



**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Financial Statements
and Supplemental Schedules

June 30, 2008 and 2007

(With Independent Auditors' Report Thereon)

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**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Table of Contents

	Page
Independent Auditors' Report	1
Management's Discussion and Analysis	3
Financial Statements:	
Statements of Net Assets – June 30, 2008 and 2007	12
Statements of Revenues, Expenses, and Changes in Net Assets – Years ended June 30, 2008 and 2007	14
Statements of Cash Flows – Years ended June 30, 2008 and 2007	15
Notes to Financial Statements	17
Supplemental Schedules	
Schedule of Net Assets – June 30, 2008	34
Schedule of Revenues, Expenses, and Changes in Net Assets – Year ended June 30, 2008	36
Grants – Federal – Year ended June 30, 2008	37
Grants – California Transportation Commission – Year ended June 30, 2008	38
Grants – Metropolitan Transportation Commission – Year ended June 30, 2008	39
Grants – San Francisco County Transportation Authority – Year ended June 30, 2008	40
Grants – Others – Year ended June 30, 2008	42
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	43



KPMG LLP
55 Second Street
San Francisco, CA 94105

Independent Auditors' Report

The Honorable Mayor, Board of Supervisors
and San Francisco Municipal Transportation Agency Board of Directors
City and County of San Francisco, California:

We have audited the accompanying financial statements of the San Francisco Municipal Railway (Muni) and the San Francisco Municipal Railway Improvement Corporation (SFMRIC), departments of the City and County of San Francisco, California (the City) and the San Francisco Municipal Transportation Agency (SFMTA), as of and for the years ended June 30, 2008 and 2007, as listed in the table of contents. These financial statements are the responsibility of the management of Muni and SFMRIC. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in note 1, the financial statements of Muni and SFMRIC are intended to present the financial position, and the changes in the financial position and cash flows of only that portion of the City that are attributable to the transactions of Muni and SFMRIC. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2008 and 2007, the changes in its financial position, or, where applicable, its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Muni and SFMRIC as of June 30, 2008 and 2007, and their changes in financial position and cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 23, 2008 on our consideration of Muni's and SFMRIC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in

accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 3 through 11 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of Muni and SFMRIC. The accompanying supplemental schedules as listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

As discussed in notes 2(b) and 8(c) to the financial statements, Muni adopted the recognition and disclosure provisions of Governmental Accounting Standards Board Statement No. 45 – *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as of July 1, 2007.

KPMG LLP

December 23, 2008

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

As management of the San Francisco Municipal Railway (Muni) and the San Francisco Municipal Railway Improvement Corporation (SFMRIC), we offer readers of Muni and SFMRIC's financial statements this narrative overview and analysis of the financial activities of Muni and SFMRIC for the fiscal years ended June 30, 2008 and 2007. We encourage readers to consider the information presented here in conjunction with information contained in the financial statements. All amounts, unless otherwise noted, are expressed in thousands of dollars.

Financial Highlights

- The assets of Muni and SFMRIC exceeded their liabilities at the close of the most recent fiscal year by \$1,856,320.
- Muni and SFMRIC's total net assets increased by \$14,330. This increase is due primarily to an increase in operating revenues and general fund subsidy.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to Muni and SFMRIC's financial statements. Muni is an enterprise fund of the City and County of San Francisco (the City). SFMRIC is a nonprofit corporation established to provide capital financial assistance on behalf of the City for the modernization of Muni by purchasing equipment and improving facilities. SFMRIC has no employees. As explained in note 2(a) to the financial statements (page 17), Muni and SFMRIC apply Governmental Accounting Standards Board (GASB) Statements. Muni and SFMRIC are an integral part of the City and these financial statements are included in the City's Comprehensive Annual Financial Report. More information regarding Muni and SFMRIC's organization and the basis of presentation is contained in notes 1 and 2(a). Only the accounts of Muni and SFMRIC are included in these financial statements.

The statements of net assets (found on pages 12 and 13) present information on all of Muni and SFMRIC's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of the financial position of Muni and SFMRIC. Comparative information of Muni and SFMRIC's financial position is presented as of June 30, 2008 and 2007.

The statements of revenues, expenses, and changes in net assets (found on page 14) present information showing how Muni and SFMRIC's net assets changed during the most recent two fiscal years. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Revenues and expenses are reported in these statements for some items that will result in cash flows in future fiscal periods.

The statements of cash flows (found on pages 15 and 16), present information about the cash receipts and payments of Muni and SFMRIC during the most recent two fiscal years. These statements show the effects on Muni and SFMRIC's cash balances of cash flows from operating, noncapital financing, capital and related financing, and investing activities. When used with related disclosures and information in the other financial statements, the information in the statements of cash flows helps readers assess Muni and SFMRIC's ability to

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

generate net cash flows, their ability to meet their obligations as they come due, and their needs for external financing.

Notes to Financial Statements

The notes provide additional information that is essential to the full understanding of the data provided in the financial statements. The notes to financial statements can be found on pages 17 through 33 of this report.

Other Information

The supplemental schedules found on pages 34 through 42 of this report are presented for the purpose of additional analysis and are not a required part of the financial statements.

Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of an entity's financial position. In the case of Muni and SFMRIC, assets exceeded liabilities by \$1,856,320 at the close of the most recent fiscal year.

Summary of Net Assets

June 30, 2008, 2007, and 2006

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Assets:			
Total current assets	\$ 251,518	215,973	192,405
Total restricted assets	27,977	25,131	32,487
Capital assets	1,900,644	1,862,353	1,782,880
Total assets	<u>2,180,139</u>	<u>2,103,457</u>	<u>2,007,772</u>
Liabilities:			
Total current liabilities	153,741	119,239	96,715
Total noncurrent liabilities	170,078	142,228	149,761
Total liabilities	<u>323,819</u>	<u>261,467</u>	<u>246,476</u>
Net assets:			
Invested in capital assets, net of related debt	1,900,644	1,854,377	1,782,880
Restricted net assets	26,480	23,675	31,590
Unrestricted net assets	(70,804)	(36,062)	(53,174)
Total net assets	<u>\$ 1,856,320</u>	<u>1,841,990</u>	<u>1,761,296</u>

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

Fiscal Year 2008

Muni and SFMRIC's net assets increased by \$14,330 with the unrestricted net asset deficit position higher compared to the prior year. This is mostly due to an increase in operating expenses partly attributable to \$31.8 million increase in personnel expense from adoption of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pension*, compared to prior fiscal year.

Almost all of Muni's net assets (\$1,900,644 as of June 30, 2008) reflect its investment in capital assets (specifically land, building structure and improvements, equipment, infrastructure, and construction-in-progress). The value of these assets of \$2,753,754 is offset by accumulated depreciation of \$853,110. More information can be found in note 5 on pages 23 through 25. Muni and SFMRIC use these assets to provide services.

The remainder of Muni's net assets is composed of restricted net assets including deposits and investments with the City and receivables and unrestricted net assets in a deficit position.

Muni received a cash advance of \$51 million in FY2008 to fund eight different capital projects from Proposition IB funds (Infrastructure Bond). The bond measure was composed of several funding programs solely for public transit projects. These funds must be obligated within three years. The amount received by Muni is reflected as grants received in advance under current liabilities category. The State Office of Homeland Security also approved funding for Muni transit security projects in the amount of \$7 million under Prop 1B. The grant award letter is dated April 22, 2008 but the cash advance of \$7 million was received in August 2008.

Fiscal Year 2007

Muni and SFMRIC's net assets increased by \$80,694 with the unrestricted net asset deficit position lower compared to the prior year. This is mostly due to an increase in capital contributions and increase in City's general fund support as compared to prior fiscal year.

Almost all of Muni's net assets (\$1,854,377 as of June 30, 2007) reflect its investment in capital assets (specifically land, building structure and improvements, equipment, infrastructure, and construction-in-progress). The value of these assets of \$2,639,588 is offset by accumulated depreciation of \$777,235 and debt of \$7,976. More information can be found in note 5 on pages 23 through 25. Muni and SFMRIC use these assets to provide services.

The remainder of Muni's net assets is composed of restricted net assets including deposits and investments with the City and receivables and unrestricted net assets in a deficit position.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

Summary of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2008, 2007, and 2006

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Revenues:			
Total operating revenues	\$ 165,055	149,185	141,135
Total nonoperating revenues, net	111,978	108,870	109,807
Capital contributions:			
Federal	59,099	73,511	43,923
State and others	78,296	71,456	46,608
Total capital contributions	137,395	144,967	90,531
Net transfers	303,403	293,513	280,413
Total revenues and net transfers	717,831	696,535	621,886
Expenses:			
Total operating expenses	703,501	615,841	581,100
Change in net assets	14,330	80,694	40,786
Total net assets – beginning	1,841,990	1,761,296	1,720,510
Total net assets – ending	\$ <u>1,856,320</u>	<u>1,841,990</u>	<u>1,761,296</u>

Fiscal Year 2008

Total revenues and net transfers for the year ended June 30, 2008 were \$717,831, an increase of \$21,296, or 3.1%, compared to the previous year. The increase is due primarily to increase in operating revenues, nonoperating revenues and operating transfers offset by a decrease in capital contributions.

Operating revenues increased by \$15,870, or 10.6%. Transit passenger fares increased by \$8,368, or 5.9%, as ridership increase and partly to gradual rebound in the Bay Area economy. In addition, advertising revenues increased by \$7,073, or 128%, with a new and improved transit shelter ads contract that took effect in December 2007. Nonoperating revenues increased by \$3,108, or 2.8%, compared to the previous year. This category includes operating support received from other sources, primarily federal and state operating grants. Capital contributions consist principally of funds received or receivable from federal, state and local grant agencies that provide funding for many of Muni's capital projects. There were less capitalized expenditures incurred and billable to the funding agencies than in the prior year. Net transfers increased by \$9,890, or 3.4%, in fiscal year 2008 compared to prior year, partly attributable to increase in subsidy from City General Fund for budgetary fund support. Parking-related revenues, such as parking fines, taxes, garages, and meters were reclassified and are being reported in the net transfers category. These revenues were reported under the nonoperating revenues category in the prior years.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

Total expenses for the year ended June 30, 2008 were \$703,501, an increase of \$87,660, or 14.2%, compared to the previous year. The resulting net increases are comprised of trend changes from various expense categories. Personnel service costs increased by \$60,298, or 14.7%. The increase is attributable to increases in salaries, fringe benefits, worker's compensation expenses and the recognition of other postemployment benefits (OPEB) costs amounting to \$31,813. This is the first year that the City implemented the *Government Accounting Standard Board* Statement 45 reporting on other post retirement benefits. Materials and supplies increased by \$7,959, or 20.8%, due to continuing rise in fuel costs and to meet service demand. General and administrative operating expenses increased by \$4,603, or 16.3%, attributable to an increase in general liability claims that were due and payable in fiscal year 2008. Depreciation expense increased by \$9,177, or 10.1%, compared to prior year. This is primarily attributable to depreciation for a significant amount of capital assets capitalized and put into service late in the prior fiscal year.

Fiscal Year 2007

Total revenues and transfers in for the year ended June 30, 2007 were \$696,535, an increase of \$74,649 compared to the previous year. The increase is due primarily to an increase in operating revenues, capital contributions, and operating transfers offset by decreases in nonoperating revenues.

Net operating revenues increased by \$8,050, or 5.7%. There was a \$6,965 increase in transit passenger fares revenue as a result of the fare rate increase that took into effect in September 2005 as well as the moderate growth resulting from the gradual rebound in the Bay Area economy. Nonoperating revenues decreased compared to the previous year by \$13,867 or 5.5%. This category includes operating support received from other sources, primarily federal and state operating grants and parking-related revenues, such as parking fines, taxes, garages, and meters. The decrease is attributable to the de-appropriation of \$25.9 million parking tax revenue effective FY 2007 and replacing it as a revenue transfer from general fund subsidy reflected in the operating transfers category. The decrease in this category was offset by an increase in garage revenue by \$9,359. Capital contributions increased by \$54,436 or 60.1%. Capital contributions consist principally of funds received or receivable from federal, state and local grant agencies that provide funding for many of Muni's capital projects. There were more capitalized expenditures incurred and billable to the funding agencies than in the prior year. Net transfers increased by \$26,030 or 18.5% in 2007 compared to fiscal year 2006. This is due to de-appropriation of parking tax and its allocation as a subsidy from City General Fund for budgetary fund support amounting to \$25.9 million.

Total expenses for the year ended June 30, 2007 were \$615,841, an increase of \$34,741 or 5.9% compared to the previous year. The resulting net increase is comprised of trend changes from various expenses category in fiscal year 2007. This net increase incorporates a \$38,268 increase in labor costs primarily due to increases in salaries and fringe benefits offset by decrease in worker's compensation expenses. Materials and supplies increased by \$5,312 to meet service demand to increase vehicle availability and for the fleet for Third Street line put in service during the fiscal year. However, general and administrative operating expenses decreased by \$4,768, attributable to a decrease in general liability claims. Depreciation expense decreased by \$3,211 compared to prior year. This is primarily due to significant capital assets that reached the useful life and retired assets in the prior fiscal year with depreciation expense totaling \$3,211 in fiscal year 2006.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

Capital Assets and Debt Administration

Capital Assets

Muni and SFMRIC's investment in capital assets amounts to \$1,900,644 net of accumulated depreciation at June 30, 2008. This investment includes land, building structures and improvements, equipment, infrastructure, and construction-in-progress. The capital assets net increase is \$38,291 or 2.1%, compared to the previous year. This increase is attributed to continued construction work for new and existing projects as well as capitalization of building structures and infrastructure investments. Capital asset transactions during the year include construction in progress additions of \$141 million of which, \$66 million was for the Third Street Phase 1 & Phase 2 projects.

Summary of Capital Assets

	Balance at June 30		
	2008	2007	2006
Capital assets not being depreciated:			
Land	\$ 18,481	18,481	18,481
Construction-in-progress	263,485	297,436	461,214
Total capital assets not being depreciated	281,966	315,917	479,695
Capital assets being depreciated:			
Building structures and improvements	273,940	264,582	247,522
Equipment	1,095,991	1,055,895	1,038,806
Infrastructure	1,101,857	1,003,194	719,066
Total capital assets being depreciated	2,471,788	2,323,671	2,005,394
Less accumulated depreciation for:			
Building structures and improvements	117,852	111,458	105,378
Equipment	427,581	388,312	342,242
Infrastructure	307,677	277,465	254,589
Total accumulated depreciation	853,110	777,235	702,209
Total capital assets being depreciated, net	1,618,678	1,546,436	1,303,185
Total capital assets, net	\$ 1,900,644	1,862,353	1,782,880

The Third Street Light Rail project, a major expansion of the Muni Metro system, links communities in the City's southeast neighborhoods to south of Market Street, Mission Bay, downtown, and the rest of the Metro system. The completion of the construction of the Third Street Light Rail Project, Phase 1, highlights one of the

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

most significant accomplishments for the SFMTA. Construction completion of Muni Metro East Maintenance Facility occurred in the summer 2008 and the facility will go into operations in the fall. The facility is located on a 13-acre site at 25th and Illinois Streets in the Bayview area and will support the operation of the Third Street Light Rail line and relieve the tremendous overcrowded conditions at the agency's only light rail facility at Metro Green/Geneva. The facility will be a new, state-of-the-art storage yard, maintenance shop and operations/dispatch facility for a fleet of 80 light rail vehicles.

Phase II of the Third Street Light Rail Project includes the construction of an underground transit link between 4th Street and King Street north of Union Square and Chinatown also referred to as the "Central Subway" Project. It is a 1.7 mile extension with 0.4 miles on the surface of Fourth Street and 1.3 miles underground in a subway. The agency is currently in a preliminary engineering phase and the Supplemental Environmental Impact Report is in the final stages. This year the agency received an overall project rating of medium-high and the cost effectiveness rating has increased from medium-low last year to medium this year. This project is one of ten (10) projects included in the Preliminary Engineering Category and is ranked at the top. A \$12 million in new starts funding was received this fiscal year bringing the total federal funding to-date on the project to approximately \$56 million. This year's budget submission includes funding necessary to advance this critical project for the City and County of San Francisco.

Other capital asset additions during the fiscal year 2008 included:

- Acquisition and modification costs of coaches amounting to \$74.1 million.
- Modification costs of automatic train control system in the amount of \$0.9 million.
- Modification costs of various maintenance facilities and other structures amounting to \$31.9 million.
- Capitalization of operator restrooms for \$1.4 million.

Other capital asset additions during the fiscal year 2007 included:

- Acquisition and modification costs of 45 Gillig Motor coaches of \$4.8 million.
- Capitalization of the Burke Central Warehouse in the amount of \$10.3 million.
- Acquisition and modification costs of 11 PCC Historic cars
- Acquisition of 20 paratransit vans

Leveraged Lease-Leaseback of Breda Vehicles

In April 2002, Muni entered into the leveraged lease-leaseback transaction for 118 Breda light rail vehicles (the Equipment). The transaction was structured as a head lease of the Equipment to separate special purpose trusts and a sublease of the Equipment back from such trusts. The sublease provides Muni with an option to purchase the Equipment in approximately 27 years, the scheduled completion date of the sublease. During the term of the sublease, Muni maintains custody of the Equipment and is obligated to insure and maintain the Equipment throughout the life of the sublease.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

Muni received an aggregate of \$388.2 million from the equity investors in full prepayment of the head lease. Muni deposited a portion of this amount into an escrow, and a portion paid to a debt payment undertaker whose repayment obligations is guaranteed by Financial Security Assurance, Inc., an "AAA/Aa3" rated bond insurance company.

Muni recorded deferred revenue in fiscal year 2002 of \$35.5 million for the difference between the amount received of \$388.2 million and the amount paid to the escrows of \$352.7 million. The deferred revenue amortized in fiscal year 2008 amounted to \$1.3 million.

In September 2003, after obtaining final approval from the San Francisco Municipal Transportation Agency (SFMTA) board of directors and the City and County's board of supervisors, Muni entered into a second leveraged lease-leaseback transaction for 21 Breda light rail vehicles (the Equipment). The transaction was structured as a head lease of the Equipment to one separate special purpose trust (formed on behalf of a certain equity investor) and a sublease of the Equipment back from such trust. The sublease provides Muni with an option to purchase the Equipment in approximately 26 years, the scheduled completion date of the sublease. During the term of the sublease, Muni maintains custody of the Equipment and is obligated to insure and maintain the Equipment throughout the life of the sublease.

Muni received an aggregate of \$72.6 million from the equity investors in full prepayment of the head lease. Muni deposited a portion of this amount into an escrow, and a portion paid to a debt payment undertaker whose repayment obligation is guaranteed by Financial Security Assurance, Inc., an "AAA/Aa3" rated bond insurance company. Approximately \$67.5 million of this head lease payment into two escrows. The deferred revenue amortized in fiscal year 2008 amounted to \$0.2 million.

Long-Term Debt

SFMRIC is authorized to issue debt to fund each of its programs, but no debt or bonds are outstanding. Muni's Transit Improvement Program (TIP) is also authorized to issue bonds, but no bonds were outstanding as of June 30, 2008 or 2007.

Economic Factors and Next Year's Budget

The November 2007 Charter Amendment or Proposition A significantly increased the financial and management self-governance of the SFMTA including the requirement to submit a two-year operating budget beginning with budget years FY 2008 – 2009 and FY 2009 – 2010, the authority to set fares, fines, fees and rates previously approved by the Board of Supervisors and an increase in the parking tax allocation to the SFMTA from 40% to 80% which represents an increase of approximately \$26 million annually. The FY 2009 and 2010 budget years include a total of 322 new positions in support of Proposition A mandates and the SFMTA 2008 – 2012 Strategic Plan Goals. In order to balance the FY 2009 and 2010 budget years, the SFMTA Board of Directors approved increases to various fares, fees, fines, rates and charges to be implemented over the next two years. The influence of these factors has resulted in an operating budget of just over \$784 million for FY 2008 – 2009. Approximately, \$471 million of the total SFMTA operating budget supports Muni operations.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Management's Discussion and Analysis

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

Requests for Information

This report is designed to provide a general overview of Muni and SFMRIC's finances for all those with a general interest. The financial statements and related disclosures in the notes to the financial statements and supplemental information are presented in accordance with U.S. generally accepted accounting principles. Questions regarding any of the information provided in this report or requests for additional financial information should be addressed to the Chief Financial Officer, SFMTA Finance and Information Technology Services, One South Van Ness Avenue, 7th Floor, San Francisco, CA 94103.

Questions regarding the City and County of San Francisco or request for a copy of the City's Comprehensive Annual Financial Report should be addressed to the Office of the Controller, City Hall, 1 Dr. Carlton B. Goodlett Place, Room 316, San Francisco, CA 94102.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Statements of Net Assets

June 30, 2008 and 2007

(In thousands)

	<u>2008</u>	<u>2007</u>
Assets:		
Current assets:		
Deposits and investments with City Treasury	\$ 159,325	77,348
Deposits and investments held outside City Treasury	100	100
Cash on hand	439	1,081
Receivables:		
Grants	34,170	48,147
Due from the San Francisco County Transportation Authority	1,434	25,922
Due from other City departments	136	25
Charges for services (net of allowance for doubtful accounts of \$913 and \$838 in 2008 and 2007, respectively)	3,613	2,688
Other (net of allowance for doubtful accounts of \$118)	5,607	17,755
Total receivables	44,960	94,537
Inventories	46,670	42,884
Current deferred charges	24	23
Total current assets	251,518	215,973
Restricted assets:		
Deposits and investments with City Treasury:		
Transit impact development fee	15,777	14,941
Other restricted investments	1,575	1,476
Deposits and investments held outside City Treasury	3,795	3,695
Interest receivable	21	32
Transit impact development fee receivable, net	6,809	4,987
Total restricted assets	27,977	25,131
Capital assets	1,900,644	1,862,353
Total noncurrent assets	1,928,621	1,887,484
Total assets	\$ 2,180,139	2,103,457

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Statements of Net Assets

June 30, 2008 and 2007

(In thousands)

	<u>2008</u>	<u>2007</u>
Liabilities:		
Current liabilities:		
Due to other funds	\$ 145	145
Accounts payable and accrued expenses	32,063	44,657
Accrued payroll	18,968	16,725
Accrued vacation and sick leave	13,940	13,637
Accrued workers' compensation	14,419	17,945
Accrued claims	14,564	14,367
Grants received in advance	50,361	—
Deferred revenue and other deferred credits	7,784	2,331
Payable from restricted assets	1,497	1,456
Current loans payable	—	7,976
Total current liabilities	<u>153,741</u>	<u>119,239</u>
Noncurrent liabilities:		
Accrued vacation and sick leave	9,747	9,760
Accrued workers' compensation	62,912	62,773
Accrued claims	35,853	38,458
Other postemployment benefits obligation	31,813	—
Deferred revenue and other deferred credits	29,753	31,237
Total noncurrent liabilities	<u>170,078</u>	<u>142,228</u>
Total liabilities	<u>\$ 323,819</u>	<u>261,467</u>
Net assets:		
Invested in capital assets, net of related debt	\$ 1,900,644	1,854,377
Restricted	26,480	23,675
Unrestricted	<u>(70,804)</u>	<u>(36,062)</u>
Total net assets	<u>\$ 1,856,320</u>	<u>1,841,990</u>

See accompanying notes to financial statements.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Statements of Revenues, Expenses,
and Changes in Net Assets

Years ended June 30, 2008 and 2007

(In thousands)

	2008	2007
Operating revenues:		
Passenger fares	\$ 149,886	141,518
Advertising	12,603	5,530
Paratransit revenue	1,645	1,475
Charter service	1	1
Rental income	905	629
Other	15	32
Total operating revenues	<u>165,055</u>	<u>149,185</u>
Operating expenses:		
Personnel services	469,766	409,468
Contractual services	28,976	24,676
Materials and supplies	46,175	38,216
Depreciation	93,107	83,930
Services from other City departments	29,471	28,563
General and administrative	32,850	28,247
Other operating expenses	3,156	2,741
Total operating expenses	<u>703,501</u>	<u>615,841</u>
Operating loss	<u>(538,446)</u>	<u>(466,656)</u>
Nonoperating revenues (expenses and losses):		
Operating assistance:		
Federal	6,099	5,156
State and other grants	98,461	97,713
Transit impact development fee, net of expenses	2,174	1,102
Capital reserve revenue	1,483	1,483
Interest income	4,379	4,398
Loss on disposal of capital assets	(1,061)	(533)
Other, net	443	(449)
Total nonoperating revenues, net	<u>111,978</u>	<u>108,870</u>
Loss before capital contributions and transfers	<u>(426,468)</u>	<u>(357,786)</u>
Capital contributions:		
Federal	59,099	73,511
State and others	78,296	71,456
Total capital contributions	<u>137,395</u>	<u>144,967</u>
Transfers in:		
City and County of San Francisco – General Fund	154,593	149,813
Parking and traffic, net	134,108	128,581
San Francisco County Transportation Authority	14,747	15,119
Total transfers in	<u>303,448</u>	<u>293,513</u>
Transfers out:		
City and County of San Francisco – Street Improvement Fund	(45)	—
Net transfers	<u>303,403</u>	<u>293,513</u>
Change in net assets	14,330	80,694
Total net assets – beginning of year	<u>1,841,990</u>	<u>1,761,296</u>
Total net assets – ending of year	<u>\$ 1,856,320</u>	<u>1,841,990</u>

See accompanying notes to financial statements.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Statements of Cash Flows

Years ended June 30, 2008 and 2007

(In thousands)

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Cash received from passengers and service contracts	\$ 186,656	170,605
Cash paid to employees for services	(438,726)	(418,556)
Cash paid to suppliers for goods and services	(148,552)	(126,961)
Cash paid for judgment and claims	(14,133)	(10,752)
Net cash used in operating activities	<u>(414,755)</u>	<u>(385,664)</u>
Cash flows from noncapital financing activities:		
Operating grants	108,276	116,975
Net transfers	318,327	299,034
Transit impact development fee received, net of expenses	169	1,309
Other noncapital increases	370	109
Net cash provided by noncapital financing activities	<u>427,142</u>	<u>417,427</u>
Cash flows from capital and related financing activities:		
Capital grants	170,100	131,968
Proceeds from sale of capital assets	32	29
Proceeds from payments on loans	—	7,976
Loan repayment	(7,976)	—
Acquisition of capital assets	(147,390)	(148,857)
Grants received in advance	50,361	—
Other capital decreases	—	(25)
Net cash provided by (used in) capital and related financing activities	<u>65,127</u>	<u>(8,909)</u>
Cash flows from investing activities:		
Purchases of investments with trustees	(3,771)	—
Proceeds from sale of investments with trustees – restricted	—	2,513
Interest income received	4,854	3,323
Net cash provided by investing activities	<u>1,083</u>	<u>5,836</u>
Net increase in cash and cash equivalents	78,597	28,690
Cash and cash equivalents – beginning of year	98,635	69,945
Cash and cash equivalents – end of year	<u>\$ 177,232</u>	<u>98,635</u>

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Statements of Cash Flows

Years ended June 30, 2008 and 2007

(In thousands)

	<u>2008</u>	<u>2007</u>
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (538,446)	(466,656)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation	93,107	83,930
Provision for doubtful accounts	75	(96)
Changes in operating assets and liabilities:		
Receivables, net	(2,025)	3,651
Inventories	(3,786)	305
Deferred charges	(1)	376
Accounts payable and accrued expenses	6,590	3,657
Accrued payroll	2,321	2,263
Accrued vacation and sick leave	290	1,655
Accrued workers' compensation	(3,386)	(13,014)
Accrued claims	(2,407)	(1,860)
Accrued other postemployment benefits	31,813	—
Deferred revenues and other deferred credits	1,100	125
Net cash used in operating activities	<u>\$ (414,755)</u>	<u>(385,664)</u>
Reconciliation of cash and cash equivalents to the statements of net assets:		
Deposits with City Treasury:		
Unrestricted	\$ 159,325	77,348
Restricted	17,352	16,417
Deposits held outside City Treasury:		
Unrestricted	100	100
Restricted	16	3,689
Cash on hand	439	1,081
Total cash and cash equivalents, end of year	<u>\$ 177,232</u>	<u>98,635</u>

See accompanying notes to financial statements.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

(1) Description of Reporting Entity

The financial statements include the San Francisco Municipal Railway (Muni) and the San Francisco Municipal Railway Improvement Corporation (SFMRIC), whose operations are interrelated. All significant inter-entity transactions have been eliminated. The entities together are a department of the City and County of San Francisco (the City) and, as such, are reported as an enterprise fund in the City's Comprehensive Annual Financial Report.

Muni has been the transit agency for the City since 1912, making it one of the first public transit agencies in the United States. Muni's sources of income include passenger fares, grant funds, City subsidies, and other miscellaneous revenues. In November 1999, voters approved Proposition E, a Charter amendment, which authorized the creation of the San Francisco Municipal Transportation Agency (SFMTA) to run Muni and the SFMTA Board of Directors to oversee Muni. The Board of Directors is comprised of seven members as appointed by the Mayor of San Francisco and confirmed by the Board of Supervisors of San Francisco. Directors' terms are staggered. Proposition E sets standards for performance and service to be provided by Muni.

Proposition E also called for the integration of the City's Department of Parking and Traffic (DPT) into the SFMTA by July 1, 2002. Although the SFMTA includes both the DPT and Muni, these financial statements only reflect the operations and financial position of Muni and SFMRIC.

SFMRIC is a nonprofit corporation whose sole purpose is to provide capital financial assistance on behalf of Muni by purchasing equipment and improving facilities. SFMRIC has no employees.

(2) Significant Accounting Policies

(a) *Measurement Focus and Basis of Accounting*

The activities of Muni and SFMRIC are reported using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded when the related liability is incurred. Muni and SFMRIC apply all Governmental Accounting Standards Boards (GASB) Statements, as well as the Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

Muni distinguishes operating revenues and expenses from nonoperating revenues and expenses. Operating revenues and expenses primarily result from providing transportation services in connection with Muni's principal ongoing operations. The principal operating revenues are generated from passenger fares and fees collected from advertisements on Muni property. Operating expenses of Muni include employment costs, materials, services, depreciation on capital assets and other expenses related to the delivery of transportation services. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

(b) Implementation of New Accounting Standards

Governmental Accounting Standards Board (GASB) No. 45

Muni has adopted the provisions of GASB Statement No. 45 – *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement establishes standards for the measurement, recognition, and display of *other postemployment benefits* (OPEB) expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers.

This Statement improves the relevance and usefulness of financial reporting by:

- Requiring systematic, accrual-basis measurement and recognition of OPEB cost (expense) over a period that approximates employees' years of service; and
- Providing information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan.

Employers that participate in *single-employer* or *multiple-employer defined benefit* OPEB plans (sole and agent employers) are required to measure and disclose an amount for annual OPEB cost on the accrual basis of accounting. Annual OPEB cost is equal to the employer's annual required contribution to the plan (ARC), with certain adjustments if the employer has a net OPEB obligation for past under- or overcontributions.

(c) Cash and Cash Equivalents

Muni maintains its deposits and investments and a portion of its restricted deposits and investments as part of the City's pool of cash and investments. Muni's portion of this pool is displayed on the statement of net assets as "Deposits and investments with City Treasury." Income earned or losses arising from pooled investments are allocated on a monthly basis to appropriate funds and entities based on their average daily cash balances.

In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, the City reports certain investments at fair value in the statements of net assets and recognizes the corresponding change in fair value of investments in the year in which the change occurred.

Muni considers its pooled deposits and investments with the City Treasury to be demand deposits and, therefore, cash equivalents for the purposes of the statements of cash flows. The City also may hold nonpooled deposits and investments for Muni. Nonpooled restricted deposits and highly liquid investments with maturities of three months or less are considered to be cash equivalents.

Of the restricted deposits and investments of SFMRIC which are held outside City Treasury, \$16 as of June 30, 2008, and \$3,689 as of June 30, 2007 are considered cash equivalents as they meet the definition of cash equivalents.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

(d) Investments

In accordance with GASB Statement No. 31, Muni and SFMRIC record investments at fair value with changes in fair value recorded as a component of nonoperating revenue (expenses and losses).

(e) Inventories

Inventories are valued using the average-cost method. Inventories are expensed using the consumption method.

Rebuilt inventory items include motors, transmission, and other smaller parts that are removed from existing coaches that are overhauled and repaired.

(f) Capital Assets

Capital assets are stated at cost. All construction-in-progress items over \$100,000 and nonconstruction-in-progress items over \$5,000 are capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets which range from 10 to 60 years for building structures and improvements, equipment, and infrastructure. No depreciation is recorded in the year of acquisition and a full year's depreciation is taken in the year of disposal.

(g) Construction-in-Progress

Construction-in-progress represents the design and construction costs of various uncompleted projects. As facilities are accepted by Muni and become operative, they are transferred to building structures and improvements, equipment, infrastructures, accounts and depreciated in accordance with Muni's depreciation policies. Costs of construction projects that are discontinued are recorded as expense in the year in which the decision is made to discontinue such projects.

(h) Accrued Vacation and Sick Leave

Accrued vacation pay, which vests and may be accumulated up to ten weeks per employee, is charged to expense as earned. Unused sick leave accumulated on or prior to December 6, 1978 is vested and payable upon termination of employment by retirement, death, or disability caused by industrial accident. Sick leave earned subsequent to that date is nonvesting, charged to expense when earned. The amount of allowable accumulation is set forth in various memorandums of understanding but is generally limited to six months per employee.

Effective July 1, 2002, any full-time employee leaving employment with the City upon service or disability retirement may receive payment of a portion of sick leave credits at the time of separation. The amount of this payment equals 2.5% of accrued sick leave credits at the time of separation, multiplied by the number of whole years of continuous employment, multiplied by the employee's salary rate, exclusive of premiums or supplements, at the time of separation. The number of hours for which an employee may receive cash payments cannot exceed one thousand forty (1,040) hours, including any vested sick leave.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

(i) Capital Grants and Contributions

Capital grants and contributions from external sources are recognized as capital contribution earned when applicable eligibility requirements are met, such as the time reimbursable expenditures related to the grants are incurred.

The U.S. Department of Transportation, through the Federal Transit Administration (FTA), provides capital assistance to Muni for the acquisition and construction of transit-related property and equipment. This assistance generally approximates 80% of acquisition cost and is administered by Muni and by the Metropolitan Transportation Commission (MTC). The capital assistance provided to Muni by the California Transportation Commission and San Francisco County Transportation Authority (SFCTA) is generally used as a local match to the federal capital assistance. However, additional capital assistance provided to Muni by other agencies is administered by MTC, and is also generally used as a local match for the federal capital assistance. With the inception of the Third Street Light Rail Project, SFCTA is also a primary local funding source for capital projects. Certain Muni expenditures for projects approved for funding by the SFCTA that are currently unbilled but will be billed to SFCTA in the near future are recorded as other current receivables.

(j) Operating Assistance Grants

Operating assistance grants are recognized as revenue when approved by the granting authority and/or when related expenditures are incurred.

Muni receives operating assistance from federal and various state and local sources. Transportation Development Act funds are received from the City to meet, in part, Muni's operating requirements based on annual claims filed with and approved by the MTC. Sales tax represents an allocation by MTC of the 1/2% transactions and use tax collected within San Francisco County for transit services. Federal operating assistance is distributed to Muni by the FTA after approval by MTC.

(k) Transit Impact Development Fees

Transit Impact Development Fees (TIDF) are restricted for the capital and operating costs of increased peak period transit service associated with new office construction in downtown San Francisco. These fees are recorded as nonoperating revenues in the year in which they are assessed.

(l) Token Revenues

Token revenues are recognized at the time the tokens are sold.

(m) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(n) Reclassifications

Certain balances in the prior year financial statements have been reclassified for comparative purposes to conform to the presentation in the current year financial statements. These reclassifications have not had any impact on the change in net assets.

(3) Net Assets

Net assets as of June 30, 2008 and 2007, consist of the following:

	<u>2008</u>	<u>2007</u>
Restricted assets:		
Deposits and investments with City Treasury	\$ 17,352	16,417
Deposits and investments outside City Treasury	3,795	3,695
Receivables	<u>6,830</u>	<u>5,019</u>
Total restricted assets	<u>27,977</u>	<u>25,131</u>
Restricted liabilities of:		
SFMRIC	(4)	(5)
Transit impact development fee	(5)	—
Others	<u>(1,488)</u>	<u>(1,451)</u>
Total restricted liabilities	<u>(1,497)</u>	<u>(1,456)</u>
Restricted assets, net	<u>\$ 26,480</u>	<u>23,675</u>
Net assets:		
Restricted:		
Transit impact development fee	\$ 22,581	19,928
SFMRIC	3,804	3,698
Others	<u>95</u>	<u>49</u>
Total restricted net assets	26,480	23,675
Unrestricted	(70,804)	(36,062)
Invested in capital assets	<u>1,900,644</u>	<u>1,854,377</u>
Net assets	<u>\$ 1,856,320</u>	<u>1,841,990</u>

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

(4) Deposits and Investments

Muni maintains its deposits and investments with City Treasury and a portion of its restricted asset deposits as part of the City's pool of deposits and investments. The City's investment pool is invested in an unrated pool pursuant to investment policy guidelines established by the City Treasurer. The objectives of the policy are, in order of priority, preservation of capital, liquidity, and yield. The policy addresses soundness of financial institutions in which the City will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio which may be invested in certain instruments with longer terms to maturity. The Comprehensive Annual Financial Report of the City categorizes the level of common deposits and investment risks associated with the City's pooled deposits and investments. As of June 30, 2008 and 2007, Muni and SFMRIC's unrestricted deposits and investments were \$159,864 and \$78,529, respectively.

The restricted assets' deposits and investments outside the City Treasury are held by a trustee. As of June 30, 2008 and 2007, Muni and SFMRIC had deposits and investments with the trustee of \$3,795 and \$3,695, respectively. Of the deposits, \$16 and \$3,689 meet the definition of cash and cash equivalents as of June 30, 2008 and 2007, respectively.

The following table shows the percentage distribution of the City's pooled investments by maturity:

Investment maturities (in months)			
Under 1	1 – 6	6 – 12	12 – 36
6.9%	52.7%	11.6%	28.8%

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

(5) Capital Assets

Capital asset balances and their movements as of and for the year ended June 30, 2008 and 2007 are as follows:

	Balance, July 1, 2007	Increases	Decreases	Balance, June 30, 2008
Capital assets not being depreciated:				
Land	\$ 18,481	—	—	18,481
Construction-in-progress	297,436	140,649	(174,600)	263,485
Total capital assets not being depreciated	315,917	140,649	(174,600)	281,966
Capital assets being depreciated:				
Building structures and improvements	264,582	9,358	—	273,940
Equipment	1,055,895	58,533	(18,437)	1,095,991
Infrastructure	1,003,194	98,663	—	1,101,857
Total capital assets being depreciated	2,323,671	166,554	(18,437)	2,471,788
Less accumulated depreciation for:				
Building structures and improvements	111,458	6,394	—	117,852
Equipment	388,312	56,501	(17,232)	427,581
Infrastructure	277,465	30,212	—	307,677
Total accumulated depreciation	777,235	93,107	(17,232)	853,110
Total capital assets being depreciated, net	1,546,436	73,447	(1,205)	1,618,678
Total capital assets, net	\$ 1,862,353	214,096	(175,805)	1,900,644

Certain buses and vans were disposed and donated during 2008. The net loss for sold assets is \$1,093 offset by proceeds of \$32 on sale of these capital asset items. \$8 million of construction-in-progress was written off.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

Capital asset balances and their movements as of and for the year ended June 30, 2007 and 2006 are as follows:

	<u>Balance, July 1, 2006</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance, June 30, 2007</u>
Capital assets not being depreciated:				
Land	\$ 18,481	—	—	18,481
Construction-in-progress	461,214	161,649	(325,427)	297,436
Total capital assets not being depreciated	<u>479,695</u>	<u>161,649</u>	<u>(325,427)</u>	<u>315,917</u>
Capital assets being depreciated:				
Building structures and improvements	247,522	17,060	—	264,582
Equipment	1,038,806	27,178	(10,089)	1,055,895
Infrastructure	719,066	284,128	—	1,003,194
Total capital assets being depreciated	<u>2,005,394</u>	<u>328,366</u>	<u>(10,089)</u>	<u>2,323,671</u>
Less accumulated depreciation for:				
Building structures and improvements	105,378	6,080	—	111,458
Equipment	342,242	54,974	(8,904)	388,312
Infrastructure	254,589	22,876	—	277,465
Total accumulated depreciation	<u>702,209</u>	<u>83,930</u>	<u>(8,904)</u>	<u>777,235</u>
Total capital assets being depreciated, net	<u>1,303,185</u>	<u>244,436</u>	<u>(1,185)</u>	<u>1,546,436</u>
Total capital assets, net	<u>\$ 1,782,880</u>	<u>406,085</u>	<u>(326,612)</u>	<u>1,862,353</u>

Certain buses and vans were disposed and donated during 2007. The net loss for disposed assets is \$562 offset by \$29 proceeds on sale of these capital asset items. The donated assets net book value was \$623.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

Construction-in-progress consists of the following projects as of June 30, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Third Street light rail	\$ 168,027	148,605
Articulated trolley coaches	2,803	96
Rail replacement	8,077	11,714
Auto Passenger Count	1,519	1,009
PM Traps Fleet	—	8,243
Motor bus Hybrid Procurement	—	40,553
Islais Creek-Woods Annex	6,317	5,504
Trolley Overhead Reconstruction	6,338	19,382
Vehicle Scheduling System	3,609	3,450
Flynn Facility Lift Construction	—	986
Vehicle Inventory Management	—	2,331
Automatic Vehicle Location	8,923	5,670
Cable Car Renovation	1,573	1,801
New Central Subway	31,958	19,236
Motor Bus Replacement	—	3,723
Bayshore & Geary Corridor	—	9,470
Light rail vehicles	11,203	8,780
Facility Maintenance	2,692	1,307
Radio Replacement	1,875	—
Wayside Fare Collection	1,078	—
Others	7,493	5,576
	<u>\$ 263,485</u>	<u>297,436</u>

(6) Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses were \$32,063 and \$44,657 at June 30, 2008 and 2007, respectively. This category consists of liabilities for goods and services either evidenced by vouchers approved for payment but have not been paid, accrued expenses for amount owed to private persons or organization for goods and services, and construction contracts retainage payable.

	<u>2008</u>	<u>2007</u>
Vouchers payable	\$ 18,698	32,786
Accruals	12,153	9,882
Contracts retainage	1,212	1,989
Total accounts payable and accrued expenses	<u>\$ 32,063</u>	<u>44,657</u>

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

(7) Long-Term Debt, Loans and Other Payables

SFMRIC is authorized to issue debt to fund each of its programs under separate indentures. Transit Equipment Progress bonds totaling \$51,500 have been authorized, of which \$30,500 is available for issuance and none are outstanding. Transit Improvement Program (TIP) bonds amounting to \$44,000 have been authorized, of which \$7,800 is available for issuance. As of June 30, 2008 and 2007, no bonds were outstanding under the TIP.

In February 2006, SFMTA entered into a loan agreement with San Francisco County Transportation Authority (SFCTA) to allow the Third Street Light Rail Transit Muni Metro East Maintenance and Operations Facility project to proceed in advance of receiving anticipated state grant funds. The authorized amount of the loan is \$22.5 million of Proposition K funds. Prior to this date, SFMTA entered into an AB3090 Project Reimbursement Agreement under the authority of Government Code Section 14529.7(b) under which SFMTA utilized local funds for the project at an earlier date than the Project was programmed in the State Transportation Improvement Program. The anticipated fund reimbursement from the State was used to repay the loan to SFCTA. The no-interest loan was payable within 30 days upon receipt of allocation of STIP funds from the State for reimbursement of the project costs. The remaining outstanding loan amount of \$7.9 million was paid to SFCTA in fiscal year 2008.

(8) Employee Benefit Plans

(a) Retirement Plan – City and County of San Francisco

Plan Description

The City has a single-employer defined benefit retirement plan (the Plan) which is administered by the San Francisco City and County Employees' Retirement System (the Retirement System). The Plan covers substantially all full-time employees of Muni along with other employees of the City. The Plan provides basic retirement, disability, and death benefits based on specified percentages of final average salary, and provide cost-of-living adjustments after retirement. The Plan also provides pension continuation benefits to qualified survivors. The San Francisco City and County Charter and Administrative Code are the authority which establishes and amends the benefit provisions and employer obligations of the Plan. The Retirement System issues a publicly available financial report that includes financial statements and required supplemental information for the Plan. That report may be obtained by writing to the San Francisco City and County Employees' Retirement System, 30 Van Ness Avenue, Suite 3000, San Francisco, CA 94102, or by calling (415) 487-7020.

Funding Policy

Contributions are made to the basic plan by both Muni and the participating employees. Employee contributions are mandatory. Employee contribution rates for 2008 and 2007 varied from 7% to 8% as a percentage of covered payroll. Muni is required to contribute at an actuarially determined rate. For fiscal year 2008 and 2007, the actuarially determined contribution rate as a percentage of

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

covered payroll was 5.91% and 6.24%, respectively. Muni's required contribution was approximately \$16.1 million in 2008 and \$16.2 million in 2007.

Muni's contributions to the Retirement System on behalf of its employees amounted to \$10,776 and \$10,229 for the years ended June 30, 2008 and 2007, respectively, which were equal to the required employee contributions for each year.

(b) *Deferred Compensation Plan*

The City offers its employees, including Muni employees, a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan is available to all employees and permits them to defer a portion of their salaries until future years. The deferred compensation is not available to employees or other beneficiaries until termination, retirement, death, or unforeseeable emergency.

Muni has no administrative involvement and does not perform the investing function. Muni has no fiduciary accountability for the plan, and accordingly, the plan assets and related liabilities to the plan participants are not included in these financial statements.

(c) *Healthcare Benefits*

Health care benefits of Muni employees, retired employees and surviving spouses are financed by beneficiaries and by the City through the City and County of San Francisco Health Service System (the Health Service System). Muni's annual contribution, which amounted to approximately \$51,549 and \$47,433 in fiscal years 2008 and 2007, respectively, is determined by a charter provision based on similar contributions made by the ten most populous counties in California. Included in these amounts are \$15,655 and \$14,008 for 2008 and 2007, respectively, to provide postretirement benefits for retired employees, on a pay-as-you-go basis.

The City has determined a City-wide ARC and OPEB cost based upon an actuarial valuation performed in accordance with GASB 45, by the City's actuaries. The City has allocated \$47,468 of the City-wide ARC and OPEB cost to Muni for the year ended June 30, 2008 based upon its percentage of City-wide payroll costs. The difference between the allocation and the amount paid is \$31,813 has been recorded as a net OPEB obligation by Muni as of June 30, 2008.

The City issues a publicly available financial report that includes the complete note disclosures and Required Supplemental Information (RSI) related to the City's postretirement health care obligations. The report may be obtained by writing to the City and County of San Francisco, Office of the Controller, 1 Dr. Carlton B. Goodlett Place, Room 316, San Francisco, California 94102, or by calling (415) 554-7500.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

(9) Peninsula Corridor Joint Powers Board

The City is a participant in the Peninsula Corridor Joint Powers Board (PCJPB), along with the Santa Clara Valley Transportation Authority and the San Mateo County Transit District. PCJPB is governed by a separate board composed of nine members, three from each participant. The PCJPB was formed in October 1991 to plan, administer, and operate the Peninsula CalTrain rail service. The PCJPB began operating the Peninsula CalTrain rail service on July 1, 1992; prior to that time, such rail service was operated by the California Department of Transportation. The agreement establishing the PCJPB expired in 2001, upon which it will continue on a year-to-year basis thereafter, until a participant withdraws, which requires one-year notice. Muni contributes 11.6% of the net operating costs and administrative expenses of the PCJPB. Muni contributed only for operating needs of \$7.1 million in fiscal year 2008. In fiscal year 2007, Muni also contributed only for operating needs amounting to \$6.8 million.

(10) Self-Insurance

Muni is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Muni is fully self-insured for its general liability and auto liability, and public transportation bus and light rail liabilities, respectively. In addition, claims liabilities are calculated considering the effect of inflation, recent claim settlement trends, including frequency and amount of payments, and other economic and social factors. Muni is self-insured for workers' compensation claims. The respective liabilities as of June 30, 2008 and 2007 have been actuarially determined and include an estimate of incurred but not reported claims. Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amount of payouts, and other economic social factors.

Changes in the balances of claims liabilities and workers' compensation liabilities for the years ended June 30, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Accrued claims liabilities, beginning of fiscal year	\$ 52,825	54,685
Incurred claims and changes in estimates	11,724	8,892
Claims payments	<u>(14,132)</u>	<u>(10,752)</u>
Accrued claims liabilities, end of fiscal year	<u>\$ 50,417</u>	<u>52,825</u>
Accrued workers' compensation, beginning of fiscal year	\$ 80,718	93,731
Incurred workers' compensation and changes in estimates	10,978	3,727
Workers' compensation payments	<u>(14,365)</u>	<u>(16,740)</u>
Accrued workers' compensation, end of fiscal year	<u>\$ 77,331</u>	<u>80,718</u>

Workers' compensation expense is part of personal services, while claims expense is part of general and administrative under operating expenses in the accompanying statements of revenue, expenses and changes in net assets.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

(11) Transactions with the City

The amount of operating subsidy provided to Muni each year is limited to the amount budgeted by the City. Such subsidy is recognized as revenue in the year received. At times, a budget deficit can be caused by a revenue shortfall for which there is an expectation that those or other revenues will be received in the subsequent year relating to the prior years. In those circumstances, the City allows Muni to show a deficit on a budgetary basis. This policy does not provide cash to finance receivables. Consequently, Muni at times maintains a cash overdraft with the City, which can be repaid only through collection of receivables.

The General Fund support from the City reflected in the accompanying financial statements includes a revenue transfer of \$27.3 million and \$25.9 million in 2008 and 2007, respectively. The transfer from the general fund is in lieu of the parking tax revenue allocation to SFMTA that has been deappropriated effective fiscal year 2007 per the city ordinance passed on March 27, 2007.

(12) Federal, State, and Local Assistance

Muni receives capital grants from various federal, state, and local agencies to finance transit-related property and equipment purchases. As of June 30, 2008, Muni had approved capital grants with unused balances amounting to \$365 million. Capital grants receivable as of June 30, 2008 and 2007, totaled \$24.7 million and \$56.7 million, respectively.

Muni also receives operating assistance from various federal, state, and local sources including Transit Development Act funds and sales tax allocations. As of June 30, 2008, Muni had various operating grants receivable of \$10.9 million. In fiscal year 2008, Muni's operating assistance also includes BART ADA revenues of \$1.2 million and other federal, state, and local grants of \$3.5 million to fund project expenses that are operating in nature.

The capital and operating grants identified above include funds received and due from SFCTA. During the fiscal year ended June 30, 2008, new capital grants were approved by SFCTA in the amount of \$28.2 million and payments received by Muni for capital grants totaled \$48.6 million. As of June 30, 2008, Muni had funds due from SFCTA for capital grants in the amount of \$0.9 million. Similarly, Muni receives operating grants from SFCTA. During the fiscal year ended June 30, 2008, SFCTA approved new operating grants in the amount of \$13.7 million and payments received by Muni totaled \$15.6 million. As of June 30, 2008, Muni had \$0.4 million and \$2.4 million of funds due from SFCTA for operating grants as of June 30, 2008 and 2007, respectively.

Proposition 1B is a ten-year \$20 billion transportation infrastructure bond that was approved by voters in November 2006. The bond measure was composed of several funding programs including the Public Transportation Modernization, Improvement and Service Enhancement Account program (PTMISEA) that is funding solely for public transit projects. Muni received \$50 million in FY 2008 for eight different projects. Proposition 1B funds do not require matching funds. These funds must be obligated within three years. The eligibility requirements for the PTMISEA program include rehabilitation of infrastructure, procurement of equipment and rolling stock, and investment in expansion projects.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

The State Office of Homeland Security also approved funding for Muni transit security projects in the amount of \$7 million under Prop 1B. The grant award letter is dated April 22, 2008 but the cash advance of \$7 million was received in August 2008.

(13) Commitments and Contingencies

(a) Grants and Subventions

Receipts from federal and state grants and other similar programs are subject to audit to determine if the funds were expended in accordance with appropriate statutes, grant terms, and regulations. Muni believes that no significant liabilities will result from any such audits.

(b) Operating Leases

Muni leases certain equipment and various properties for use as office space, fleet storage space, and machine shops under lease agreements that expire at various dates through fiscal year 2030. These agreements are accounted for as operating leases. Rent expense was \$9,040 and \$5,577 for the years ended June 30, 2008 and 2007, respectively.

Muni has operating leases for certain buildings and equipment that require the following minimum annual payments:

Years ending June 30:		
2009	\$	7,149
2010		7,328
2011		6,434
2012		6,520
2013		6,668
2014 – 2018		35,717
2019 – 2023		40,598
2024 – 2028		46,733
2029 – 2033		54,383
Total	\$	<u>211,530</u>

(c) Other Commitments

As of June 30, 2008, Muni has outstanding commitments of approximately \$46,706 with third parties for various capital projects. Grant funding is available for the majority of this amount. Muni also has outstanding commitments of approximately \$16,301 with third parties for noncapital expenditures. Various local funding sources are used to finance these expenditures.

Muni is also committed to numerous capital projects for which it anticipates that federal and state grants will be the primary source of funding. SFMRIC's board of directors has authorized SFMRIC to extend financial guarantees to Muni for certain projects. The projects for which SFMRIC has

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

guaranteed funding and the maximum amounts of such guarantees as of June 30, 2008, are as follows:

Central Control and Revenue Center	\$	75
Historic Streetcar Shed		775
Islais Creek Storage Facility		622
Historic Streetcar Rehab		846
Total	\$	<u>2,318</u>

In addition, Muni is involved in various lawsuits, claims, and disputes, which have arisen in Muni's routine conduct of business. In the opinion of management, the costs that might be incurred, if any, would not materially affect Muni's or SFMRIC's financial position or changes in their net assets.

(14) Leveraged Lease-Leaseback of Breda Vehicles

Tranches 1 and 2

The Municipal Transportation Agency board of directors authorized the Director of Transportation to solicit proposals regarding a leveraged lease-leaseback transaction involving up to 150 BRED A light rail vehicles. The transaction would not involve financing or procurement of any new vehicles. Rather, Muni's intention was to obtain an upfront economic benefit in return for entering into a lease-leaseback transaction involving the Breda light rail vehicles, without impairing the day-to-day operations of the transit system.

In April 2002 and in September 2003, following the approval of the Federal Transit Administration Transportation Agency and the City and County's board of Supervisors, Muni entered into the leveraged lease-leaseback transactions for over 118 and 21, respectively, Breda light rail vehicles (the Tranche 1 and Tranche 2 Equipment). Each transaction, also referred to as "sale in lease out" or "SILO", was structured as a head lease of the Equipment to separate special purpose trusts and a sublease of the Equipment back from such trusts. Each sublease provides Muni with an option to purchase the Tranche 1 and Tranche 2 Equipment in approximately 26 and 27 years, respectively, following the scheduled expiration dates of the subleases. During the terms of the subleases, Muni maintains custody of the Tranche 1 and Tranche 2 Equipment and is obligated to insure and maintain the Tranche 1 and Tranche 2 Equipment throughout the life of each sublease.

Muni received an aggregate of \$388.2 million and \$72.6 million, respectively in 2002 and 2003, from the head lessors in full prepayment of the head lease. Muni deposited a portion of these head lease payments into an escrow and paid a portion to a debt payment undertaker whose repayment obligations are guaranteed by Financial Security Assurance (FSA), an "AAA/Aa3" rated bond insurance company. The terms of the SILO documents require the City to replace FSA as guarantor of debt payment undertaker if its ratings are downgraded below BBB+/Baa1. FSA is currently rated AAA/Aa3 – which is rated above the applicable ratings trigger of FSA in its role as debt payment undertaker guarantor. In addition, FSA provided a surety policy with respect to each leveraged lease transaction to guarantee potential payments in

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

the event such transaction is terminated in whole or in part prior to the sublease expiration date. The terms of the SILO documents require the City to replace FSA as surety provider if its ratings are downgraded below "AA-/Aa3." Although S&P has placed FSA on "credit watch with negative implications," and Moody's indicated that FSA's outlook is "developing," it is not known whether or to what level downgrades, if any, may occur. Failure of the City to replace FSA following a downgrade within a specified period of time could allow the equity investors, in effect, to issue a default notice to the City. Because replacement of FSA in either of its roles as a debt payment undertaker guarantor or surety will either be difficult or very expensive in the current economic climate, the City could be liable to pay a termination cost as provided in certain schedules of the transaction documents. These termination costs are in the nature of liquidated damages as a result of early termination. The scheduled net termination costs as of December 1, 2008 after giving effect to the market value of the securities in the escrow account, would approximate \$86.1 million. The scheduled termination costs increase over the next several years.

The escrows were invested in U.S. agency securities with maturity dates that correspond to the purchase option dates in each sublease.

Although these transactions do not represent a legal defeasance of MUNI's obligations under the subleases, management believes that these transactions are structured in such a way that it is not probable that MUNI will need to access other monies to make sublease payments. Therefore, the assets and the sublease obligations are not recorded on the financial statements of MUNI as of June 30, 2008 and 2007.

As a result of the cash transactions above, Muni recorded deferred revenue of \$35.5 million and \$4.4 million in fiscal years 2002 and 2003, respectively, for the difference between the amounts received of \$388.2 million and \$72.6 million, respectively, and the amounts paid to the escrows and the debt payment undertaker of \$352.7 million and \$67.5 million. The deferred revenue will be amortized over the life of the sublease. The deferred revenue amortized amounts were \$1.3 million and \$0.2 million in fiscal years 2008 and 2007, respectively.

As of June 30, 2008, the outstanding payments to be made on the subleases through fiscal years 2027 and 2030 are \$105.3 million and \$53.4 million, for Tranche 1 and Tranche 2, respectively, and the payments to be made on the purchase option, if exercised, would be \$680.8 million and \$154.2 million. These payments are to be funded from the amounts in escrow and by the payment undertaker. If Muni does not exercise the purchase option, Muni would be required to either: 1) pay service and maintenance costs related to the continued operation and use of the vehicles beyond the term of the sublease; or 2) arrange for another party to be the "service recipient," under a "service contract," and to perhaps guarantee the obligations of that party under the service contract if the replacement service recipient does not meet specified credit or net worth criteria.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands, unless otherwise noted)

(15) Wellness Incentive Program

Effective July 1, 2002, the City established a pilot “wellness incentive program” (the Wellness Program) to promote workforce attendance. Under the Wellness Program, any full-time employee leaving the employment of the City upon service or disability retirement may receive payment of a portion of accrued sick leave credits at the time of separation.

The amount of this payment shall equal to 2.5% of accrued sick leave credits at the time of separation times the number of whole years of continuous employment times an employee’s salary rate, exclusive of premiums or supplements, at the time of separation. Vested sick leave credits, as set forth under Civil Service Commission Rules, shall not be included in this computation.

SUPPLEMENTAL SCHEDULES

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Supplemental Schedule – Schedule of Net Assets

June 30, 2008

(In thousands)

	<u>MUNI</u>	<u>SFMRIC</u>	<u>Eliminations</u>	<u>Total</u>
Assets:				
Current assets:				
Deposits and investments with City Treasury	\$ 159,325	—	—	159,325
Deposits and investments held outside City Treasury	100	—	—	100
Cash on hand	439	—	—	439
Receivables:				
Grants	34,170	—	—	34,170
Due from the San Francisco County Transportation Authority	1,434	—	—	1,434
Due from other City departments	263	198	(325)	136
Charges for services, net	3,613	—	—	3,613
Other, net	5,607	—	—	5,607
Total receivables	45,087	198	(325)	44,960
Inventories	46,670	—	—	46,670
Current deferred charges	24	—	—	24
Total current assets	251,645	198	(325)	251,518
Restricted assets:				
Deposits and investments with City Treasury:				
Transit impact development fee	15,777	—	—	15,777
Other restricted investments	1,575	—	—	1,575
Deposits and investments held outside City Treasury	—	3,795	—	3,795
Interest receivable	8	13	—	21
Transit impact development fee receivable, net	6,809	—	—	6,809
Total restricted assets	24,169	3,808	—	27,977
Noncurrent other, net	—	197	(197)	—
Capital assets	1,900,644	—	—	1,900,644
Total noncurrent assets	1,924,813	4,005	(197)	1,928,621
Total assets	\$ 2,176,458	4,203	(522)	2,180,139

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Supplemental Schedule – Schedule of Net Assets

June 30, 2008

(In thousands)

	<u>MUNI</u>	<u>SFMRIC</u>	<u>Eliminations</u>	<u>Total</u>
Liabilities:				
Current liabilities:				
Due to other funds	\$ 343	127	(325)	145
Accounts payable and accrued expenses	32,063	—	—	32,063
Accrued payroll	18,968	—	—	18,968
Accrued vacation and sick leave	13,940	—	—	13,940
Accrued workers' compensation	14,419	—	—	14,419
Accrued claims	14,564	—	—	14,564
Deferred tax, grant and subvention revenues	50,361	—	—	50,361
Deferred revenue and other deferred credits	7,784	—	—	7,784
Payable from restricted assets	1,493	4	—	1,497
Total current liabilities	<u>153,935</u>	<u>131</u>	<u>(325)</u>	<u>153,741</u>
Noncurrent liabilities:				
Due to other funds	197	—	(197)	—
Accrued vacation and sick leave	9,747	—	—	9,747
Accrued workers' compensation	62,912	—	—	62,912
Accrued claims	35,853	—	—	35,853
Other postemployment benefits obligation	31,813	—	—	31,813
Deferred revenue and other deferred credits	29,753	—	—	29,753
Total noncurrent liabilities	<u>170,275</u>	<u>—</u>	<u>(197)</u>	<u>170,078</u>
Total liabilities	<u>\$ 324,210</u>	<u>131</u>	<u>(522)</u>	<u>323,819</u>
Net assets:				
Invested in capital assets, net of related debt	\$ 1,900,644	—	—	1,900,644
Restricted	22,803	3,677	—	26,480
Unrestricted	(71,199)	395	—	(70,804)
Total net assets	<u>\$ 1,852,248</u>	<u>4,072</u>	<u>—</u>	<u>1,856,320</u>

See accompanying independent auditors' report.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Supplemental Schedule – Schedule of Revenues, Expenses,
and Changes in Net Assets

Year ended June 30, 2008

(In thousands)

	MUNI	SFMRIC	Eliminations	Total
Operating revenues:				
Passenger fares	\$ 149,886	—	—	149,886
Advertising	12,603	—	—	12,603
Paratransit revenue	1,645	—	—	1,645
Charter service	1	—	—	1
Rental income	905	—	—	905
Other	15	—	—	15
Total operating revenues	165,055	—	—	165,055
Operating expenses:				
Personal services	469,766	—	—	469,766
Contractual services	28,976	—	—	28,976
Materials and supplies	46,175	—	—	46,175
Depreciation	93,107	—	—	93,107
Services from other City departments	29,471	—	—	29,471
General and administrative	32,823	27	—	32,850
Other operating expenses	3,156	—	—	3,156
Total operating expenses	703,474	27	—	703,501
Operating loss	(538,419)	(27)	—	(538,446)
Nonoperating revenues (expenses and losses):				
Operating assistance:				
Federal	6,099	—	—	6,099
State and other grants	98,461	—	—	98,461
Transit impact development fee, net of expenses:	2,174	—	—	2,174
Capital reserve revenue	1,483	—	—	1,483
Interest income	4,260	119	—	4,379
Loss on disposal of capital assets	(1,061)	—	—	(1,061)
Capital assistance of SFMRIC to MUNI	221	(221)	—	—
Other, net	443	—	—	443
Total nonoperating revenues, net	112,080	(102)	—	111,978
Loss before capital contribution and transfers	(426,339)	(129)	—	(426,468)
Capital contributions:				
Federal	59,099	—	—	59,099
State and others	78,296	—	—	78,296
Total capital contributions	137,395	—	—	137,395
Transfers in:				
City and County of San Francisco – General Fund	154,593	—	—	154,593
Parking and traffic	134,108	—	—	134,108
San Francisco County Transportation Authority	14,747	—	—	14,747
Total transfers in	303,448	—	—	303,448
Transfers out:				
City and County of San Francisco – Street Improvement Fund	(45)	—	—	(45)
Net transfers	303,403	—	—	303,403
Change in net assets	14,459	(129)	—	14,330
Total net assets – beginning	1,837,789	4,201	—	1,841,990
Total net assets – ending	\$ 1,852,248	4,072	—	1,856,320

See accompanying independent auditors' report.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Supplemental Schedule of Grants – Federal

Year ended June 30, 2008

(In thousands)

	Authorized grants as of July 1, 2007	New grants approved/ spending commences	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2008	Amounts not expended as of June 30, 2008	Grants receivable as of June 30, 2008
Capital grants:							
Sec 3 – Construct Islais Creek Facility	\$ 15,035	1	—	—	15,036	(15,036)	—
Sec 4 – Islais Creek ITS & AVL	3,693	1,806	—	—	5,499	(5,499)	—
Sec 3 – Third street Phase II Central Subway	24,503	—	(2,334)	—	22,169	(19,158)	3,011
Sec 4 – Glen Park Intermodal Facility	785	—	—	—	785	(785)	—
Section 9 fiscal year 1998/99	2,924	—	(1,424)	—	1,500	(1,233)	267
Section 9 fiscal year 1999/00	7,180	—	(1,008)	—	6,172	(6,172)	—
Section 9 fiscal year 2000/01	2,068	—	—	—	2,068	(2,068)	—
Section 9 fiscal year 2001/02	6,808	—	(713)	—	6,095	(6,039)	56
Section 9 fiscal year 2002/03	9,901	—	(5,328)	—	4,573	(4,268)	305
Section 9 fiscal year 2003/04	20,313	—	(3,506)	—	16,807	(16,807)	—
Section 9 fiscal year 2004/05	30,787	—	(14,231)	—	16,556	(15,844)	712
Section 9 fiscal year 2005/06	25,357	—	(9,060)	—	16,297	(15,870)	427
Section 9 fiscal year 2006/07	28,047	—	(2,392)	—	25,655	(18,425)	7,230
Section 3 – Central Control Facility	647	—	(532)	—	115	(71)	44
Section 3 New Central Subway	8,190	—	(8,190)	—	—	—	—
Section 3 Third Street Metro East	11,214	(188)	(1,257)	—	9,769	(8,714)	1,055
Section 3 – PM Traps Fleet	3,088	—	—	—	3,088	(3,088)	—
Section 3 – Fixed Guideway	98,718	—	(10,428)	—	88,290	(84,245)	4,045
Section 15 Radio Replacement	1,500	—	—	—	1,500	(1,500)	—
Alternative Fuel	460	—	—	—	460	(392)	68
Radio Replacement	207	—	—	—	207	(207)	—
Automatic Vehicle Location	24	—	(24)	—	—	—	—
Total capital grants	<u>\$ 301,449</u>	<u>1,619</u>	<u>(60,427)</u>	<u>—</u>	<u>242,641</u>	<u>(225,421)</u>	<u>17,220</u>
Pass-through grants:							
Transbay Terminal CA90 – 0212	\$ 685	—	(685)	—	—	—	—
Total pass-through grants	<u>\$ 685</u>	<u>—</u>	<u>(685)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Operating grants:							
Paratransit	\$ 3,808	3,922	(3,808)	—	3,922	—	3,922
SRTP – CPT529 and 473 and 548	—	87	—	—	87	(2)	85
Total operating grants	<u>\$ 3,808</u>	<u>4,009</u>	<u>(3,808)</u>	<u>—</u>	<u>4,009</u>	<u>(2)</u>	<u>4,007</u>

See accompanying independent auditors' report.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Supplemental Schedule of Grants – California Transportation Commission

Year ended June 30, 2008

(In thousands)

	Authorized grants as of July 1, 2007	New grants approved/ spending commences	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2008	Amounts not expended as of June 30, 2008	Grants receivable as of June 30, 2008
Capital grants:							
Diesel Bus Purchase	\$ 191	—	(97)	—	94	(94)	—
Third Street Light Rail-Metro East	—	22,570	(22,570)	—	—	—	—
Prop IB – Third Street Light Rail	—	3,700	—	—	3,700	(3,700)	—
Prop IB – Auto Passenger Counter	—	2,500	(419)	—	2,081	(2,081)	—
Prop IB – Overhead Relocation	—	3,000	(126)	—	2,874	(2,874)	—
Prop IB – Farebox Rehabilitation	—	20,000	—	—	20,000	(20,000)	—
Prop IB – Geneva Yard	—	7,500	—	—	7,500	(7,500)	—
Prop IB – Metro East LRV Facility	—	9,700	—	—	9,700	(9,700)	—
Prop IB – Operator Restrooms	—	2,965	—	—	2,965	(2,965)	—
Prop IB – Wayside Fare Collection	—	1,000	—	—	1,000	(1,000)	—
Prop IB – Homeland Security	—	7,071	—	—	7,071	(7,071)	—
Total capital grants	\$ 191	80,006	(23,212)	—	56,985	(56,985)	—

See accompanying independent auditors' report.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Supplemental Schedule of Grants – Metropolitan Transportation Commission

Year ended June 30, 2008

(In thousands)

	<u>Authorized grants as of July 1, 2007</u>	<u>New grants approved/ spending commences</u>	<u>Payments received</u>	<u>Expired/ rescinded grants</u>	<u>Authorized grants as of June 30, 2008</u>	<u>Amounts not expended as of June 30, 2008</u>	<u>Grants receivable as of June 30, 2008</u>
Capital grants:							
Bridge toll:							
Accessible Vans	\$ 80	—	(80)	—	—	—	—
Cable Car Renovation	3,443	—	(340)	—	3,103	(1,726)	1,377
F-Embarcadero Extension	—	—	—	—	—	—	—
Motor Coach Replacement	883	—	(90)	—	793	(793)	—
Tract Replacement	574	—	(50)	—	524	—	524
Third Street Light Rail	13,001	—	(12,491)	—	510	—	510
Cable Car Guideway	84	—	(84)	—	—	—	—
Historic rail Enclosure	539	—	(55)	—	484	(428)	56
Bus Catalyst Devices	22	—	(22)	—	—	—	—
MC Procurement Hybrids	—	741	(3)	—	738	(612)	126
Paratransit Mini Vans	58	—	(58)	—	—	—	—
Automatic Vehicle Location	11,189	—	(3,243)	—	7,946	(7,288)	658
E-line Embarcadero Streetcar	2,744	608	(592)	—	2,760	(2,729)	31
Match to Capital Grants	6,635	—	(2,696)	—	3,939	(2,911)	1,028
Total capital grants	<u>\$ 39,252</u>	<u>1,349</u>	<u>(19,804)</u>	<u>—</u>	<u>20,797</u>	<u>(16,487)</u>	<u>4,310</u>
State Transit Assistance							
Third Street Light Rail	\$ 24,156	—	(17,043)	—	7,113	(5,082)	2,031
Operating grants:							
AB1107 Sales Tax	\$ 3,232	33,833	(33,965)	—	3,100	—	3,100
State Transit Assistance	6,494	23,901	(30,395)	—	—	—	—
Transportation Development Act	—	35,061	(35,061)	—	—	—	—
Owl Operations	93	187	(186)	—	94	—	94
Third Street Start Up Operations	538	—	(538)	—	—	—	—
Third Street Operations	—	2,500	(1,667)	—	833	—	833
Translink Regional Fare Study	—	1,000	(217)	—	783	(405)	378
Translink Project	—	363	(167)	—	196	—	196
Translink Project – Marketing	—	90	—	—	90	—	90
Lifeline – Route 108 & Route 29	—	1,416	(540)	—	876	(876)	—
Total operating grants	<u>\$ 10,357</u>	<u>98,351</u>	<u>(102,736)</u>	<u>—</u>	<u>5,972</u>	<u>(1,281)</u>	<u>4,691</u>

See accompanying independent auditors' report.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Supplemental Schedule of Grants – San Francisco County Transportation Authority

Year ended June 30, 2008

(In thousands)

	Authorized grants as of July 1, 2007	New grants approved/ spending commences	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2008	Amounts not expended as of June 30, 2008	Grants receivable as of June 30, 2008
Capital grants:							
3rd Light Rail-Preliminary Design	\$ 31,727	7,976	(32,245)	—	7,458	(7,458)	—
Accessible Vans	245	—	(35)	—	210	(207)	3
Articulated Trolley Bus Purchase	481	—	(481)	—	—	—	—
Auto Vehicle Location & ETI Bus Lifts	346	—	(229)	—	117	(117)	—
Cable Car Infrastructure	174	—	—	—	174	(174)	—
Central Subway	—	11,861	(1,438)	—	10,423	(10,423)	—
Diesel Bus Purchase	1,352	—	(114)	—	1,238	(1,238)	—
Escalator Replacement Study	57	228	(56)	—	229	(229)	—
Facilities Rehabilitation and Improvement	4,395	150	(1,428)	(340)	2,777	(2,745)	32
Financial Capacity Study	240	—	—	—	240	(240)	—
Geneva Building Demolition	95	581	(9)	—	667	(667)	—
Gillig Motor Coaches	498	—	(250)	—	248	(248)	—
Historic Trolley Shed	24	—	(24)	—	—	—	—
Hybrid Electric Buses	15,074	—	(6,338)	—	8,736	(8,736)	—
Metro East LRV Facility	2	—	—	—	2	(2)	—
Overhead Rehab Program	3,033	1,850	(624)	—	4,259	(4,259)	—
PCC Overhaul	—	613	(3)	—	610	(610)	—
Procurement of 40' Hybrid Buses	20,458	—	(4,167)	—	16,291	(15,517)	774
Radio Communications Systems	—	2,693	—	—	2,693	(2,693)	—
Rail Replacement/Maintenance Equipment	674	462	(182)	—	954	(954)	—
Rear Wheel Safety Guards	—	1,200	(667)	—	533	(533)	—
Streetcar Rehabilitation	618	—	(3)	—	615	(615)	—
Trolley Coach Rebuild	1,118	—	(93)	—	1,025	(864)	161
Woods Division Renovation	1,004	630	(230)	—	1,404	(1,404)	—
Wood/Potrero Roof Replacement	611	—	(10)	—	601	(601)	—
Total capital grants	\$ 82,226	28,244	(48,626)	(340)	61,504	(60,534)	970

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Supplemental Schedule of Grants – San Francisco County Transportation Authority

Year ended June 30, 2008

(In thousands)

	Authorized grants as of July 1, 2007	New grants approved/ spending commences	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2008	Amounts not expended as of June 30, 2008	Grants receivable as of June 30, 2008
Operating grants:							
Graffiti preventions	\$ 3	—	—	—	3	(3)	—
Capital grant staffing	293	410	(310)	—	393	(277)	116
Emergency pavement repairs	464	—	(16)	—	448	(100)	348
Muni metro extension operations and maintenance	301	3,151	(3,452)	—	—	—	—
Paratransit contract	1,870	9,670	(11,540)	—	—	—	—
Transit preferential streets	20	—	—	—	20	(20)	—
Trolley bus lifts operations and maintenance	532	481	(337)	—	676	(676)	—
Total operating grants	\$ <u>3,483</u>	<u>13,712</u>	<u>(15,655)</u>	<u>—</u>	<u>1,540</u>	<u>(1,076)</u>	<u>464</u>

See accompanying independent auditors' report.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Supplemental Schedule of Grants – Others

Year ended June 30, 2008

(In thousands)

	Authorized grants as of July 1, 2007	New grants approved/ spending commences	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2008	Amounts not expended as of June 30, 2008	Grants receivable as of June 30, 2008
Capital grants:							
Bay Area Air Quality Management District							
Bike Rack Retrofit	\$ 10	—	—	—	10	(10)	—
PM Traps Fleet	22	—	(20)	—	2	(2)	—
Gillig Motor Coaches Retrofit	506	—	(506)	—	—	—	—
Private Foundation – Photo Restoration	—	11	(11)	—	—	—	—
GSA – Radio Communications System Replacement	—	744	—	—	744	(562)	182
Total capital grants	<u>\$ 538</u>	<u>755</u>	<u>(537)</u>	<u>—</u>	<u>756</u>	<u>(574)</u>	<u>182</u>
Operating in nature:							
CA Office of the Governor – Homeland Security	\$ 2,402	—	(397)	—	2,005	(425)	1,580
Translink Project	15	—	—	—	15	(15)	—
TS K 9 Project	100	242	(90)	—	252	(103)	149
Total capital grants	<u>\$ 2,517</u>	<u>242</u>	<u>(487)</u>	<u>—</u>	<u>2,272</u>	<u>(543)</u>	<u>1,729</u>

See accompanying independent auditors' report.



KPMG LLP
55 Second Street
San Francisco, CA 94105

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

The Honorable Mayor, Board of Supervisor,
and San Francisco Municipal Transportation Agency Board of Directors
City and County of San Francisco, California:

We have audited the financial statements of the San Francisco Municipal Railway (Muni) and San Francisco Municipal Railway Improvement Corporation (SFMRIC), departments of the City and County of San Francisco, California (the City), and the San Francisco Municipal Transportation Agency (SFMTA), as of and for the year ended June 30, 2008, and have issued our report thereon dated December 23, 2008. Our report included an explanatory paragraph, related to Muni's and SFMRIC's adoption of the provisions of Government Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as of July 1, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered Muni's and SFMRIC's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Muni's and SFMRIC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Muni's and SFMRIC's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control over financial reporting. We consider the deficiency described in the accompanying schedule of findings and responses (Appendix A) to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and Other Matters

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

Muni's and SFMRIC's response to the finding identified in our audit are described in the accompanying schedule of findings and responses. We did not audit Muni's and SFMRIC's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Mayor, Board of Supervisors, San Francisco Municipal Transportation Agency Board of Directors, and management, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

December 23, 2008

**SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY
IMPROVEMENT CORPORATION**

Schedule of Findings and Responses

June 30, 2008

2008-1. Lack of controls over inventory count process

Criteria

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

Condition

In performing inventory count at Woods Warehouse on April 5, 2008, the count of stock item 019-00-7055 PCS-BAE was erroneously recorded by the warehouse personnel to be 4 items on hand, when the warehouse had only 2 items in stock at the point of count.

Cause

Adequate controls over the inventory count process were not in place at Woods warehouse which potentially caused an error in the inventory count process.

Recommendation

In performing the inventory count in warehouses management should implement general controls to prevent errors in recording the count.

Management Response

SFMTA has established written procedures and instructions on inventory count process to ensure accurate counting. During the cycle count at Woods warehouse, there was a procedural error in accounting for the stock items noted during the physical count observation. The actual quantity in the bin location is the quantity that should have been noted on the count sheets.

The counters were accounting for the two units that were not issued in SHOPS system but were physically issued to the warranty repair technicians on the Woods floor for a repair. The counter and supervisor were responding to a legitimate business requirement to capture the issuance of the items to the open work orders. (The Work Order Module is a SHOPS maintenance module that is used to capture labor and materials for each repair.) The items in SHOPS were frozen for inventory purposes, thus the quantity adjustment that would have occurred with noting the quantity in the bin would have precluded that possibility.

Appendix A

In future physical inventories, SFMTA Materials Management will implement a procedural change in the SHOPS system controls and procedures to allow issuance to occur in near real time to address the requirement of issuing stock to work orders, while also capturing the actual physical quantity in the bin for inventory purposes.

The inventory count instructions have been updated for this procedural change.

2008-2. Reclassification of completed assets out of the construction-in-progress account

Criteria

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

Condition

Several modules of a project were placed in service over prior years but were not reclassified out of the construction-in-progress account into a fixed asset account. The total balance of the assets that should have been reclassified is approximately \$3.5 million.

Cause

Muni is holding a project in the construction-in-progress account until all of the modules of the project are completed. There is no policy in place to reclassify to a fixed asset account the completed modules of a project that have been placed in service.

Recommendation

Assets should be reclassified out of the construction-in-progress account into a fixed asset account when they are placed in service.

Management Response

SFMTA follows the City-wide guidelines, policies and procedures on Capital Asset capitalization. In addition to the City guidelines, SFMTA has additional procedures in place, to ensure and determine whether a project is completed or not.

SFMTA Finance Division's Capital Assets Unit uses the completion date from the milestone report submitted by the Construction Division's Project Control Unit to determine if a project is completed or not. In addition, Capital Assets Unit utilizes the Grants Accounting's quarterly projects status report to compare the amount expended to-date with total project budget as supplementary tool in the capitalization analysis. For those projects not included in the milestone report (which is the case of the item questioned), Finance sends communication to project manager to verify and confirm if a project is completed or not.

In this case, the project manager informed and communicated to Finance that the Trapeze project is not yet completed. Although some components/modules were put in place, the Time keeping software program is not yet operational. This module is designed to track Muni operators' work schedules and actual time of work, as a basis of Payroll Unit's computing operators' bi-weekly pay. The objective of the Trapeze project is to install and implement an integrated scheduling, data collection, operator dispatch and timekeeping system. The project manager noted that the Timekeeping system module of this project needs to be fully operational before the entire integration system project can be deemed complete.

2008-3. Lack of control over the review of cash flow statement presentation

Criteria

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

Condition

In preparing the Statement of Cash Flows for the fiscal year ended June 30, 2008, cash received from passengers and cash paid to suppliers were both understated by \$37.6M due to a computer operation malfunction.

Cause

An adequate review control over the preparation of the Statement of Cash Flows was not in place.

Recommendation

When preparing the Statement of Cash Flows, management should perform a thorough review of the information to ensure the amounts are properly captured and classified in the financial statements.

Management Response

While SFMTA has an established quality control review process in place to review the accuracy of the amounts presented in our financial statements, this particular error was due to staff oversight. Changes were made to a particular spreadsheet but were not updated on the linked spreadsheets. Going forward, a senior staff member will prepare the statement of cash flows and a manager will review the information to ensure the figures in all linked spreadsheets reconcile.