivable, Accounts payable, Investments, and Notes receivable balances at December 31, 2004 and 2003 approximate their carrying value as reflected in the Consolidated Statements of Financial Position.

As of December 31, 2004 and 2003, the carrying amount of debt, net of capital leases, was $11,884 and $14,044 and the fair value of debt, based on current market rates for debt of the same risk and maturities, was estimated at $13,198 and $15,301. Our debt is generally not callable until maturity.

With regard to financial instruments with off-balance sheet risk, it is not practicable to estimate the fair value of future financing commitments because there is not a market for such future commitments. Other off-balance sheet financial instruments, including asset-related guarantees, credit guarantees, and interest rate guarantees related to an ETC, are estimated to have a fair value of $165 and $196 at December 31, 2004 and 2003.

Note 23 – Contingencies

Legal

Various legal proceedings, claims and investigations related to products, contracts and other matters are pending against us. Most significant legal proceedings are related to matters covered by our insurance. Major contingencies are discussed below.

Government investigations We are subject to various U.S. Government investigations, including those related to procurement activities and the alleged possession and misuse of third-party proprietary data, from which civil, criminal or administrative proceedings could result or have resulted. Such proceedings involve, or could involve claims by the Government for fines, penalties, compensatory and treble damages, restitution and/or forfeitures. Under government regulations, a company, or one or more of its operating divisions or subdivisions, can also be suspended or debarred from government contracts, or lose its export privileges, based on the results of investigations. We believe, based upon current information, that the outcome of any such government disputes and investigations will not have a material adverse effect on our financial position, except as set forth below.

A-12 litigation In 1991, the U.S. Navy notified McDonnell Douglas (now one of our subsidiaries) and General Dynamics Corporation (the "Team") that it was terminating for default the

Team's contract for development and initial production of the A-12 aircraft. The Team filed a legal action to contest the Navy's default termination, to assert its rights to convert the termination to one for "the convenience of the Government," and to obtain payment for work done and costs incurred on the A-12 contract but not paid to date. As of December 31, 2004, inventories included approximately $583 of recorded costs on the A-12 contract, against which we have established a loss provision of $350. The amount of the provision, which was established in 1990, was based on McDonnell Douglas' belief, supported by an opinion of outside counsel, that the termination for default would be converted to a termination for convenience, and that the best estimate of possible loss on termination for convenience was $350.

On August 31, 2001, the U.S. Court of Federal Claims issued a decision after trial upholding the Government's default termination of the A-12 contract. The court did not, however, enter a money judgment for the U.S. Government on its claim for unliquidated progress payments. In 2003, the Court of Appeals for the Federal Circuit, finding that the trial court had applied the wrong legal standard, vacated the trial court's 2001 decision and ordered the case sent back to that court for further proceedings. This follows an earlier trial court decision in favor of the Team and reversal of that initial decision on appeal.

If, after all judicial proceedings have ended, the courts determine, contrary to our belief, that a termination for default was appropriate, we would incur an additional loss of approximately $275, consisting principally of remaining inventory costs and adjustments, and, if the courts further hold that a money judgment should be entered against the Team, we would be required to pay the U.S. Government one-half of the unliquidated progress payments of $1,350 plus statutory interest from February 1991 (currently totaling approximately $1,150). In that event, our loss would total approximately $1,518 in pre-tax charges. Should, however, the March 31, 1998 judgment of the United States Court of Federal Claims in favor of the Team be reinstated, we would receive approximately $1,001, including interest.

We believe that the termination for default is contrary to law and fact and that the loss provision established by McDonnell Douglas in 1990, which was supported by an opinion from outside counsel, continues to provide adequately for the reasonably possible reduction in value of A-12 net contracts in process as of December 31, 2004. Final resolution of the A-12 litigation will depend upon the outcome of further proceedings or possible negotiations with the U.S. Government.

EELV litigation In 1999, two employees were found to have in their possession certain information pertaining to a competitor, Lockheed Martin Corporation ("Lockheed"), under the Evolved Expendable Launch Vehicle (EELV) Program. The employees, one of whom was a former employee of Lockheed, were terminated and a third employee was disciplined and resigned. In March 2003, the USAF notified us that it was reviewing our present responsibility as a government contractor in connection with the incident. On July 24, 2003, the USAF suspended certain organizations in our space launch services business and the three former employees from receiving government contracts for an indefinite period as a direct result of alleged wrongdoing relating to possession of the Lockheed information during the EELV source selection in 1998. The USAF also terminated 7 out of 21 of our EELV launches previously awarded through a mutual contract modification and disqualified the launch services business from competing for three additional launches under a follow-on procurement. The same incident is under investigation by the U.S. Attorney in Los Angeles, who indicted two of the former employees in July 2003. We are in discussions with the USAF regarding a possible administrative agreement that would facilitate lifting of the suspension in advance of final resolution of the criminal investigation. In addition, in June 2003, Lockheed filed a lawsuit in the United States District Court for the Middle District of Florida against us and the three individual former employees arising from the same facts. Subsequently, Lockheed filed an amended complaint which added McDonnell Douglas Corporation and Boeing Launch Services as defendants. Lockheed's current complaint, which includes some 29 causes of action, seeks injunctive relief, compensatory damages in excess of $2 billion and treble and punitive damages. In August 2004, we filed counterclaims against Lockheed seeking compensatory and punitive damages. The counterclaims allege, among other things, that Lockheed made false statements to the U.S government regarding the reasons for the initial allocation of the majority of launches to us in the EELV procurement. We further allege that these false statements resulted in the claimed damages. Lockheed has filed a motion to dismiss the counterclaims, which remains pending before the court. It is not possible at this time to determine whether an adverse outcome would have a material adverse effect on our financial position.

Shareholder derivative lawsuits In September 2003, two virtually identical shareholder derivative lawsuits were filed in Cook County Circuit Court, Illinois, against us as nominal defendant and against each then current member of our Board of Directors. These suits have now been consolidated. The plaintiffs allege that the directors breached their fiduciary duties in failing to put in place adequate internal controls and means of supervision to prevent the EELV incident described above, the July 2003 charge against earnings, and various other events that have been cited in the press during 2003. The lawsuit seeks an unspecified amount of damages against each director, the return of certain salaries and other remunerations and the implementation of remedial measures.

In October 2003, a third shareholder derivative action was filed against the same defendants in federal court for the Southern District of New York. This third suit charged that our 2003 Proxy Statement contained false and misleading statements concerning the 2003 Incentive Stock Plan. The lawsuit sought a declaration voiding shareholder approval of the 2003 Incentive Stock Plan, injunctive relief and equitable accounting. This case was dismissed by the court and the plaintiff has appealed to the U.S. Court of Appeals for the Second Circuit.

It is not possible at this time to determine whether these shareholder derivative actions would have a material adverse effect on our financial position.

Department of Justice and Securities and Exchange Commission (SEC) inquiry On November 24, 2003, our Executive Vice President and Chief Financial Officer, Mike Sears, was dismissed for cause as the result of circumstances surrounding the hiring of Darleen Druyun, a former U.S. Government official. Druyun, who had been vice president and deputy general manager of Missile Defense Systems since January 2003, also was dismissed for cause. At the time of our November 24 announcement that we had dismissed the two executives for unethical conduct, we also advised that we had informed the USAF of the actions taken and were cooperating with the U.S. Government in its ongoing investigation. The investigation is being conducted by the U.S. Attorney in Alexandria, Virginia, and the DoD Inspector General concerning this and related matters. Subsequently, the SEC requested information from us regarding the circumstances underlying dismissal of the two employees. We are cooperating with the SEC's inquiry. In 2004, Druyun and Sears each pleaded guilty to a single conflict-of-interest-related criminal charge arising from Druyun having engaged in employment discussions with Sears more than two weeks prior to disqualifying herself from participating in USAF business involving us. At her sentencing, Druyun and the government asserted that she gave us favorable treatment on the USAF 767 Tanker negotiations, NATO AWACS claim, C-130 AMP Contract award, and C-17 negotiations in 2000, and that this treatment was influenced by employment negotiations and relationships with us. The Government Accountability Office has subsequently recommended that the U.S. Air Force compete additional Small Diameter Bomb work and the installation portion of the C-130 AMP Contract and analyze whether the C-130 AMP Contract should be recompeted. It is not possible to determine at this time what further actions the government authorities might take with respect to this matter, or whether those actions would have a material adverse effect on our financial position.

On October 13, 2004, the SEC requested information from us in connection with an inquiry concerning accounting issues involving pension and other post retirement benefits at several companies. We are cooperating with the SEC's inquiry. Although an SEC spokesman has publicly stated that the agency has no evidence of wrong doing, we cannot predict what actions, if any, the SEC might take with respect to this matter and whether those actions would have a material adverse effect on our financial position.

Employment discrimination litigation We are a defendant in nine employment discrimination matters filed during the period of June 1998 through January 2005, in which class certification is sought or has been granted. Three matters were filed in the federal court for the Western District of Washington in Seattle; one case was filed in the federal court for the Central District of California in Los Angeles; one case was filed in state court in California; one case was filed in the federal court in St. Louis, Missouri; one case was filed in the federal court in Tulsa, Oklahoma; one case was filed in the federal court in Wichita, Kansas, and the final case was filed in the federal court in Chicago. The lawsuits seek various forms of relief including front and back pay, overtime, injunctive relief and punitive damages. We intend to continue our aggressive defense of these cases.

The lawsuits are in varying stages of litigation. One case in Seattle alleging discrimination based on national origin (Asian) resulted in a verdict for the company following trial and is now on appeal. One case in Seattle alleging discrimination based on gender has been settled. Three cases—one in Los Angeles, one in Missouri, and one in Kansas, all alleging gender discrimination—have resulted in denials of class certification; each of those decisions is being challenged. The case in Oklahoma, also alleging gender discrimination, resulted in the granting of class action status, and is scheduled for trial in August 2005. The second case alleging discrimination based on gender in California, this one in state court, has been stayed pending the outcome of the appeal of the denial of class certification in the companion federal court case in Los Angeles. The court certified a limited class in the race discrimination case (African-American) filed in federal court in Seattle (consisting of heritage Boeing salaried employees only) and set a December 2005 trial date. The final case, also alleging race discrimination (African-American) and filed in Chicago, seeks a class of all individuals excluded from the limited class in the Seattle case.

BSSI/ICO litigation On August 16, 2004, in response to a draft demand for arbitration from ICO Global Communications (Operations), Ltd. ("ICO") seeking return of monies paid by ICO to Boeing Satellite Systems International, Inc. ("BSSI") under contracts for manufacture and launch of communications satellites, BSSI filed a complaint for declaratory relief against ICO in Los Angeles County Superior Court. BSSI's suit seeks a declaratory judgment that ICO's prior termination of the contracts for convenience extinguished all claims between the parties. ICO filed a cross complaint with the court on September 16, 2004, alleging breach of contract, and other claims, and seeking recovery of all amounts it invested in the contracts, which are alleged to be approximately $2 billion. We believe that ICO's claims lack merit and intend to aggressively pursue our suit against ICO for declaratory relief and to vigorously defend against ICO's cross-complaint.

It is not possible to determine whether any of the actions discussed would have a material adverse effect on our financial position.

Other contingencies

We are subject to federal and state requirements for protection of the environment, including those for discharge of hazardous materials and remediation of contaminated sites discussed. Such requirements have resulted in our being involved in legal proceedings, claims and remediation obligations since the 1980s.

We routinely assess, based on in-depth studies, expert analyses and legal reviews, our contingencies, obligations and commitments for remediation of contaminated sites, including assessments of ranges and probabilities of recoveries from other responsible parties who have and have not agreed to a settlement and of recoveries from insurance carriers. Our policy is to immediately accrue and charge to current expense identified exposures related to environmental remediation sites based on

our best estimate within a range of potential exposure for investigation, cleanup and monitoring costs to be incurred.

The costs incurred and expected to be incurred in connection with such activities have not had, and are not expected to have, a material adverse effect on us. With respect to results of operations, related charges have averaged less than 1% of historical annual revenues. Although not considered likely, should we be required to incur remediation charges at the high level of the range of potential exposure, the additional charges would be less than 3% of historical annual revenues.

Because of the regulatory complexities and risk of unidentified contaminated sites and circumstances, the potential exists for environmental remediation costs to be materially different from the estimated costs accrued for identified contaminated sites. However, based on all known facts and expert analyses, we believe it is not reasonably likely that identified environmental contingencies will result in additional costs that would have a material adverse impact on our financial position or to our operating results and cash flow trends.

We have possible material exposures related to the 747 program, principally attributable to termination costs that could result from a lack of market demand. We are continuing to monitor the commercial market for the 747 and potential new derivatives. Due to uncertainty of the market acceptance, termination of production is reasonably possible. A forward loss is not expected as a result of a decision to complete production but program margins would be modestly impacted. Additionally, completion of production may create excess spare inventory, resulting in a charge that is not expected to be material. A decision to proceed with new derivatives or complete production is likely to be made mid-year 2005.

Additionally, we have possible material exposures related to the 767 program, also attributable to termination costs that could result from a lack of market demand. The long-term viability of the 767 program is dependent on receiving a timely USAF Tanker contract. Due to the uncertainty, production completion is reasonably possible. A forward loss is not expected as a result of this decision but program margins would be significantly impacted. Additionally, completion of production may create excess spares inventory, resulting in a charge that is not expected to be material. We continue to actively market the 767 program to commercial customers and position the program to support a USAF 767 Tanker contract and other military applications. A decision to complete production is likely to be made mid-year 2005.

We have entered into standby letters of credit agreements and surety bonds with financial institutions primarily relating to the guarantee of future performance on certain contracts. Contingent liabilities on outstanding letters of credit agreements and surety bonds aggregated approximately $3,183 as of December 31, 2004 and approximately $2,364 at December 31, 2003.

Note 24 – Segment Information

We operate in six principal segments: Commercial Airplanes; A&WS, Network Systems, Support Systems, and L&OS, collectively IDS; and BCC. All other activities fall within the Other segment, principally made up of Boeing Technology, Connexion by Boeing[SM] and our Shared Services Group. Our primary profitability measurements to review a segment's operating results are earnings from operations and operating margins.

Our Commercial Airplanes operation principally involves development, production and marketing of commercial jet aircraft and providing related support services, principally to the commercial airline industry worldwide.

IDS operations principally involve research, development, production, modification and support of the following products and related systems: military aircraft, both land-based and aircraft-carrier-based, including fighter, transport and attack aircraft with wide mission capability, and vertical/short takeoff and landing capability; helicopters and missiles, space systems, missile defense systems, satellites and satellite launching vehicles, rocket engines and information and battle management systems. Although some IDS products are contracted in the commercial environment, the primary customer is the U.S. Government.

See Note 25 for a discussion of the BCC segment operations.

Boeing Technology is an advanced research and development organization focused on innovative technologies, improved processes and the creation of new products. Effective April 1, 2004, ATM was absorbed into the Phantom Works research division which is included within Boeing Technology. Connexion by Boeing[SM] provides two-way broadband data communications service for global travelers. Financing activities other than BCC, consisting principally of four C-17 transport aircraft under lease to the UKRAF, are included within the Other segment classification.

While our principal operations are in the United States, Canada, and Australia, some key suppliers and subcontractors are located in Europe and Japan. Sales and other operating revenue by geographic area consisted of the following:

Year ended December 31,	**2004**	2003	2002
Asia, other than China	**$ 6,091**	$ 6,885	$ 7,607
China	**1,769**	745	1,433
Europe	**4,506**	3,826	5,865
Oceania	**1,032**	1,944	1,813
Africa	**625**	670	526
Canada	**644**	639	287
Latin America, Caribbean and other	**738**	607	354
	15,405	15,316	17,885
United States	**37,052**	34,940	35,946
Total sales	**$52,457**	$50,256	$53,831

Commercial Airplanes segment sales were approximately 77%, 80% and 78% of total sales in Europe and approximately 90%, 90% and 87% of total sales in Asia, excluding China, for 2004, 2003 and 2002, respectively. IDS sales were approximately 20%, 16% and 20% of total sales in Europe and approximately 8%, 8% and 12% of total sales in Asia, excluding China, for 2004, 2003 and 2002 respectively. Exclusive of these amounts, IDS sales were principally to the U.S. Government and represented 56%, 50% and 42% of consolidated sales for 2004, 2003 and 2002, respectively. Approximately 6% of operating assets are located outside the United States.