



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

Financial Statements
and Supplemental Schedules

June 30, 2007 and 2006

(With Independent Auditors' Report Thereon)

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KPMG LLP
55 Second Street
San Francisco, CA 94105

Independent Auditors' Report

The Honorable Mayor, Board of Supervisors
and 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 Municipal Transportation Agency (MTA), as of and for the years ended June 30, 2007 and 2006, 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 present only MUNI and SFMRIC and do not purport to, and do not, present fairly the financial position of the City and MTA as of June 30, 2007 and 2006, and the changes in their financial position or, where applicable their 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, 2007 and 2006, 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 November 26, 2007 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 10 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.

KPMG LLP

November 26, 2007

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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, 2007 and 2006. 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 \$1,841,990.
- MUNI and SFMRIC's total net assets increased by \$80,694. This increase is due primarily to an increase in capital contributions 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 16), 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 11 and 12) 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, 2007 and 2006.

The statements of revenues, expenses, and changes in net assets (found on page 13) 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 14 and 15) 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

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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 16 through 32 of this report.

Other Information

The supplemental schedules found on pages 33 through 41 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 \$1,841,990 at the close of the most recent fiscal year.

Summary of Net Assets

June 30, 2007, 2006, and 2005

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Assets:			
Total current assets	\$ 215,973	192,405	151,742
Total restricted assets	25,131	32,487	41,477
Capital assets	<u>1,862,353</u>	<u>1,782,880</u>	<u>1,778,547</u>
Total assets	<u>2,103,457</u>	<u>2,007,772</u>	<u>1,971,766</u>
Liabilities:			
Total current liabilities	119,239	96,715	98,068
Total noncurrent liabilities	<u>142,228</u>	<u>149,761</u>	<u>153,188</u>
Total liabilities	<u>261,467</u>	<u>246,476</u>	<u>251,256</u>
Net assets:			
Invested in capital assets, net of related debt	1,854,377	1,782,880	1,778,547
Restricted net assets	23,675	31,590	40,616
Unrestricted net assets	<u>(36,062)</u>	<u>(53,174)</u>	<u>(98,653)</u>
Total net assets	<u>\$ 1,841,990</u>	<u>1,761,296</u>	<u>1,720,510</u>

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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 22 through 24. 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.

Fiscal Year 2006

MUNI and SFMRIC's net assets increased by \$40,786 with the unrestricted net asset deficit position significantly lower compared to the prior year. This is due to increase in revenues and subsidy support from general fund as compared to prior fiscal year.

Almost all of MUNI's net assets (\$1,782,880 as of June 30, 2006) reflect its investment in capital assets (specifically land, building structure and improvements, equipment, infrastructure, and construction-in-progress). The value of these assets of \$2,485,089 is offset by accumulated depreciation and amortization of \$702,209. More information can be found in note 5 on pages 22 through 24. 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.

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Summary of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2007, 2006, and 2005

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Revenues:			
Total operating revenues	\$ 149,185	141,135	127,431
Total nonoperating revenues, net	235,948	249,815	229,652
Capital contributions:			
Federal	73,511	43,923	42,240
State and others	71,456	46,608	81,747
Total capital contributions	144,967	90,531	123,987
Total net operating transfers	166,435	140,405	117,953
Total revenues and net transfers	696,535	621,886	599,023
Expenses:			
Total operating expenses	615,841	581,100	579,065
Change in net assets	80,694	40,786	19,958
Total net assets – beginning	1,761,296	1,720,510	1,700,552
Total net assets – ending	\$ 1,841,990	1,761,296	1,720,510

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 increase in operating revenues, capital contributions, and operating transfers offset by decrease 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 deappropriation of \$25.9 million parking tax revenue effective FY2007 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.

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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 expenses 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.

Fiscal Year 2006

Total revenues and transfers in for the year ended June 30, 2006 were \$621,886. This is \$22,863 higher than the previous year, due primarily to an increase in operating revenues, nonoperating revenues, and operating transfers offset by a decrease in capital contributions.

Net operating revenues increased by \$13,704, or 11%. There was a \$14,360 increase in transit passenger fares revenue as a result of the implementation of another fare rate increase that took effect in September 2005. Nonoperating revenues increased compared to the previous year by \$20,163 or 9%. 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 increase was attributable to an increase in parking fines and from contributions from state operating grants. Capital contributions decreased by \$33,456 or 27%. 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 capital expenditures incurred and billable to the funding agencies than in the prior year. Net transfers increased by \$22,452 or 19% in 2006 compared to fiscal year 2005, due to an additional City fund subsidy allocated from the City General Fund and Parking and Traffic budgetary support.

Total expenses for the year ended June 30, 2006, were \$581,100. Operating expenses slightly increased by \$2,035 or 0.4% compared from the previous year. The resulting net increase is comprised of trend changes from various expenses category in fiscal year 2006. The significant trend changes occurred in three major expense categories. Personal services net increase of \$3,942 is due to increase in salaries and retirement costs offset by the decrease in workers compensation expenses. Materials and supplies increased by \$3,699 due mostly to the continuing rise in fuel costs. However, general and administrative operating expenses decreased by \$6,101, attributable partly to a decrease in general liability claims.

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Capital Assets and Debt Administration

Capital Assets

MUNI and SFMRIC's investment in capital assets amounts to \$1,862,353 net of accumulated depreciation at June 30, 2007. This investment includes land, building structures and improvements, equipment, infrastructure, and construction-in-progress. The capital assets net increase is \$79,473 or 4.4%, 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 \$161 million of which, \$73 million was for the Third Street Phase 1 & Phase 2 projects.

Summary of Capital Assets

	<u>Balance, June 30, 2007</u>	<u>Balance, June 30, 2006</u>	<u>Balance, June 30, 2005</u>
Capital assets not being depreciated:			
Land	\$ 18,481	18,481	18,481
Construction-in-progress	297,436	461,214	379,203
Total capital assets not being depreciated	<u>315,917</u>	<u>479,695</u>	<u>397,684</u>
Capital assets being depreciated:			
Building structures and improvements	264,582	247,522	244,272
Equipment	1,055,895	1,038,806	1,046,554
Infrastructure	1,003,194	719,066	716,725
Total capital assets being depreciated	<u>2,323,671</u>	<u>2,005,394</u>	<u>2,007,551</u>
Less accumulated depreciation for:			
Building structures and improvements	111,458	105,378	99,398
Equipment	388,312	342,242	295,607
Infrastructure	277,465	254,589	231,683
Total accumulated depreciation	<u>777,235</u>	<u>702,209</u>	<u>626,688</u>
Total capital assets being depreciated, net	<u>1,546,436</u>	<u>1,303,185</u>	<u>1,380,863</u>
Total capital assets, net	<u>\$ 1,862,353</u>	<u>1,782,880</u>	<u>1,778,547</u>

The Third Street Light Rail project, a major expansion of the MUNI Metro system, link 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

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most significant accomplishments for the MTA during this period of time. This accomplishment involved an integration of professionals at various levels including Construction, Contract Management, Project Management, Engineering, and Project Integration staff. The MTA launched the "soft-launch" of weekend service for the T-Third Line on January 13, 2007, followed by the "hard-launch" of revenue service on April 7, 2007, and the closeout of minor construction activities. Phase II of the Third Street Light Rail Project includes the construction of an underground transit link between 4th Street and King Street north to Union Square and Chinatown also referred to as the "Central Subway" Project. MTA has made significant strides on the initial planning, financing, and staffing of this project during the fiscal year 2007. Conceptual engineering and the supplemental environmental process continued. Community meetings and stakeholder outreach meetings were conducted in addition to the community advisory meetings held during the year. In addition, MTA began the development of request for proposal on major consultant contract for construction and design work.

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

Other capital asset additions during the fiscal year 2006 included:

- Completion and capitalization of the Cable Car Renovation project amounting to \$2.9 million.
- Completion and capitalization of the Metro Access Improvement Project in the amount of \$2.2 million.

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.

MUNI received an aggregate of \$388.2 million from the equity investors in full prepayment of the head lease. MUNI deposited \$352.7 million of this lease payment into two escrows. One escrow was deposited with a debt payment undertaker whose repayment obligations are guaranteed by Financial Security Assurance, Inc., an "Aaa/AAA" 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 2007 amounted to \$1.3 million.

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In September 2003, after obtaining final approval from the Municipal Transportation Agency (MTA) 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 approximately \$67.5 million of this head lease payment into two escrows. The deferred revenue amortized in fiscal year 2007 amounted to \$168.

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, 2007 or 2006.

Economic Factors and Next Year's Budget

The Bay Area economy continues to grow as a result of the economic expansion. In an effort to balance the fiscal year 2007 budget, the MTA implemented new revenue generating initiatives, increased the general fund contributions and increased the garage rates and intergovernmental revenues. The MTA balanced its FY 2008 budget by increasing parking garage rates, auto tow and storage fees, cable car and historical vehicle rent, and implemented a new special parking citation collection fee. The FY 2008 budget also includes the realignment of certain vacancies into positions required to support SFMTA strategic goals.

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, MTA Finance and Administration, 1 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.

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Statements of Net Assets

June 30, 2007 and 2006

(In thousands)

	<u>2007</u>	<u>2006</u>
Assets:		
Current assets:		
Deposits and investments with City Treasury	\$ 77,348	44,354
Deposits and investments held outside City Treasury	100	100
Cash on hand	1,081	507
Receivables:		
Grants	48,147	52,626
Due from the San Francisco County Transportation Authority	25,922	24,822
Due from other City departments	25	—
Charges for services (net of allowance for doubtful accounts of \$838 and \$933 in 2007 and 2006, respectively)	2,688	6,995
Other (net of allowance for doubtful accounts of \$118)	17,755	19,413
Total receivables	94,537	103,856
Inventories	42,884	43,189
Current deferred charges	23	399
Total current assets	215,973	192,405
Restricted assets:		
Deposits and investments with City Treasury:		
Transit Impact Development Fee	14,941	23,131
Other restricted investments	1,476	885
Deposits and investments held outside City Treasury	3,695	3,416
Interest receivable	32	9
Transit Impact Development Fee receivable, net	4,987	5,046
Total restricted assets	25,131	32,487
Capital assets	1,862,353	1,782,880
Total noncurrent assets	1,887,484	1,815,367
Total assets	\$ 2,103,457	2,007,772

See accompanying notes to financial statements.

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

Statements of Net Assets

June 30, 2007 and 2006

(In thousands)

	<u>2007</u>	<u>2006</u>
Liabilities:		
Current liabilities:		
Due to other funds	\$ 145	145
Accounts payable and accrued expenses	44,657	25,902
Accrued payroll	16,725	14,396
Accrued vacation and sick leave	13,637	12,273
Accrued workers' compensation	17,945	21,488
Accrued claims	14,367	19,356
Deferred revenue and other deferred credits	2,331	2,259
Payable from restricted assets	1,456	896
Current loans payable	7,976	—
Total current liabilities	<u>119,239</u>	<u>96,715</u>
Noncurrent liabilities:		
Accrued vacation and sick leave	9,760	9,469
Accrued workers' compensation	62,773	72,243
Accrued claims	38,458	35,329
Deferred revenue and other deferred credits	31,237	32,720
Total noncurrent liabilities	<u>142,228</u>	<u>149,761</u>
Total liabilities	<u>261,467</u>	<u>246,476</u>
Net assets:		
Invested in capital assets, net of related debt	\$ 1,854,377	1,782,880
Restricted	23,675	31,590
Unrestricted	(36,062)	(53,174)
Total net assets	<u>\$ 1,841,990</u>	<u>1,761,296</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, 2007 and 2006

(In thousands)

	2007	2006
Operating revenues:		
Passenger fares	\$ 141,518	134,553
Advertising	5,530	4,423
Paratransit revenue	1,475	1,411
Charter service	1	2
Rental income	629	631
Other	32	115
Total operating revenues	<u>149,185</u>	<u>141,135</u>
Operating expenses:		
Personal services	409,468	374,504
Contractual services	24,676	23,728
Materials and supplies	38,216	32,904
Depreciation	83,930	87,141
Services from other City departments	28,563	24,944
General and administrative	28,247	33,015
Other operating expenses	2,741	4,864
Total operating expenses	<u>615,841</u>	<u>581,100</u>
Operating loss	<u>(466,656)</u>	<u>(439,965)</u>
Nonoperating revenues (expenses and losses):		
Operating assistance:		
Department of Parking and Traffic	127,078	140,008
Federal	5,156	23,651
State and other grants	97,713	84,153
Transit Impact Development Fee, net of expenses	1,102	111
Capital reserve revenue	1,483	1,483
Interest income	4,398	2,040
Interest expense	—	(543)
Loss on disposal of capital assets	(533)	(386)
Other, net	(449)	(702)
Total nonoperating revenues, net	<u>235,948</u>	<u>249,815</u>
Loss before capital contributions and transfers	<u>(230,708)</u>	<u>(190,150)</u>
Capital contributions:		
Federal	73,511	43,923
State and others	71,456	46,608
Total capital contributions	<u>144,967</u>	<u>90,531</u>
Transfers in:		
City and County of San Francisco – General Fund	149,813	118,377
San Francisco County Transportation Authority	15,119	15,594
San Francisco Water Department	—	542
San Francisco Parking and Traffic Department (net of transfer out)	1,503	5,892
Total transfers in	<u>166,435</u>	<u>140,405</u>
Change in net assets	80,694	40,786
Total net assets – beginning of year	<u>1,761,296</u>	<u>1,720,510</u>
Total net assets – ending of year	<u>\$ 1,841,990</u>	<u>1,761,296</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, 2007 and 2006

(In thousands)

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities:		
Cash received from passengers and service contracts	\$ 170,605	149,448
Cash paid to employees for services	(418,556)	(381,909)
Cash paid to suppliers for goods and services	(98,763)	(89,245)
Cash paid for judgment and claims	(10,752)	(7,742)
Cash paid for quasi-external transactions	(28,198)	(27,777)
Net cash used in operating activities	<u>(385,664)</u>	<u>(357,225)</u>
Cash flows from noncapital financing activities:		
Operating grants	244,053	230,888
Net transfers	171,956	140,405
Transit Impact Development Fee received, net of expenses	1,309	410
Other noncapital increases	109	—
Other noncapital decreases	—	(821)
Net cash provided by noncapital financing activities	<u>417,427</u>	<u>370,882</u>
Cash flows from capital and related financing activities:		
Capital grants	131,968	103,653
Proceeds from sale of capital assets	29	16
Proceeds from loans	7,976	—
Acquisition of capital assets	(148,857)	(97,452)
Other capital increases	—	2,574
Other capital decreases	(25)	—
Net cash provided by (used in) capital and related financing activities	<u>(8,909)</u>	<u>8,791</u>
Cash flows from investing activities:		
Proceeds from sale of investments with trustees – restricted	2,513	460
Interest income received	3,323	1,976
Interest expense paid	—	(543)
Net cash provided by investing activities	<u>5,836</u>	<u>1,893</u>
Net increase in cash and cash equivalents	28,690	24,341
Cash and cash equivalents – beginning of year	69,945	45,604
Cash and cash equivalents – end of year	<u>\$ 98,635</u>	<u>69,945</u>

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

Statements of Cash Flows

Years ended June 30, 2007 and 2006

(In thousands)

	<u>2007</u>	<u>2006</u>
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (466,656)	(439,965)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation	83,930	87,141
Provision for doubtful accounts	(96)	(378)
Changes in operating assets and liabilities:		
Receivables, net	3,651	(5,788)
Inventories	305	(230)
Deferred charges	376	(398)
Accounts payable and accrued expenses	3,657	3,789
Accrued payroll	2,263	1,061
Accrued vacation and sick leave	1,655	495
Accrued workers' compensation	(13,014)	(8,947)
Accrued claims	(1,860)	8,653
Due to other funds	—	(2,448)
Deferred revenues and other deferred credits	125	(210)
Net cash used in operating activities	<u>\$ (385,664)</u>	<u>(357,225)</u>
Reconciliation of cash and cash equivalents to the statements of net assets:		
Deposits with City Treasury:		
Unrestricted	\$ 77,348	44,354
Restricted	16,417	24,016
Deposits held outside City Treasury:		
Unrestricted	100	100
Restricted	3,689	968
Cash on hand	1,081	507
Total cash and cash equivalents, end of year	<u>\$ 98,635</u>	<u>69,945</u>

See accompanying notes to financial statements.

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

Notes to Financial Statements

June 30, 2007 and 2006

(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 Municipal Transportation Agency (MTA) to run MUNI and the MTA 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 MTA by July 1, 2002. Although the MTA 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.

(b) 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.

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

Notes to Financial Statements

June 30, 2007 and 2006

(Dollars in thousands, unless otherwise noted)

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.

Restricted deposits and investments held by a trustee outside City Treasury are not considered to be cash and cash equivalents.

Of the restricted deposits and investments of SFRMIC which are held outside City Treasury, \$3,689 as of June 30, 2007, and \$968 as of June 30, 2006 are considered cash equivalents as they meet the definition of cash equivalents.

(c) 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).

(d) 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.

(e) Capital Assets

Capital assets are stated at cost. 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.

(f) 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.

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

Notes to Financial Statements

June 30, 2007 and 2006

(Dollars in thousands, unless otherwise noted)

(g) *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.

(h) *Capital Grants and Contributions*

Capital grants and contributions from external sources are recognized as capital contribution earned at 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 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.

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

Notes to Financial Statements

June 30, 2007 and 2006

(Dollars in thousands, unless otherwise noted)

(i) 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.

(j) 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.

(k) Token Revenues

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

(l) Use of Estimates

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

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

Notes to Financial Statements

June 30, 2007 and 2006

(Dollars in thousands, unless otherwise noted)

(3) Net Assets

Net assets as of June 30, 2007 and 2006, consist of the following:

	<u>2007</u>	<u>2006</u>
Restricted assets:		
Deposits and investments with City Treasury	\$ 16,417	24,016
Deposits and investments outside City Treasury	3,695	3,416
Receivables	5,019	5,054
Total restricted assets	<u>25,131</u>	<u>32,486</u>
Restricted liabilities of:		
SFMRIC	(5)	(4)
Transit Impact Development Fee	—	(5)
Others	(1,451)	(887)
Total restricted liabilities	<u>(1,456)</u>	<u>(896)</u>
Restricted assets, net	<u>\$ 23,675</u>	<u>31,590</u>
Net assets:		
Restricted:		
Transit Impact Development Fee	\$ 19,928	28,172
SFMRIC	3,698	3,418
Others	49	—
Total restricted net assets	<u>23,675</u>	<u>31,590</u>
Unrestricted	(36,062)	(53,174)
Invested in capital assets	<u>1,854,377</u>	<u>1,782,880</u>
Net assets	<u>\$ 1,841,990</u>	<u>1,761,296</u>

(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, 2007 and 2006, MUNI and SFMRIC's unrestricted deposits and investments were \$78,529 and \$44,961, respectively.

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

Notes to Financial Statements

June 30, 2007 and 2006

(Dollars in thousands, unless otherwise noted)

The restricted assets' deposits and investments outside the City Treasury are held by a trustee. As of June 30, 2007 and 2006, MUNI and SFMRIC had deposits and investments with the trustee of \$3,695 and \$3,416, respectively. Of the deposits, \$3,689 and \$968 meet the definition of cash and cash equivalents as of June 30, 2007 and 2006, 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
25.9%	43.6%	28.4%	2.1%

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

Notes to Financial Statements

June 30, 2007 and 2006

(Dollars in thousands, unless otherwise noted)

(5) Capital Assets

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

	Balance, July 1, 2006	Increases	Decreases	Balance, June 30, 2007
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, 2007 and 2006

(Dollars in thousands, unless otherwise noted)

Capital asset balances and their movements as of and for the year ended June 30, 2006 and 2005 are as follows:

	<u>Balance, July 1, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance, June 30, 2006</u>
Capital assets not being depreciated:				
Land	\$ 18,481	—	—	18,481
Construction-in-progress	379,203	90,748	(8,737)	461,214
Total capital assets not being depreciated	<u>397,684</u>	<u>90,748</u>	<u>(8,737)</u>	<u>479,695</u>
Capital assets being depreciated:				
Building structures and improvements	244,272	3,250	—	247,522
Equipment	1,046,554	4,275	(12,023)	1,038,806
Infrastructure	716,725	2,341	—	719,066
Total capital assets being depreciated	<u>2,007,551</u>	<u>9,866</u>	<u>(12,023)</u>	<u>2,005,394</u>
Less accumulated depreciation for:				
Building structures and improvements	99,398	5,980	—	105,378
Equipment	295,607	58,255	(11,620)	342,242
Infrastructure	231,683	22,906	—	254,589
Total accumulated depreciation	<u>626,688</u>	<u>87,141</u>	<u>(11,620)</u>	<u>702,209</u>
Total capital assets being depreciated, net	<u>1,380,863</u>	<u>(77,275)</u>	<u>(403)</u>	<u>1,303,185</u>
Total capital assets, net	<u>\$ 1,778,547</u>	<u>13,473</u>	<u>(9,140)</u>	<u>1,782,880</u>

MUNI has capital assets acquired from 1945 to 1987 with estimated lives of over 50 years, mainly cable car barn rehabilitation and substations, with a total cost of \$25,701 and a net book value of \$15,641 as of June 30, 2007.

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

Notes to Financial Statements

June 30, 2007 and 2006

(Dollars in thousands, unless otherwise noted)

Construction-in-progress consists of the following projects as of June 30, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Third Street light rail	\$ 148,605	358,646
Articulated trolley coaches	96	5,101
Rail replacement	11,714	4,846
Auto Passenger Count	1,009	—
PM Traps Fleet	8,243	—
Motor bus Hybrid Procurement	40,553	—
Islais Creek-Woods Annex	5,504	4,634
Trolley Overhead Reconstruction	19,382	11,819
Vehicle Scheduling System	3,450	2,861
Flynn Facility Lift Construction	986	982
Vehicle Inventory Management	2,331	2,171
Automatic Vehicle Location	5,670	3,690
Burke Ave Central Warehouse	—	10,130
New Central Subway	19,236	13,308
Motor Bus Replacement	3,723	1,180
Bayshore & Geary Corridor	9,470	9,469
Light rail vehicles	8,780	5,496
Others	8,684	26,881
	<u>\$ 297,436</u>	<u>461,214</u>

(6) 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, 2007 and 2006, no bonds were outstanding under the TIP.

In February 2006, MTA 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, MTA entered into an AB3090 Project Reimbursement Agreement under the authority of Government Code section 14529.7(b) under which MTA utilize local funds for the project at an earlier date than the Project is programmed in the State Transportation Improvement Program. The anticipated fund reimbursement from the State will be used to repay the loan to SFCTA. During the fiscal year 2007, SFCTA advanced to MUNI loan funds totaling \$7.9 million. The no-interest loan is payable within 30 days upon receipt of allocation of STIP funds from the State for reimbursement of the project costs.

**SAN FRANCISCO MUNICIPAL RAILWAY AND
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IMPROVEMENT CORPORATION**

Notes to Financial Statements

June 30, 2007 and 2006

(Dollars in thousands, unless otherwise noted)

(7) 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 2007 and 2006 varied from 7% to 8% as a percentage of covered payroll. MUNI is required to contribute at an actuarially determined rate. For fiscal year 2007 and 2006, the actuarially determined contribution rate as a percentage of covered payroll was 6.24% and 6.58%, respectively. MUNI's required contribution was approximately \$16.2 million in 2007 and \$16.0 million in 2006.

MUNI's contributions to the Retirement System on behalf of its employees amounted to \$10,229 and \$10,288 for the years ended June 30, 2007 and 2006, 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.

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IMPROVEMENT CORPORATION**

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(Dollars in thousands, unless otherwise noted)

(c) Healthcare Benefits

Healthcare benefits for employees, retired employees, and surviving spouses (beneficiaries) are financed by beneficiaries and by the City through the City Health Service System, an employee benefit trust fund. The contribution for all of the City's fund groups is mandated and determined by a Charter provision based on similar contributions made by the ten most populous counties in California. The costs to MUNI for the years ended June 30, 2007 and 2006 were \$47,433 and \$45,088, respectively. Included in these amounts are \$14,008 and \$14,073 for fiscal year 2007 and fiscal year 2006, respectively, to provide postretirement healthcare benefits for retired employees.

(8) 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 \$6.8 million in fiscal year 2007. In fiscal year 2006, MUNI also contributed only for operating needs amounting to \$6.6 million.

(9) 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, 2007 and 2006 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.

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Changes in the balances of claims liabilities and workers' compensation liabilities for the years ended June 30, 2007 and 2006 are as follows:

	2007	2006
Accrued claims liabilities, beginning of fiscal year	\$ 54,685	46,032
Incurred claims and changes in estimates	8,892	17,221
Claims payments	<u>(10,752)</u>	<u>(8,568)</u>
Accrued claims liabilities, end of fiscal year	<u>\$ 52,825</u>	<u>54,685</u>
Accrued workers' compensation, beginning of fiscal year	\$ 93,731	102,678
Incurred workers' compensation and changes in estimates	3,727	7,030
Workers' compensation payments	<u>(16,740)</u>	<u>(15,977)</u>
Accrued workers' compensation, end of fiscal year	<u>\$ 80,718</u>	<u>93,731</u>

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

(10) 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 \$25.9 million. The new operating transfer from the general fund is in lieu of the parking tax revenue allocation to MTA that has been deappropriated effective fiscal year 2007 per the city ordinance passed on March 27, 2007.

(11) 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, 2007, MUNI had approved capital grants with unused balances amounting to \$391 million. Capital grants receivable as of June 30, 2007 and 2006, totaled \$56.7 million and \$40.2 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, 2007, MUNI had various operating grants receivable of \$17.4 million. In fiscal year 2007, MUNI's operating assistance also includes BART ADA

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revenues of \$1.2 million and other federal, state, and local grants of \$3.0 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, 2007, new capital grants were approved by SFCTA in the amount of \$35.0 million and payments received by MUNI for capital grants totaled \$41.7 million. As of June 30, 2007, MUNI had funds due from SFCTA for capital grants in the amount of \$23.5 million. Similarly, MUNI receives operating grants from SFCTA. During the fiscal year ended June 30, 2007, SFCTA approved new operating grants in the amount of \$14.1 million and payments received by MUNI totaled \$19.5 million. As of June 30, 2007, MUNI had \$2.4 million and \$7.9 million of funds due from SFCTA for operating grants as of June 30, 2007 and 2006, respectively.

(12) Property Rights in Perpetuity with the Port of San Francisco

Given that the proposed Metro East Light Rail Vehicle Maintenance and Operating Facility (Metro East) is an integral part of the Third Street Light Rail Project and is vital for relieving overcrowded conditions at MUNI's existing light rail facility, MUNI identified an approximately 17-acre site of the Western Pacific Railroad under the jurisdiction of the Port of San Francisco (Port) as the best location for the Metro East facility.

In March 2001, MUNI and the Port entered into a Memorandum of Understanding (MOU) under which MUNI may use the Metro East facility in perpetuity for rail vehicle maintenance, operations, and other operational needs at a cost of \$25.7 million.

The MOU also required MUNI to pay the Port an additional \$4 million to construct the Illinois Street Bridge over Islais Creek. Construction of this bridge will mitigate traffic in the area and improve coordination with MUNI's Metro East and Third Street Light Rail Project. In the event the Port fails to expend the money toward construction of the bridge within three years after the effective date of the MOU, the Port shall return the \$4 million to MUNI. Any such return of funds shall have no effect on the rights granted to MUNI as specified in the MOU. The entire \$4 million fund had been expended since 2005. The construction of Illinois Street Bridge which began in May 2005 was substantially completed on October 31, 2006. The remaining work was completed by December 31, 2006.

(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 monies 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.

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These agreements are accounted for as operating leases. Rent expense was \$5,577 and \$5,841 for the years ended June 30, 2007 and 2006, respectively.

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

Years ending June 30:	
2008	\$ 6,110
2009	6,041
2010	6,310
2011	6,367
2012	6,492
2013 – 2017	34,856
2018 – 2022	39,514
2023 – 2027	45,387
2028 – 2032	52,807
Total	<u>\$ 203,884</u>

(c) Other Commitments

As of June 30, 2007, MUNI has outstanding commitments of approximately \$96,436 with third parties for various capital projects. Grant funding is available for the majority of this amount. MUNI also has outstanding commitments of approximately \$14,196 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 guaranteed funding and the maximum amounts of such guarantees as of June 30, 2007, are as follows:

Central Control and Revenue Center	\$ 75
Local Match for Paratransit Program	112
Historic Streetcar Shed	775
Islais Creek Storage Facility	728
New Orleans Historic Street Car	849
Total	<u>\$ 2,539</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,

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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

Tranche 1

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, MUNI entered into the leveraged lease-leaseback transaction for over 118 Breda light rail vehicles (the Tranche 1 Equipment). The transaction was structured as a head lease of the Tranche 1 Equipment to separate special purpose trusts and a sublease of the Tranche 1 Equipment back from such trusts. The sublease provides MUNI with an option to purchase the Tranche 1 Equipment in approximately 27 years, the scheduled completion date of the sublease. During the term of the sublease, MUNI maintains custody of the Tranche 1 Equipment and is obligated to insure and maintain the Tranche 1 Equipment throughout the life of the sublease.

MUNI received an aggregate of \$388.2 million from the equity investors in full prepayment of the head lease. MUNI deposited \$352.7 million of this head lease payment into two escrows. One escrow was deposited with a debt payment undertaker whose repayment obligations are guaranteed by Financial Security Assurance, an "Aaa/AAA" rated bond insurance company. The other escrow was invested in U.S. government bonds with maturity dates that match the completion of the sublease. Payments under these escrows are to be made at such times and in such amounts so as to fund MUNI's scheduled payments under the sublease as well as to provide a source of funding for MUNI's purchase option if it chooses to exercise it. Although these escrows do not represent a legal defeasance of MUNI's obligations under the sublease, management believes that the creditworthiness of these escrows is such that they will fund MUNI's obligations under the sublease and that the possibility that MUNI will need to access other monies to make sublease payments is remote. Therefore, the trust assets and the sublease obligations are not recorded on the financial statements of MUNI as of June 30, 2007 or 2006.

As a result of the cash transactions above, 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 will be amortized over the life of the sublease. The deferred revenue amortized amounts were \$1.3 million in fiscal year 2007 and 2006, respectively.

As of June 30, 2007, the outstanding payments to be made on the sublease through fiscal year 2027 are \$238.7 million and the payments to be made on the purchase option of the Tranche 1 Equipment would be \$643.1 million, if exercised. All of these payments are to be funded from the amounts in escrow. If MUNI does not exercise the purchase option, MUNI would be required to either: 1) pay service and maintenance

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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.

Tranche 2

In September 2003, after obtaining final approval from the Municipal Transportation Agency board of directors and the City and County’s board of supervisors, MUNI entered into a second leveraged lease-back transaction for over 21 BREDAs 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 approximately \$67.5 million of this head lease payment into two escrows. One escrow was deposited with a debt payment undertaker whose repayment obligations are guaranteed by Financial Security Assurance, an “Aaa/AAA” rated bond insurance company. The other escrow was invested in U.S. government bonds with maturity dates that match the completion of the sublease.

Payments under these escrows are to be made at such times and in such amounts so as to fund MUNI’s scheduled payments under the sublease as well as to provide a source of funding for MUNI’s purchase option if it chooses to exercise it. Although these escrows do not represent a legal defeasance of MUNI’s obligations under the sublease, management believes that the creditworthiness of these escrows is such that they will fund MUNI’s obligations under the sublease and that the possibility that MUNI will need to access other monies to make sublease payments is remote.

The deferred revenue will be amortized over the life of the sublease. The deferred revenue amortized in fiscal years 2007 and 2006 amounted to \$168.

As of June 30, 2007, the outstanding payments to be made on the sublease through 2029 are \$55.5 million and the payments to be made on the purchase option of the Equipment would be \$198.5 million, if exercised. All of these payments are to be funded from the amounts in escrow. 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; 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.

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(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
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IMPROVEMENT CORPORATION**

Supplemental Schedule – Schedule of Net Assets

June 30, 2007

(In thousands)

	<u>MUNI</u>	<u>SFMRIC</u>	<u>Eliminations</u>	<u>Total</u>
Assets:				
Current assets:				
Deposits and investments with City				
Treasury	\$ 77,348	—	—	77,348
Deposits and investments held outside				
City Treasury	100	—	—	100
Cash on hand	1,081	—	—	1,081
Receivables:				
Grants	48,147	—	—	48,147
Due from the San Francisco County				
Transportation Authority	25,922	—	—	25,922
Due from other City departments	25	—	—	25
Charges for services, net	2,688	—	—	2,688
Other, net	17,755	592	(592)	17,755
Total receivables	94,537	592	(592)	94,537
Inventories	42,884	—	—	42,884
Current deferred charges	23	—	—	23
Total current assets	215,973	592	(592)	215,973
Restricted assets:				
Deposits and investments with City				
Treasury:				
Transit Impact Development Fee	14,941	—	—	14,941
Other restricted investments	1,476	—	—	1,476
Deposits and investments held outside City				
Treasury	6	3,689	—	3,695
Interest receivable	18	14	—	32
Transit Impact Development Fee				
receivable, net	4,987	—	—	4,987
Total restricted assets	21,428	3,703	—	25,131
Capital assets	1,862,353	—	—	1,862,353
Total noncurrent assets	1,883,781	3,703	—	1,887,484
Total assets	\$ 2,099,754	4,295	(592)	2,103,457

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Supplemental Schedule – Schedule of Net Assets

June 30, 2007

(In thousands)

	<u>MUNI</u>	<u>SFMRIC</u>	<u>Eliminations</u>	<u>Total</u>
Liabilities:				
Current liabilities:				
Due to other funds	\$ 145	89	(89)	145
Accounts payable and accrued expenses	44,657	—	—	44,657
Accrued payroll	16,725	—	—	16,725
Accrued vacation and sick leave	13,637	—	—	13,637
Accrued workers' compensation	17,945	—	—	17,945
Accrued claims	14,367	—	—	14,367
Deferred revenue and other deferred credits	2,331	—	—	2,331
Payable from restricted assets	1,451	5	—	1,456
Current loans payable	7,976	—	—	7,976
Total current liabilities	<u>119,234</u>	<u>94</u>	<u>(89)</u>	<u>119,239</u>
Noncurrent liabilities:				
Accrued vacation and sick leave	9,760	—	—	9,760
Accrued workers' compensation	62,773	—	—	62,773
Accrued claims	38,458	—	—	38,458
Deferred revenue and other deferred credits	31,237	—	—	31,237
Total noncurrent liabilities	<u>142,228</u>	<u>—</u>	<u>—</u>	<u>142,228</u>
Total liabilities	<u>\$ 261,462</u>	<u>94</u>	<u>(89)</u>	<u>261,467</u>
Net assets:				
Invested in capital assets, net of related debt	\$ 1,854,377			1,854,377
Restricted	19,977	4,201	(503)	23,675
Unrestricted	(36,565)	—	503	(36,062)
Total net assets	<u>\$ 1,837,789</u>	<u>4,201</u>	<u>—</u>	<u>1,841,990</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, 2007

(In thousands)

	MUNI	SFMRIC	Eliminations	Total
Operating revenues:				
Passenger fares	\$ 141,518	—	—	141,518
Advertising	5,530	—	—	5,530
Paratransit revenue	1,475	—	—	1,475
Charter service	1	—	—	1
Rental income	629	—	—	629
Other	32	—	—	32
Total operating revenues	149,185	—	—	149,185
Operating expenses:				
Personal services	409,468	—	—	409,468
Contractual services	24,676	—	—	24,676
Materials and supplies	38,216	—	—	38,216
Depreciation	83,930	—	—	83,930
Services from other City departments	28,563	—	—	28,563
General and administrative	28,987	50	(790)	28,247
Other operating expenses	2,741	—	—	2,741
Total operating expenses	616,581	50	(790)	615,841
Operating loss	(467,396)	(50)	790	(466,656)
Nonoperating revenues (expenses and losses):				
Operating assistance:				
Department of Parking and Traffic	127,078	—	—	127,078
Federal	5,156	—	—	5,156
State and other grants	97,713	—	—	97,713
Transit Impact Development Fee, net of expenses	1,102	—	—	1,102
Capital reserve revenue	1,483	—	—	1,483
Interest income	4,214	184	—	4,398
Loss on disposal of capital assets	(533)	—	—	(533)
Capital assistance of SFMRIC to MUNI	94	(94)	—	—
Other, net	(449)	790	(790)	(449)
Total nonoperating revenues, net	235,858	880	(790)	235,948
Loss before capital contribution and transfers	(231,538)	830	—	(230,708)
Capital contributions:				
Federal	73,511	—	—	73,511
State and others	71,456	—	—	71,456
Total capital contributions	144,967	—	—	144,967
Transfers in:				
City and County of San Francisco – General Fund	149,813	—	—	149,813
San Francisco County Transportation Authority	15,119	—	—	15,119
San Francisco Water Department	—	—	—	—
San Francisco Parking & Traffic Department	1,503	—	—	1,503
Total transfers in	166,435	—	—	166,435
Change in net assets	79,864	830	—	80,694
Total net assets – beginning	1,757,925	3,371	—	1,761,296
Total net assets – ending	\$ 1,837,789	4,201	—	1,841,990

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, 2007

(In thousands)

	Authorized grants as of July 1, 2006	New grants approved/ spending commences	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2007	Amounts not expended as of June 30, 2007	Grants receivable as of June 30, 2007
Capital grants:							
Sec 3 -Construct Islais Creek Facility	\$ 15,036	—	—	(1)	15,035	(15,035)	—
Sec 4 - Islais Creek ITS & AVL	—	3,693	—	—	3,693	(3,693)	—
Sec 3 - Third street Phase II Central Subway	—	24,503	—	—	24,503	(24,503)	—
Sec 4 - Glen Park Intermodal Facility	—	785	—	—	785	(785)	—
Section 9 Fiscal Year 1993/94	135	—	(135)	—	—	—	—
Section 9 Fiscal Year 1995/96	91	—	(91)	—	—	—	—
Section 9 Fiscal Year 1998/99	3,193	—	(269)	—	2,924	(2,531)	393
Section 9 Fiscal Year 1999/00	8,706	—	(1,526)	—	7,180	(7,072)	108
Section 9 Fiscal Year 2000/01	2,068	—	—	—	2,068	(2,068)	—
Section 9 Fiscal Year 2001/02	12,008	—	(5,200)	—	6,808	(6,179)	629
Section 9 Fiscal Year 2002/03	22,806	—	(12,905)	—	9,901	(8,012)	1,889
Section 9 Fiscal Year 2003/04	22,704	—	(2,391)	—	20,313	(19,602)	711
Section 9 Fiscal Year 2004/05	47,046	—	(16,259)	—	30,787	(18,490)	12,297
Section 9 Fiscal Year 2005/06	—	25,487	(130)	—	25,357	(25,256)	101
Section 9 Fiscal Year 2006/07	—	28,047	—	—	28,047	(28,047)	—
Section 3 -Central Control Facility	822	—	(175)	—	647	(617)	30
Section 3 New Central Subway	12,621	—	(4,431)	—	8,190	(5,979)	2,211
Section 3 Third Street Metro East	35,136	—	(23,922)	—	11,214	(11,034)	180
Section 3 -PM Traps Fleet	3,088	—	—	—	3,088	(3,088)	—
Section 3 -Fixed Guideway	23,306	76,001	(589)	—	98,718	(98,560)	158
Section 15 Radio Replacement	3,175	—	(1,675)	—	1,500	(1,500)	—
Alternative Fuel	497	—	(37)	—	460	(460)	—
Radio Replacement	207	—	—	—	207	(207)	—
Automatic Vehicle Location	1,124	—	(1,100)	—	24	—	24
Total capital grants	<u>\$ 213,769</u>	<u>158,516</u>	<u>(70,835)</u>	<u>(1)</u>	<u>301,449</u>	<u>(282,718)</u>	<u>18,731</u>
Pass-through grants:							
Transbay Terminal CA90-0212	\$ 955	—	(270)	—	685	(27)	658
Transbay Terminal CA90-0124	743	—	(742)	(1)	—	—	—
Total pass-through Grants	<u>\$ 1,698</u>	<u>—</u>	<u>(1,012)</u>	<u>(1)</u>	<u>685</u>	<u>(27)</u>	<u>658</u>
Operating grants:							
Operating assistance	\$ —	3,808	—	—	3,808	—	3,808
Paratransit	3,697	—	(3,697)	—	—	—	—
SRTP-CPT529 and 473 and 548	82	—	(28)	(54)	—	—	—
Preventive Maintenance	16,991	—	(16,991)	—	—	—	—
Total operating grants	<u>\$ 20,770</u>	<u>3,808</u>	<u>(20,716)</u>	<u>(54)</u>	<u>3,808</u>	<u>—</u>	<u>3,808</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, 2007

(In thousands)

	Authorized grants as of July 1, 2006	New grants approved/ spending commences	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2007	Amounts not expended as of June 30, 2007	Grants receivable as of June 30, 2007
Capital grants:							
Diesel Bus Purchase	\$ —	300	(109)	—	191	(191)	—
Total capital grants	<u>\$ —</u>	<u>300</u>	<u>(109)</u>	<u>—</u>	<u>191</u>	<u>(191)</u>	<u>—</u>

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, 2007

(In thousands)

	Authorized grants as of July 1, 2006	New grants approved/ spending commences	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2007	Amounts not expended as of June 30, 2007	Grants receivable as of June 30, 2007
Capital grants:							
Bridge toll:							
Accessible Vans	\$ 183	—	—	(103)	80	(80)	—
Cable Car Renovation	3,671	—	(228)	—	3,443	(3,369)	74
F-Embarcadero Extension	1,046	—	(16)	(1,030)	—	—	—
Motor Coach Replacement	2,018	—	(158)	(977)	883	(883)	—
Tract Replacement	574	—	—	—	574	(574)	—
Third Street Light Rail	24,709	—	(11,708)	—	13,001	(7,752)	5,249
Cable Car Guideway	421	—	(337)	—	84	(34)	50
Historic rail Enclosure	539	—	—	—	539	(539)	—
Bus Catalyst Devices	48	—	(26)	—	22	—	22
MC Procurement Hybrids	174	—	(174)	—	—	—	—
Paratransit Mini Vans	78	—	(20)	—	58	(40)	18
Automatic Vehicle Location	—	11,283	(94)	—	11,189	(10,580)	609
E-line Embarcadero Streetcar	4,964	2,239	(4,459)	—	2,744	(2,503)	241
Match to Capital Grants	2,887	3,985	(237)	—	6,635	(6,449)	186
Diesel Bus Purchase	406	—	—	(406)	—	—	—
Total capital grants	<u>\$ 41,718</u>	<u>17,507</u>	<u>(17,457)</u>	<u>(2,516)</u>	<u>39,252</u>	<u>(32,803)</u>	<u>6,449</u>
State Transit Assistance							
Third Street Light Rail	<u>\$ —</u>	<u>25,000</u>	<u>(844)</u>	<u>—</u>	<u>24,156</u>	<u>(16,689)</u>	<u>7,467</u>
Operating grants:							
AB1107 Sales Tax	\$ 2,773	33,180	(32,721)	—	3,232	—	3,232
State Transit Assistance	4,795	22,651	(20,952)	—	6,494	—	6,494
Transportation Development Act	—	37,744	(37,744)	—	—	—	—
Owl Operations	—	185	(92)	—	93	—	93
Third Street Start Up Operations	923	2,500	(2,748)	(137)	538	—	538
Lifeline - Route 108 & Route 29	—	275	(275)	—	—	—	—
Total operating grants	<u>\$ 8,491</u>	<u>96,535</u>	<u>(94,532)</u>	<u>(137)</u>	<u>10,357</u>	<u>—</u>	<u>10,357</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, 2007

(In thousands)

	Authorized grants as of July 1, 2006	New grants approved/ spending commences	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2007	Amounts not expended as of June 30, 2007	Grants receivable as of June 30, 2007
Capital grants:							
3rd Light Rail-Preliminary Design	\$ 56,615	4,263	(29,151)	—	31,727	(16,762)	14,965
Accessible Vans	—	245	—	—	245	(244)	1
Articulated Trolley Bus Purchase	997	—	(516)	—	481	(325)	156
Auto Vehicle Location & ETI Bus Lifts	173	180	(7)	—	346	(335)	11
Cable Car Infrastructure	174	—	—	—	174	(174)	—
Diesel Bus Purchase	1,675	—	(323)	—	1,352	(1,238)	114
Escalator Replacement Study	110	65	(118)	—	57	(27)	30
F-Line Embarcadero Extension	783	—	—	(783)	—	—	—
Facilities Rehabilitation and Improvement	3,858	1,227	(363)	(327)	4,395	(3,907)	488
Financial Capacity Study	240	—	—	—	240	(240)	—
Geneva Building Demolition	187	—	(92)	—	95	(88)	7
Gillig Motor Coaches	2,514	635	(2,651)	—	498	(397)	101
Historic Trolley Shed	91	—	(67)	—	24	(22)	2
Hybrid Electric Buses	15,500	609	(1,035)	—	15,074	(10,464)	4,610
Metro East LRV Facility	2	—	—	—	2	(2)	—
Overhead Rehab Program	2,297	2,981	(2,127)	(118)	3,033	(2,764)	269
Rail Replacement/Maintenance Equipment	2,154	—	(1,480)	—	674	(609)	65
Streetcar Rehabilitation	675	—	(57)	—	618	(615)	3
Trolley Coach Rebuild	—	1,212	(94)	—	1,118	(1,118)	—
Woods Division Renovation	1,270	—	(266)	—	1,004	(996)	8
Wood/Potrero Roof Replacement	763	—	(152)	—	611	(601)	10
Procurement of 40' Hybrid Buses	—	23,670	(3,212)	—	20,458	(17,786)	2,672
TPS Corridor	73	—	4	(77)	—	—	—
Total capital grants	<u>\$ 90,151</u>	<u>35,087</u>	<u>(41,707)</u>	<u>(1,305)</u>	<u>82,226</u>	<u>(58,714)</u>	<u>23,512</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, 2007

(In thousands)

	Authorized grants as of July 1, 2006	New grants approved/ spending commences	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2007	Amounts not expended as of June 30, 2007	Grants receivable as of June 30, 2007
Operating grants:							
Graffiti Preventions	\$ 3	—	—	—	3	(3)	—
Capital Grant Staffing	342	390	(439)	—	293	(172)	121
Emergency Pavement Repairs	409	95	(40)	—	464	(464)	—
Muni Metro Extension Operations and Maintenance	3,819	3,497	(7,015)	—	301	—	301
Paratransit Contract	3,508	9,670	(11,308)	—	1,870	—	1,870
Transit Preferential Streets	20	—	—	—	20	(20)	—
Trolley Bus Lifts Operations and Maintenance	793	533	(794)	—	532	(414)	118
Total operating grants	<u>\$ 8,894</u>	<u>14,185</u>	<u>(19,596)</u>	<u>—</u>	<u>3,483</u>	<u>(1,073)</u>	<u>2,410</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, 2007

(In thousands)

	Authorized grants as of July 1, 2006	New grants approved/ spending commences	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2007	Amounts not expended as of June 30, 2007	Grants receivable as of June 30, 2007
Capital grants:							
Bay Area Air Quality Management District:							
Bike Rack Retrofit	\$ 10	—	—	—	10	(10)	—
Bus Signal & Communication Equipments	22	—	(22)	—	—	—	—
PM Traps Fleet	22	—	—	—	22	—	22
Gillig Motor Coaches Retrofit	506	—	—	—	506	—	506
Lighting Retrofit	—	—	—	—	—	—	—
Department of Justice	1,097	—	(956)	(141)	—	—	—
Bay Area Rapid Transit	50	—	(39)	(11)	—	—	—
Total capital grants	<u>\$ 1,707</u>	<u>—</u>	<u>(1,017)</u>	<u>(152)</u>	<u>538</u>	<u>(10)</u>	<u>528</u>
Operating in nature:							
State Homeland Security	\$ 77	—	(76)	(1)	—	—	—
Office of Emergency Services – Homeland Security	200	—	(55)	(145)	—	—	—
CA Office of the Governor – Homeland Security	2,852	—	(450)	—	2,402	(2,281)	121
Translink Project	15	—	—	—	15	(15)	—
TS K 9 Project	—	121	(21)	—	100	(72)	28
Total capital grants	<u>\$ 3,144</u>	<u>121</u>	<u>(602)</u>	<u>(146)</u>	<u>2,517</u>	<u>(2,368)</u>	<u>149</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 Municipal Transportation Agency Board of Directors
City and County of San Francisco, California:

We have audited the financial statements of the City and County of San Francisco 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 Municipal Transportation Agency (MTA), as of and for the year ended June 30, 2007, and have issued our report thereon dated November 26, 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 the MUNI's and SFMRIC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the 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, 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

November 26, 2007

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

Schedule of Findings and Responses

June 30, 2007

2007-1. Accounting and Recording of Contributions Made to San Francisco Municipal Railway/Transport Workers Local 250-A Trust Fund

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

Under the City Charter, a contribution to a trust fund for fiscal year 2006-2007 is made based upon the dollar value of differences in benefits between the City and County of San Francisco and the two municipalities used for wage certification for the fiscal year. Based on the actuarial valuation as of July 1, 2006 for fiscal year 2006-2007 performed by Milliman Consultants and Actuaries, the recommended contribution to the trust fund for the fiscal year 2006-2007 was \$5,613,000.

Of the \$5,613,000, \$613,000 was paid and recorded in fiscal year 2006-2007, while the remaining \$5.0 million was paid and recorded in fiscal year 2007-2008. However, there was no accounting theory documented to make this arbitrary allocation of this expense between the two fiscal years, or determination why it was not reported as an accrued expense at June 30, 2007.

Cause

Historically, MUNI has recorded the expenditure related to the contribution to the trust fund in the period the payment is made and not in the accounting period where the employee services are provided.

Recommendation

When non-routine transactions or new agreements are entered into, management should review the decisions made regarding the accounting implications to ensure that the activities are properly accounted for in accordance with U.S. generally accepted accounting principles.

Management Response

The actuarial valuation as of July 1, 2006 for fiscal year 2006-2007 identified a contribution of \$5,613,000 due for Local 250 benefits under the negotiated agreement. This amount was paid partially in fiscal year 2006-2007 and partially in fiscal year 2007-2008. We do concur, however, that the amount paid in fiscal year 2007-2008 should have been recorded as a liability in fiscal year 2006-2007. Going forward, the SFMTA will ensure that liabilities are recorded in the appropriate fiscal year.

2007-2. Lack of control over the review of cash flow statement presentation of payment received for capital, operating grants & assistance.

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, 2007, payments of \$20 million received in relation to grants that are operating in nature were erroneously classified as payments received for capital grants.

Cause

An adequate control over the preparation of the statement of cash flows was not in place. Further, no procedure was in place to reconcile the payments received in the statement of cash flows to the corresponding grant revenue stream to ensure the consistency of the classification of grant revenues and payments received.

Recommendation

When preparing the statement of cash flows, management should reconcile the payments received to grant information and to the schedules included in the financial statements to ensure consistency in the classification of grant revenues and payments received.

Management Response

MTA Finance maintains a worksheet that reconciles operating and capital grants, and to the supporting cash flow schedule. The audit finding was based on auditor's review of MTA's preliminary draft financial report. As a practice, MTA Finance performs a final review and reconciliation of the cash flow when all the audit adjustments are posted. Because additional year end adjustments were still under discussion, we did not perform the final review of cash flow statement until a determination on these adjustments was made.

Going forward, MTA Finance will ensure that review and reconciliation of the statement of cash flows are performed at each stage of the audit process.