KPMG

SAN FRANCISCO MUNICIPAL RAILWAY AND SAN FRANCISCO MUNICIPAL RAILWAY IMPROVEMENT CORPORATION

Consolidated Financial Statements
and Supplemental Schedules

June 30, 2002 and 2001

(With Independent Auditors' Report Thereon)

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SAN FRANCISCO MUNICIPAL RAILWAY AND
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IMPROVEMENT CORPORATION

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Three Embarcadero Center
San Francisco, CA 94111

Independent Auditors' Report

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

We have audited the accompanying basic 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)], as of and for the years ended June 30, 2002 and 2001, 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. 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our 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 as of June 30, 2002, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of MUNI and SFMRIC as of June 30, 2002 and 2001, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 2 through 9 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The accompanying supplemental schedules on pages 30 through 38 for the year ended June 30, 2002 are presented for the purpose of additional analysis and are not a required part of the consolidated financial statements. These schedules have been subjected to the auditing procedures applied in our audit of the June 30, 2002 consolidated financial statements and, in our opinion, are fairly stated in all material respects when considered in relation to the consolidated financial statements taken as a whole.

KPMG LLP

October 25, 2002

SAN FRANCISCO MUNICIPAL RAILWAY AND SAN FRANCISCO MUNICIPAL RAILWAY IMPROVEMENT CORPORATION

Management's Discussion and Analysis

June 30, 2002 and 2001
(Dollars in thousands, unless otherwise noted)

As management of the San Francisco Municipal Railway (MUNI) and the San Francisco Municipal Railway Improvement Corporation (SFMRIC), we offer readers of MUNI and SFMRIC's financial statements this narrative overview and analysis of the financial activities of MUNI and SFMRIC for the fiscal years ended June 30, 2002 and 2001. 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 $1,553,140.
- MUNI and SFMRIC's total net assets increased by $126,191. This increase is due primarily to an increase in fixed assets.

Overview of the Consolidated Financial Statements

This discussion and analysis are intended to serve as an introduction to MUNI and SFMRIC's basic financial statements, which can be found on pages 10 through 14 of this report. 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(b) to the financial statements (pages 16 and 17), MUNI applies Governmental Accounting Standards Board (GASB) Statements. MUNI and SFMRIC are an integral part of the City and these financial statements are included as a component of 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 consolidated statements of net assets (found on pages 10 and 11) presents 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, 2002 and 2001.

The consolidated statements of revenues, expenses and changes in net assets (found on page 12) presents 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 this statement for some items that will result in cash flows in future fiscal periods.

The consolidated statements of cash flows (found on pages 13 and 14) present information about the cash receipts and payments of MUNI and SFMRIC during the most recent two fiscal years. This statement shows the effects on MUNI and SFMRIC's financial position cash balance 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 consolidated statements of cash flows helps readers assess MUNI and SFMRIC's ability to generate net cash flows, their ability to meet their obligations as they come due, and their needs for external financing.

Notes to the Financial Statements. The notes provide additional information that is essential to the full understanding of the data provided in the consolidated financial statements. The notes to the financial statements can be found on pages 15 through 29 of this report.

Other Information. The supplemental schedules found on pages 30 through 38 of this report are presented for the purpose of additional analysis and are not a required part of the consolidated 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 $1,553,140 at the close of the most recent fiscal year.

Summary of Consolidated Statements of Net Assets

June 30, 2002, 2001 and 2000
(In thousands)

		2002	2001	2000
Assets:				
Total current assets	$	165,715	144,175	110,408
Total restricted assets		62,376	69,647	73,012
Noncurrent deferred charges		4,000	4,000	—
Capital assets		1,559,864	1,401,069	1,181,080
Total assets		1,791,955	1,618,891	1,364,500
Liabilities:				
Total current liabilities		111,539	112,709	84,642
Current liabilities payable from restricted assets		923	919	1,002
Total noncurrent liabilities		126,353	78,314	75,072
Total liabilities		238,815	191,942	160,716
Net assets:				
Invested in capital assets, net of related debt		1,559,864	1,401,069	1,181,080
Total restricted net assets		61,453	68,628	70,649
Total unrestricted net assets		(68,177)	(42,748)	(47,945)
Total net assets	$	1,553,140	1,426,949	1,203,784

SAN FRANCISCO MUNICIPAL RAILWAY AND SAN FRANCISCO MUNICIPAL RAILWAY IMPROVEMENT CORPORATION

Management's Discussion and Analysis

June 30, 2002 and 2001
(Dollars in thousands, unless otherwise noted)

Fiscal Year 2002

MUNI and SFMRIC's net assets increased by $126,191 compared to the prior year, due primarily to an increase in total capital assets, less accumulated depreciation and amortization. Specifically, there were increases in equipment due to the acquisition of new rolling stock and rehabilitation of historic vehicles, including cable cars, and the capitalization of infrastructure investments.

Almost all of MUNI's net assets ($1,553,140 as of June 30, 2002) reflect its investment in capital assets (specifically land, building structure and improvements, equipment, infrastructure and construction-in-progress). The value of these assets of $2,002,369 is offset by accumulated depreciation and amortization of $442,505. More information can be found in note 5 on pages 21 through 23.

MUNI and SFMRIC use these assets to provide services. Although the investment is shown reported net of related debt, as of the end of June 30, 2002, 2001 and 2000, no related debt was outstanding.

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 which are in a deficit position.

Fiscal Year 2001

MUNI and SFMRIC's net assets increased by $223,165 compared to the prior year, due primarily to an increase in total capital assets, less accumulated depreciation and amortization. Specifically, there were increases in the value of equipment due to the acquisition of new rolling stock and in construction-in-progress, primarily for the Third Street Light Rail project and acquisition of revenue vehicles. The Third Street Light Rail project is a major vehicle and infrastructure project that will bring modern light rail service to the eastern side of San Francisco. The project is in final design and the line is expected to open in 2004. A table summarizing construction-in-progress can be found in note 5 on page 23.

Almost all of MUNI's net assets (98% as of June 30, 2001) reflect its investment in capital assets (specifically land, building structure and improvements, equipment, infrastructure and construction-in-progress). The cost of these assets of $1,867,367 is offset by accumulated depreciation and amortization of $466,298. More information can be found in note 5 on page 22. MUNI and SFMRIC use these assets to provide services. As of the end of June 30, 2001 and 2000, no related fixed asset debt was outstanding.

The remainder of MUNI's net assets (2%) is composed of its restricted and unrestricted net assets. This includes deposits and investments with the City, receivables, including grants and inventories.

Summary of Consolidated Statements of Operations and Changes in Net Assets

Years ended June 30, 2002, 2001 and 2000
(In thousands)

		2002	2001	2000
Revenues:				
Total operating revenues	$	107,455	113,196	110,653
Total nonoperating revenues, net		220,453	197,850	198,281
Capital contributions:				
Federal		163,071	192,508	108,419
State and others		52,992	98,568	50,456
Total capital contributions		216,063	291,076	158,875
Total operating transfers in		111,138	114,792	100,356
Total revenues		655,109	716,914	568,165
Expenses:				
Total operating expenses		528,725	468,049	439,767
Operating transfers out		193	—	2,400
Special item – property rights in perpetuity with San Francisco Port Commission		—	25,700	—
Total expenditures		528,918	493,749	442,167
Changes in net assets		126,191	223,165	125,998
Total net assets – beginning		1,426,949	1,203,784	1,077,786
Total net assets – ending	$	1,553,140	1,426,949	1,203,784

Fiscal Year 2002

Total revenues for the year ended June 30, 2002 were $655,109. This is $61,805 lower than the previous year, due primarily to a decrease in operating revenues and capital contributions.

Operating revenues decreased by $5,741 or 5%, which reflects reduced ridership because of the economic slowdown and drop in tourism, which was exacerbated by the events of September 11, 2001. Nonoperating revenues increased compared to the previous year ($22,603 or 11%). 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. Parking-related revenues increased as a result of stepped-up collection efforts and increases in fines levied for parking violations. Capital contributions decreased by $75,013 or 26%. Capital contributions consist principally of funds received or receivable from federal and state grant agencies that provide funding for many of MUNI's capital projects. Details of capital and operating grants from major funding agencies can be found on pages 33 through 38 of this report. Net transfers decreased by $3,847 or 3%, due primarily to a reduction in the transfer from the City's General Fund. The City's General Fund revenues, including business taxes, hotel and sales taxes, were also severely affected by the recession and decline in tourism.

Total expenditures for the year ended June 30, 2002 were $528,918. This is $35,169 higher than for the previous year, due primarily to contractual increases in salaries and fringe benefits, additional claims cost for workers' compensation, higher expenses for professional services, and depreciation for newly acquired rolling stock acquired in recent years. The workers' compensation reserve increased by $14,952 due primarily to the increased severity in the claims and an increase in claims reserves.

Fiscal Year 2001

Total revenues and transfers-in for the year ended June 30, 2001 were $716,914. This is $148,749 higher than for the previous year, due primarily to an increase in capital contributions and transfers-in.

Operating revenues increased by $2,543 or 2%, due to increased ridership and an increase in advertising revenue. Nonoperating revenues decreased slightly compared to the previous year ($431 or less than 1%). This category includes operating support received from other sources, including operating sources and the Department of Parking and Traffic, which is the conduit for MUNI to receive money from certain parking fines, taxes, garages and meters. Capital contributions increased by $132,201 or 83%. The increase is mainly due to funding for MUNI to procure new motor coaches and light rail vehicles, as well as preliminary designs and other related costs required for the Third Street Light Rail project. Capital contributions consist principally of funds received or receivable from federal and state grant agencies that provide funding for many of MUNI's capital projects. Net transfers increased by $16,836 or 17%, due to increased transfers from the General Fund as per Proposition E and due to funding received from the San Francisco County Transportation Authority in support of transit operating projects such as improved paratransit programs.

Total expenses (including special item) for the year ended June 30, 2001 were $493,749. This is $53,982 higher than the previous year, due primarily to operating budget expenses and a one-time payment to the San Francisco Port commission for property rights in perpetuity.

Operating expenses increased by $28,282 or 6% compared to the previous year. This increase is due primarily to increased personal services expenditures due to mandated salary adjustments in Employee Memorandums of Understanding and increased benefits costs. There was also a special item of $25,700 to the San Francisco Port Commission for property rights in perpetuity. This payment grants MUNI the permanent right to use a Port site (the Western Pacific Railroad Yard) for its Metro East Maintenance and Operations Facility, in support of the Third Street Light Rail project.

Capital Asset and Debt Administration

Capital Assets. MUNI and SFMRIC's investment in capital assets amounts to $1,559,864, which is net of accumulated depreciation and amortization. This investment includes land, buildings, structures and improvements, equipment, infrastructures and construction-in-progress. The net capital assets increased by $158,795 or 11% compared to the previous year. This increase is attributable to increases in the balance of equipment due to the acquisition of new rolling stock and capitalization of infrastructure investments.

Summary of Capital Assets

(In thousands)

	Balance, June 30,		
	2002	**2001**	**2000**
Capital assets not being depreciated:			
Land	$ 18,481	18,537	18,537
Construction-in-progress	291,645	354,426	245,797
Total capital assets not being depreciated	310,126	372,963	264,334
Capital assets being depreciated:			
Building structures and improvements	231,967	234,944	233,640
Equipment	814,000	665,898	533,344
Infrastructures	646,276	593,562	591,898
Total capital assets being depreciated	1,692,243	1,494,404	1,358,882
Less accumulated depreciation for:			
Building structures and improvements	81,413	78,272	72,591
Equipment	195,944	249,363	251,309
Infrastructures	165,148	138,663	118,236
Total accumulated depreciation	442,505	466,298	442,136
Total capital assets being depreciated, net	1,249,738	1,028,106	916,746
Total capital assets, net	$ 1,559,864	1,401,069	1,181,080

Significant capital asset events during the fiscal year 2002 included:

- Additional renovation and improvements at Woods Division facilities.
- Acquisition of 145 motor coaches and 24 light rail vehicles.
- Completion and capitalization of the Automated Train Control System.

Leveraged Lease-Leaseback of Breda Vehicles

In April 2002, MUNI entered into a leveraged lease-leaseback transaction over 118 Breda light rail vehicles (the Equipment). The transaction was structured as a head lease of the Equipment to separate special purpose trusts (each formed on behalf of certain equity investors) and a sublease of the Equipment back from such trusts.

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.

As a result of the cash transactions, 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.

Long-Term Debt. MUNI and SFMRIC had no long-term debt at year end. SFMRIC is authorized to issue debt to fund each of its programs, but no debt or bonds are outstanding. One of SFMRIC's programs, the Transit Improvement Program (TIP), is also authorized to issue bonds, but no bonds are outstanding as of June 30, 2002, 2001 and 2000.

Economic Factors and Next Year's Budget

The economic downturn that began in April 2000, coupled with the impact of the events of September 11, 2001, on the tourist and consumer markets, continues to affect several sources of MUNI revenues. Passenger fares, which were down 5.8% in fiscal year 2002, continue to show limited recovery from the low point reached in the second quarter of fiscal year 2002. These factors were considered in preparing MUNI's budget for fiscal year 2003.

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 required supplemental information are presented in accordance with the accounting and reporting standards known as "generally accepted accounting principles." Questions regarding any of the information provided in this report or requests for additional financial information should be addressed to Virginia Harrington, Finance and Administration, MUNI, 875 Stevenson, Room 260, San Francisco, CA 94103.

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

SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY IMPROVEMENT CORPORATION

Consolidated Statements of Net Assets

June 30, 2002 and 2001
(In thousands)

		2002	2001
Assets:			
Current assets:			
Deposits and investments with City Treasury	$	74,329	9,098
Deposits and investments held outside City Treasury		100	100
Cash on hand		488	353
Receivables:			
Grants		36,452	50,007
Due from the San Francisco County Transportation Authority		10,445	40,932
Due from other City Departments		2,000	—
Charges for services (net of allowance for doubtful accounts of $34 and $20 in 2002 and 2001, respectively)		4,718	4,304
Other		6,661	5,000
Total receivables		60,276	100,243
Inventories		29,798	33,790
Current deferred charges		724	591
Total current assets		165,715	144,175
Restricted assets:			
Deposits and investments with City Treasury:			
Transit Impact Development Fee		50,324	57,911
Other restricted investments		836	821
Deposits and investments held outside City Treasury:			
Cash and cash equivalents		4,787	5,416
Interest receivable		—	11
Transit Impact Development Fee receivable (net of allowance of $0 in 2002 and $940 2001)		6,429	5,488
Total restricted assets		62,376	69,647
Noncurrent deferred charges		4,000	4,000
Capital assets		1,559,864	1,401,069
Total noncurrent assets		1,626,240	1,474,716
Total assets		1,791,955	1,618,891

(Continued)

SAN FRANCISCO MUNICIPAL RAILWAY AND SAN FRANCISCO MUNICIPAL RAILWAY IMPROVEMENT CORPORATION

Consolidated Statements of Net Assets

June 30, 2002 and 2001
(In thousands)

		2002	2001
Liabilities:			
Current liabilities:			
Accounts payable and accrued expenses	$	39,913	48,448
Accrued payroll		21,170	18,986
Accrued vacation and sick leave		12,025	11,311
Accrued workers' compensation		19,852	16,776
Accrued claims		13,197	11,118
Deferred revenue and other deferred credits		5,382	6,070
Total current liabilities		111,539	112,709
Current liabilities payable from restricted assets		923	919
Noncurrent liabilities:			
Accrued vacation and sick leave		8,958	8,804
Accrued workers' compensation		62,490	50,614
Accrued claims		16,714	14,896
Deferred revenue and other deferred credits		38,191	4,000
Total noncurrent liabilities		126,353	78,314
Total liabilities		238,815	191,942
Net assets:			
Invested in capital assets		1,559,864	1,401,069
Restricted		61,453	68,728
Unrestricted		(68,177)	(42,848)
Total net assets	$	1,553,140	1,426,949

See accompanying notes to consolidated financial statements.

SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY IMPROVEMENT CORPORATION

Consolidated Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2002 and 2001
(In thousands)

	2002	2001
Operating revenues:		
Passenger fares	$ 97,162	103,289
Advertising	9,067	8,899
Paratransit revenue	1,010	866
Charter bus	24	21
Rental income	160	62
Other	32	59
Total operating revenues	107,455	113,196
Operating expenses:		
Personal services	368,604	327,368
Contractual services	21,268	15,768
Materials and supplies	36,182	39,507
Depreciation	55,336	47,826
Services from other City departments	21,329	18,815
General and administrative	20,979	13,796
Other operating expenses	5,027	4,969
Total operating expenses	528,725	468,049
Operating loss	(421,270)	(354,853)
Nonoperating revenues (expenses):		
Operating assistance:		
Department of Parking and Traffic	114,254	110,932
Federal	3,363	12,749
State and other grants	93,129	66,936
Transit Impact Development Fee, net of expenses	8,329	2,345
Capital reserve revenue	15	383
Interest income	3,901	6,032
Interest expense	—	(704)
Loss on disposal of capital assets	(2,256)	(880)
Other, net	(282)	57
Total nonoperating revenues, net	220,453	197,850
Loss before capital contributions, transfers and special item	(200,817)	(157,003)
Capital contributions:		
Federal	163,071	192,508
State and others	52,992	98,568
Total capital contributions	216,063	291,076
Transfers-in:		
City and County of San Francisco – General Fund	94,305	98,025
San Francisco County Transportation Authority	16,833	16,767
Total transfers-in	111,138	114,792
Transfers-out:		
City and County of San Francisco – General Fund	(193)	—
Net transfers	110,945	114,792
Special item:		
Property rights in perpetuity with San Francisco Port Commission	—	(25,700)
Change in net assets	126,191	223,165
Total net assets – beginning	1,426,949	1,203,784
Total net assets – ending	$ 1,553,140	1,426,949

See accompanying notes to consolidated financial statements.

SAN FRANCISCO MUNICIPAL RAILWAY AND SAN FRANCISCO MUNICIPAL RAILWAY IMPROVEMENT CORPORATION

Consolidated Statements of Cash Flows

Years ended June 30, 2002 and 2001
(In thousands)

		2002	2001
Cash flows from operating activities:			
Cash received from passengers and service contracts	$	120,817	127,133
Cash paid to employees for services		(350,612)	(320,413)
Cash paid to suppliers for goods and services		(86,835)	(87,287)
Cash paid for judgment and claims		(7,941)	(7,755)
Cash paid for quasi-external transactions		(20,518)	(18,397)
Net cash used in operating activities		(345,089)	(306,719)
Cash flows from noncapital financing activities:			
Operating grants		215,057	198,698
Transfers-in		111,138	115,465
Transfers-out		(193)	—
Transit Impact Development Fee received, net of expenses		7,062	2,123
Other noncapital increases		—	3,982
Other noncapital decreases		(232)	(29,700)
Net cash provided by noncapital financing activities		332,832	290,568
Cash flows from capital and related financing activities:			
Capital grants		253,311	236,717
Proceeds from sale of capital assets		(15)	23
Breda Lease receipts		388,156	—
Breda Lease payments		(352,635)	—
Acquisition of capital assets		(223,594)	(248,179)
Net cash provided by (used in) capital and related financing activities		65,223	(11,439)
Cash flows from investing activities:			
Purchases of investments with trustees – restricted		(25,339)	(34,228)
Proceeds from sale of investments with trustees – restricted		25,339	35,637
Interest income received		4,199	6,067
Interest expense paid		—	(704)
Net cash provided by investing activities		4,199	6,772
Net increase (decrease) in cash and cash equivalents		57,165	(20,818)
Cash and cash equivalents – beginning of year		73,699	94,517
Cash and cash equivalents – end of year	$	130,864	73,699

(Continued)

SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY IMPROVEMENT CORPORATION

Consolidated Statements of Cash Flows

Years ended June 30, 2002 and 2001
(In thousands)

		2002	2001
Reconciliation of operating loss to net cash used in operating activities:			
Operating loss	$	(421,270)	(354,853)
Adjustments to reconcile operating loss to net cash used in operating activities:			
Depreciation		55,336	47,826
Provision for doubtful accounts		14	1
Changes in operating assets and liabilities:			
Receivables, net		(396)	(180)
Inventories		3,993	(5,181)
Deferred charges		(133)	(567)
Accounts payable		(1,337)	3,086
Accrued payroll and accrued expenses		2,173	1,934
Accrued vacation and sick leave		868	976
Accrued workers' compensation		14,952	4,045
Accrued claims		2,697	(4,284)
Deferred revenues and other deferred credits		(1,986)	478
Net cash used in operating activities	$	(345,089)	(306,719)
Reconciliation of cash and cash equivalents to the statements of net assets:			
Deposits and investments with City Treasury:			
Unrestricted	$	74,329	9,098
Restricted		51,160	58,732
Unrestricted deposits and investments held outside City Treasury		588	453
Total deposits and investments		126,077	68,283
Add restricted deposits and investments held outside City Treasury meeting the definition of cash equivalents		4,787	5,416
Total cash and cash equivalents, end of year	$	130,864	73,699

See accompanying notes to consolidated financial statements.

(1) Description of Reporting Entity

The consolidated financial statements include the San Francisco Municipal Railway (MUNI) and the San Francisco Municipal Railway Improvement Corporation (SFMRIC), whose operations are interrelated. All significant interentity transactions have been eliminated. The consolidated entities 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. As a result of voters approved Proposition E, MUNI is governed by the Municipal Transit Agency (MTA) Board. Voters approved Proposition E, a Charter amendment, which authorized the creation of an MTA. Proposition E sets standards for performance and service to be provided by MUNI.

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) Basis of Accounting

MUNI and SFMRIC are accounted for using the accrual method. 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) Implementation of New Accounting Principles

(i) Governmental Accounting Standards Board Statement No . 33

MUNI adopted the provisions of GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* during the fiscal year ended June 30, 2001. This statement establishes accounting and financial reporting standards for nonexchange transactions involving financial and capital resources such as taxes and grants. In a nonexchange transaction, a government gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal value. This statement affects the timing of recognition of nonexchange transaction, that is, when governments recognize them in the financial statements. Accordingly, MUNI has recognized revenue in the statement of revenues, expenses, and changes in net assets for capital contributions earned during the current year in lieu of directly recording such earned contributions as contributed capital which was a component of fund equity prior to MUNI's adoption of GASB Statement No. 34 (note 2(b)(ii)) in the fiscal year ended June 30, 2001. The adoption of this standard increased revenues of MUNI by $291,075 for the year ended June 30, 2001.

(ii) Governmental Accounting Standards Board Statement No. 34

During the fiscal year ended June 30, 2001, MUNI adopted the provisions of GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – For State and Local Governments*. This statement affects the manner in which MUNI prepares and presents financial information.

GASB Statement No. 34 establishes new requirements and a new reporting model for financial reports of state and local governments. The statement was developed to make annual reports of state and local governments easier to understand and more useful to the people who use governmental financial information to make decisions.

Management's Discussion and Analysis – GASB Statement No. 34 requires that financial statements be accompanied by a narrative introduction and analytical overview of the government's financial activities in the form of "management's discussion and analysis" (MD&A). This analysis is similar to the analysis provided in the annual reports of private sector organizations.

Statement of Net Assets – The statement of net assets is designed to display the financial position of MUNI. MUNI's fund equity is no longer reported as retained earnings, and contributed capital, but rather as net assets which is broken down into three categories defined as follows:

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets including *restricted* capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- Restricted – This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or law or regulations of other governments. It also pertains to constraints imposed by law or constitutional provisions or enabling legislation.
- Unrestricted – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

Statement of Revenues, Expenses, and Changes in Net Assets – The statement of revenues, expenses, and changes in net assets is the operating statement for proprietary funds. Revenues are reported by major source. This statement distinguishes between operating and nonoperating revenues and expenses and presents a separate subtotal for operating revenues, operating expenses, and operating income.

(iii) Governmental Accounting Standards Board Statement No. 37

During the fiscal year ended June 30, 2001, MUNI adopted the provisions of GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – For State and Local Governments: Omnibus*. This statement amends GASB Statement No. 34 to either 1) clarify certain provisions or 2) modify other provisions that GASB believes may have unintended consequences in some circumstances. Accordingly, MUNI considered the effects of this statement when adopting the provisions of GASB Statement No. 34 as previously described.

(iv) Governmental Accounting Standards Board Statement No. 38

During the fiscal year ended June 30, 2001, MUNI adopted the provisions of GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. This statement modifies, establishes and rescinds certain financial statement disclosure requirements. Accordingly, certain note disclosures have been revised to conform to the provisions of GASB Statement No. 38.

(c) Investments

MUNI and SFMRIC record investments at fair value with changes in fair value recorded as a component of gains/losses.

(d) ***Capital Assets***

Capital assets are stated at cost. Depreciation is computed by the straight-line method based on the estimated useful lives of the related assets which ranges from 10 to 60 years for ways and structures and from 3 to 45 years for equipment. No depreciation is recorded in the year of acquisition and a full year's depreciation is taken in the year of disposal.

(e) ***Construction-in-Progress***

Construction-in-progress represents the design and construction costs of various uncompleted projects.

(f) ***Accrued Vacation and Sick Leave***

Accrued vacation pay, which vests and may be accumulated up to 10 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 memorandum of understanding but is generally limited to six months per employee.

(g) ***Capital Grants and Contributions***

Capital grants and contributions from external sources are recognized as capital contributions 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 is generally used as local match to the federal capital assistance. 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.

(h) ***Operating Assistance Grants***

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

(i) ***Transit Impact Development Fees***

Transit Impact Development Fees (TIDF) are collected by MUNI and 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.

(j) ***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 month-end cash balances.

In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, the City reports certain investments at fair value in the statement of net assets and recognizes the corresponding change in fair value of investments in the year in which the change occurred. In accordance with GASB Statement No. 31, MUNI has reported its investments at fair value based on quoted market information obtained from fiscal agents or other sources.

MUNI considers its pooled deposits and investments held with the City Treasury to be demand deposits, and therefore cash equivalents for the purposes of the statement of cash flows. The City also holds 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 of SFRMIC which are held outside City Treasury are also considered cash equivalents as they do meet the same definition of cash and cash equivalents.

(k) ***Use of Estimates***

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

(Continued)

(Dollars in thousands, unless otherwise noted)

(3) Net Assets

Net assets as of June 30, 2002 and 2001 consist of the following:

		2002	2001
Restricted assets:			
Deposits and investments with City Treasury	$	51,160	58,732
Deposits and investments held outside City Treasury		4,787	5,416
Receivables		6,429	5,499
Total restricted assets		62,376	69,647
Restricted liabilities of:			
SFMRIC		(81)	(64)
TIDF		(6)	(34)
Others		(836)	(821)
Total restricted liabilities		(923)	(919)
Net restricted assets	$	61,453	68,728
Net assets:			
Invested in capital assets	$	1,559,864	1,401,069
Restricted		61,453	68,728
Unrestricted		(68,177)	(42,848)
Total net assets	$	1,553,140	1,426,949

(4) Deposits and Investments

MUNI's deposits and investments with the City Treasury are held by the City 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 custodial risk associated with the City's pooled deposits and investments. As of June 30, 2002 and 2001, MUNI and SFMRIC's unrestricted deposits and investments were $74,917 and $9,551, respectively.

The restricted assets' deposits and investments outside the City Treasury are held by a trustee. As of June 30, 2002 and 2001, MUNI and SFMRIC had deposits and investments with the trustee of $4,787 and $5,416, respectively, which meet the definition of cash and cash equivalents.

(Continued)

(Dollars in thousands, unless otherwise noted)

(5) Capital Assets

Capital assets balances and their movements as of and for the years ended June 30, 2002 and 2001 are as follows:

		Balance, July 1, 2001	Increases	Decreases	Balance, June 30, 2002
Capital assets not being depreciated:					
Land	$	18,537	—	(56)	18,481
Construction-in-progress		354,426	214,864	(277,645)	291,645
Total capital assets not being depreciated		372,963	214,864	(277,701)	310,126
Capital assets being depreciated:					
Building structures and improvements		234,944	22,631	(25,608)	231,967
Equipment		665,898	234,338	(86,236)	814,000
Rails, roadways, and substations		593,562	52,714	—	646,276
Total capital assets being depreciated		1,494,404	309,683	(111,844)	1,692,243
Less accumulated depreciation for:					
Building structures and improvements		78,272	3,141	—	81,413
Equipment		249,363	25,710	(79,129)	195,944
Rails, roadways, and substations		138,663	26,485	—	165,148
Total accumulated depreciation		466,298	55,336	(79,129)	442,505
Total capital assets being depreciated, net		1,028,106	254,347	(32,715)	1,249,738
Total capital assets, net	$	1,401,069	469,211	(310,416)	1,559,864

(Continued)

SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY IMPROVEMENT CORPORATION

Notes to Consolidated Financial Statements

June 30, 2002 and 2001
(Dollars in thousands, unless otherwise noted)

	Balance, July 1, 2000	Increases	Decreases	Balance, June 30, 2001
Capital assets not being depreciated:				
Land	$ 18,537	—	—	18,537
Construction-in-progress	245,797	108,629	—	354,426
Total capital assets not being depreciated	264,334	108,629	—	372,963
Capital assets being depreciated:				
Building structures and improvements	233,640	1,304	—	234,944
Equipment	533,344	157,121	(24,567)	665,898
Infrastructure	591,898	1,664	—	593,562
Total capital assets being depreciated	1,358,882	160,089	(24,567)	1,494,404
Less accumulated depreciation for:				
Building structures and improvements	72,591	5,681	—	78,272
Equipment	251,309	21,718	(23,664)	249,363
Infrastructure	118,236	20,427	—	138,663
Total accumulated depreciation	442,136	47,826	(23,664)	466,298
Total capital assets being depreciated, net	916,746	112,263	(903)	1,028,106
Total capital assets, net	$ 1,181,080	220,892	(903)	1,401,069

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 $17,775 as of June 30, 2002.

(Dollars in thousands, unless otherwise noted)

Construction-in-progress consists of the following projects as of June 30, 2002 and 2001:

		2002	2001
Light rail vehicles	$	67,476	81,117
Third Street light rail		62,367	33,458
Automatic train control system		—	58,112
Articulated trolley coaches		94,449	99,282
Wood division renovation		—	18,463
Rail replacement		14,342	13,600
Others		53,011	50,394
	$	291,645	354,426

(6) Long-Term Debt

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 is 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, 2002 and 2001, no bonds were outstanding under the TIP.

(7) Employee Benefit Plans

(a) Retirement Plan Description and Funding Policy

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 provides 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.

Contributions are made to the basic plan by both MUNI and its employees. Employee contributions are mandatory. Employee contribution rates for 2002 and 2001 varied from 7% to 8% as a percentage of covered payroll. MUNI is required to contribute at an actuarially determined rate. No MUNI contributions were required for 2002 and 2001 as the actuarially determined contribution rate as a percentage of covered payroll was 0%. MUNI's contributions to the Retirement System on behalf of its employees amounted to $18,679 and $16,335 for the years ended June 30, 2002 and 2001, respectively, which were equal to the required employee contributions for each year.

(Continued)

(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 consolidated financial statements.

(c) *Healthcare Benefits*

Healthcare benefits for employees, retired employees and surviving spouses (beneficiaries) are financed by beneficiaries and by the City through the City and County of San Francisco Health Service System, a pension and other employee benefit fund. The contribution for all of the City's fund groups are 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, 2002 and 2001 were $32,685 and $27,758, respectively. Included in these amounts are $5,634 and $3,674 for 2002 and 2001, respectively, to provide postretirement healthcare benefits for retired employees. MUNI's liability for postretirement healthcare benefits is limited to its annual contribution.

(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 expires in 2001, upon which it will continue on a year-to-year basis thereafter, until a participant withdraws, which requires a one-year notice. The City on behalf of MUNI is responsible for 11.6% of the net operating costs and administrative expenses of the PCJPB for operating and capital needs, which amounted to $8.7 million and $8.1 million in fiscal years 2002 and 2001, respectively.

(Dollars in thousands, unless otherwise noted)

(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 purchases insurance to cover certain real and personal property and the operators of various vehicles. 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, 2002 and 2001 have been actuarially determined and include an estimate of incurred but not reported claims. Claims liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amount of payouts, and other economic social factors.

Changes in the balances of claims liabilities and workers' compensation liabilities for the years ended June 30, 2002 and 2001 are as follows:

		2002	2001
Accrued claims liabilities, beginning of fiscal year	$	26,014	30,298
Incurred claims and changes in estimates		11,838	3,471
Claims payments		(7,941)	(7,755)
Accrued claims liabilities, end of fiscal year	$	29,911	26,014
Accrued workers' compensation, beginning of fiscal year	$	67,390	63,345
Incurred workers' compensation and changes in estimates		33,956	22,398
Workers' compensation payments		(19,004)	(18,353)
Accrued workers' compensation, end of fiscal year	$	82,342	67,390

Workers' compensation expense is part of personal services, while claims expense is part of general and administrative under operating expenses in the accompanying consolidated financial statements for the years ended June 30, 2002 and 2001.

(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 consolidated financial statements includes a revenue transfer of $704 to fund additional interest expense for the years ended June 30, 2001 that was recorded relating to the overdraft with the City Treasurer.

(Continued)

(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, 2002, MUNI had approved capital grants with unused balances amounting to $294.6 million. Capital grants receivable as of June 30, 2002 totaled $41.2 million.

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, 2002, MUNI had various operating grants receivable of $5.7 million. MUNI receives operating assistance from BART ADA revenues of $1,257 million and other state and local grants of $4,066 million to fund project expenses that are operating in nature.

The capital and operating grants identified above include funds received and due from the San Francisco County Transportation Authority (SFCTA). During the fiscal year ended June 30, 2002, new capital grants were approved by SFCTA in the amount of $79.0 million and payments received by MUNI for capital grants totaled $68.7 million. As of June 30, 2002, MUNI had funds due from SFCTA for capital grants in the amount of $10.4 million. Similarly, MUNI receives operating grants from SFCTA. During the fiscal year ended June 30, 2002, SFCTA approved new operating grants in the amount of $17.2 million and payments received by MUNI totaled $18.4 million. As of June 30, 2002, MUNI had no funds due from SFCTA for operating grants.

(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 Port entered into a Memorandum of Understanding (MOU) under which MUNI may use the Metro East in perpetuity for rail vehicle maintenance, operations and other operational needs at a cost of $25.7 million. Such amount paid to Port is reflected as a special item, with the funding received from SFCTA as capital contribution, in the accompanying consolidated statement of revenues, expenses, and changes in net assets for the year ended June 30, 2001.

The MOU also required MUNI to pay 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. MUNI has agreed to reasonably extend this deadline for up to two additional years provided the Port has demonstrated good faith efforts toward construction of the bridge. Any such return of funds shall have no effect on the rights granted to MUNI as specified in the MOU. Accordingly, the $4 million paid to Port is reflected as noncurrent deferred charge, with the funding received from SFCTA as long-term deferred credit, in the accompanying consolidated statement net assets as of June 30, 2002 and 2001.

(Dollars in thousands, unless otherwise noted)

(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.

(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 2030. These agreements are accounted for as operating leases. Rent expense was $6,000 and $3,882 for the years ended June 30, 2002 and 2001, respectively.

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

Year ending June 30:		
2003	$	4,267
2004		3,931
2005		2,440
2006		803
2007 – 2011		153
2012 – 2016		121
2017 – 2021		121
2022 – 2026		121
2027 – 2030		97
Total	$	12,054

(c) Other Commitments

As of June 30, 2002, MUNI has outstanding commitments of approximately $88,109 with third parties for various capital projects. Grant funding is available for the majority of this amount. MUNI also has outstanding commitments of approximately $10,627 with third parties for noncapital expenditures. Various local funding sources are used to finance these expenditures.

(Dollars in thousands, unless otherwise noted)

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, 2002 are as follows:

Tank Cleanup	$	35
FTA Section 9 Matching		54
MUNI Metro Accessibility Improvements		18
FTA Section 23 Matching		80
Diesel Bus Rehabilitation		43
Central Control and Revenue Center		150
Rail Replacement Program		1,139
Islais Creed Storage and Maintenance Facility		1,045
Local Match CA 90-0607		14
Local Match for Paratransit Program		112
	$	2,690

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

(14) Leveraged Lease-Leaseback of Breda Vehicles

In April 2001, 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 Breda 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, after obtaining final approval from the Municipal Transportation Agency Board of Directors and the City and County's Board of Supervisors, MUNI entered into the leveraged lease-lease back transaction over 118 Breda light rail vehicles (the Equipment). The transaction was structured as a head lease of the Equipment to separate special purpose trusts (each formed on behalf of certain equity investors) 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 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 be 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, 2002.

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.

As of June 30, 2002, the outstanding payments to be made on the sublease through 2027 are $328.2 million and the payments to be made on the purchase option of the 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 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.

(15) Subsequent Event

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 two and one-half percent 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.

Future annual payments under the Wellness Program are not deemed material to MUNI's operational results.

SUPPLEMENTAL SCHEDULES

SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY IMPROVEMENT CORPORATION

Supplemental Schedule – Consolidating Statement of Net Assets

June 30, 2002
(In thousands)

		MUNI	SFMRIC	Eliminations	Consolidated
Assets:					
Current assets:					
Deposits and investments with City Treasury	$	74,329	—	—	74,329
Deposits and investments held outside City Treasury		100	—	—	100
Cash on hand		488	—	—	488
Receivables:					
Grants		36,452	—	—	36,452
Due from the San Francisco County Transportation Authority		10,445	—	—	10,445
Due from the San Francisco County Public Utilities Commission		2,000	—	—	2,000
Charges for services, net		4,718	—	—	4,718
Other		6,661	—	—	6,661
Total receivables		60,276	—	—	60,276
Inventories		29,798	—	—	29,798
Current deferred charges		724	—	—	724
Total current assets		165,715	—	—	165,715
Restricted assets:					
Deposits and investments with City Treasury:					
Transit Impact Development Fee		50,324	—	—	50,324
Other restricted investments		836	—	—	836
Deposits and investments held outside City Treasury – cash and cash equivalents		—	4,787	—	4,787
Interest receivable		—	—	—	—
Transit Impact Development Fee receivable, net		6,429	—	—	6,429
Total restricted assets		57,589	4,787	—	62,376
Noncurrent deferred charges		4,000	—	—	4,000
Capital assets, net		1,559,864	—	—	1,559,864
Total assets		1,787,168	4,787	—	1,791,955

(Continued)

SAN FRANCISCO MUNICIPAL RAILWAY AND SAN FRANCISCO MUNICIPAL RAILWAY IMPROVEMENT CORPORATION

Supplemental Schedule – Consolidating Statement of Net Assets

June 30, 2002
(In thousands)

		MUNI	SFMRIC	Eliminations	Consolidated
Liabilities:					
Current liabilities:					
Accounts payable and accrued expenses	$	39,913	—	—	39,913
Accrued payroll		21,170	—	—	21,170
Accrued vacation and sick leave		12,025	—	—	12,025
Accrued workers' compensation		19,852	—	—	19,852
Accrued claims		13,197	—	—	13,197
Deferred revenue and other deferred credits		5,382	—	—	5,382
Total current liabilities		111,539	—	—	111,539
Current liabilities payable from restricted assets		842	81	—	923
Noncurrent liabilities:					
Accrued vacation and sick leave		8,958	—	—	8,958
Accrued workers' compensation		62,490	—	—	62,490
Accrued claims		16,714	—	—	16,714
Deferred revenue and other deferred credits		38,191	—	—	38,191
Total noncurrent liabilities		126,353	—	—	126,353
Total liabilities		238,734	81	—	238,815
Net assets:					
Invested in capital assets		1,559,864	—	—	1,559,864
Restricted		56,747	4,706	—	61,453
Unrestricted		(68,177)	—	—	(68,177)
Total net assets	$	1,548,434	4,706	—	1,553,140

See accompanying independent auditors' report.

SAN FRANCISCO MUNICIPAL RAILWAY AND SAN FRANCISCO MUNICIPAL RAILWAY IMPROVEMENT CORPORATION

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

Year ended June 30, 2002
(In thousands)

	MUNI	SFMRIC	Eliminations	Consolidated
Operating revenues:				
Passenger fares	$ 97,162	—	—	97,162
Advertising	9,067	—	—	9,067
Paratransit revenue	1,010	—	—	1,010
Charter bus	24	—	—	24
Rental income	160	—	—	160
Other	32	—	—	32
Total operating revenues	107,455	—	—	107,455
Operating expenses:				
Personal services	368,604	—	—	368,604
Contractual services	21,268	—	—	21,268
Materials and supplies	36,182	—	—	36,182
Depreciation	55,336	—	—	55,336
Services from other city departments	21,329	—	—	21,329
General and administrative	20,872	107	—	20,979
Other operating expenses	5,027	—	—	5,027
Total operating expenses	528,618	107	—	528,725
Operating loss	(421,163)	(107)	—	(421,270)
Nonoperating revenues (expenses):				
Operating assistance:				
Department of Parking and Traffic	114,254	—	—	114,254
Federal	3,363	—	—	3,363
State and other grants	93,129	—	—	93,129
Transit Impact Development Fee, net of expenses	8,329	—	—	8,329
Capital reserve revenue	15	—	—	15
Interest income	3,801	100	—	3,901
Interest expense	—	—	—	—
Loss on disposal of capital assets	(2,256)	—	—	(2,256)
Capital assistance of SFMRIC to MUNI	563	(563)	—	—
Other, net	(282)	—	—	(282)
Total nonoperating revenues, net	220,916	(463)	—	220,453
Loss before capital contribution, transfers and special item	(200,247)	(570)	—	(200,817)
Capital contributions:				
Federal	163,071	—	—	163,071
State and others	52,992	—	—	52,992
Total capital contributions	216,063	—	—	216,063
Transfers-in:				
City and County of San Francisco – General Fund	94,305	—	—	94,305
San Francisco County Transportation Authority	16,833	—	—	16,833
Total transfers-in	111,138	—	—	111,138
Transfers-out:				
City and County of San Francisco General Fund	(193)	—	—	(193)
Change in net assets	126,761	(570)	—	126,191
Total net assets – beginning	1,421,686	5,263	—	1,426,949
Total net assets – ending	$ 1,548,447	4,693	—	1,553,140

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, 2002
(In thousands)

	Authorized grants as of July 1, 2001	New grants approved	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2002	Amounts not expended as of June 30, 2002	Grants receivable as of June 30, 2002 (1)
Capital grants:							
Construct Islais Creek	$ 2,467	—	—	—	2,467	(2,467)	—
LRV Purchase	12,981	45,712	(41,461)	—	17,232	(6,723)	10,509
Section 9 FY 1987/88	181	—	(142)	—	39	(39)	—
Section 9 FY 1989/90	21	—	—	—	21	(21)	—
Section 9 FY 1990/91	534	—	(67)	—	467	(417)	50
Section 9 FY 1992/93	456	—	(387)	—	69	(69)	—
Section 9 FY 1993/94	845	—	(29)	—	816	(803)	13
Section 9 FY 1994/95	5,853	—	(638)	(17)	5,198	(5,215)	(17)
Section 9 FY 1995/96	2,526	—	(487)	(6,372)	(4,333)	(1,676)	(6,009)
Section 9 FY 1997/98	51,988	—	(38,521)	(516)	12,951	(2,895)	10,056
Section 9 FY 1998/99	62,911	—	(32,183)	—	30,728	(24,358)	6,370
Section 9 FY 1999/00	86,049	—	(34,823)	—	51,226	(50,949)	277
Section 9 FY 2000/01	—	50,229	(19,193)	—	31,036	(26,229)	4,807
Section 9 FY 2001/02	—	78,876	—	—	78,876	(76,493)	2,383
Diesel Bus Purchase	—	1,981	—	—	1,981	(1,981)	—
Total capital grants	$ 226,812	176,798	(167,931)	(6,905)	228,774	(200,335)	28,439
Operating grants:							
Operating assistance	$ 3,803	3,281	(3,803)	—	3,281	—	3,281
SRTP-CPT529 and 473	168	—	(82)	(4)	82	(82)	—
Federal Disaster Relief – Earthquake (FEMA):							
FEMA – Geneva Building Demolition	19	—	(1)	—	18	(18)	—
Total operating grants	$ 3,990	3,281	(3,886)	(4)	3,381	(100)	3,281

(1) The grant receivable balances are for selected projects, and will not agree to the total grants receivable balance on MUNI's June 30, 2002 consolidated statement of net assets.

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, 2002
(In thousands)

	Authorized grants as of July 1, 2001	New grants approved	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2002	Amounts not expended as of June 30, 2002	Grants receivable as of June 30, 2002 (1)
Capital grants:							
F-Market Street Thoroughfare	$ 2,463	—	—	—	2,463	(2,463)	—
Maintenance Shop Facility Improvements	876	—	(876)	—	—	—	—
Muni Metro Extension	2,481	—	—	—	2,481	(2,481)	—
Trolley Bus Purchases	4,861	—	(4,861)	—	—	—	—
Muni, Metro Extra Cost	—	7,000	(3,083)	—	3,917	(2,878)	1,039
Total capital grants	$ 10,681	7,000	(8,820)	—	8,861	(7,822)	1,039

(1) The grant receivable balances are for selected projects, and will not agree to the total grants receivable balance on MUNI's June 30, 2002 consolidated statement of net assets.

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, 2002
(In thousands)

	Authorized grants as of July 1, 2001	New grants approved	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2002	Amounts not expended as of June 30, 2002	Grants receivable as of June 30, 2002 (1)
Capital grants:							
Bridge toll:							
Accessible Vans	$ 407	—	(362)	(2)	43	—	43
Artic Trolley Coach	1,660	—	(1,660)	—	—	—	—
Cable Car Renovation	154	174	(154)	—	174	(83)	91
F-Embarcadero Extension	675	—	(465)	—	210	(202)	8
Local Match to Federal Section 9 FY91/92	404	—	(404)	—	—	—	—
Local Match to Federal Section 9 FY94/95	115	—	(116)	1	—	—	—
MMX to F Line connection	175	—	(175)	—	—	—	—
Motor Coach Replacement	3,203	339	(260)	—	3,282	(3,042)	240
Overhead Reconstruction	1,250	1,875	—	—	3,125	(2,846)	279
Rail Replacement	879	—	(879)	—	—	—	—
Diesel Bus Purchase	2,227	—	(2,227)	—	—	—	—
Tract Replacement	800	—	(224)	—	576	(51)	525
Trolley Bus Replacement	1,660	—	—	—	1,660	(1,660)	—
Trolley Overhead Construction	981	—	(981)	—	—	—	—
Total capital grants	$ 14,590	2,388	(7,907)	(1)	9,070	(7,884)	1,186
Operating grants:							
AB1107 Sales Tax	$ 4,608	30,979	(35,587)	—	—	—	—
State Transit Assistance	—	17,553	(17,553)	—	—	—	—
Transportation Development Act	—	39,273	(36,848)	—	2,425	—	2,425
Total operating grants	$ 4,608	87,805	(89,988)	—	2,425	—	2,425

(1) The grant receivable balances are for selected projects, and will not agree to the total grants receivable balance on MUNI's June 30, 2002 consolidated statement of net assets.

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, 2002
(In thousands)

	Authorized grants as of July 1, 2001	New grants approved	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2002	Amounts not expended as of June 30, 2002	Grants receivable as of June 30, 2002 (1)
Capital grants:							
3rd Light Rail-Preliminary Design	$ 8,948	59,080	(20,582)	—	47,446	(37,331)	10,115
Alternative Fuel Demo	1,545	—	(1,544)	—	1	—	1
Articulated Trolley Bus Purchase	10,174	1,331	(3,805)	—	7,700	(7,692)	8
Bus Stop Improvements	189	168	(258)	—	99	(99)	—
Diesel Bus Purchase	2,015	5,146	(5,025)	—	2,136	(2,099)	37
Escalator Replacement Study	828	—	—	(718)	110	(110)	—
F Embarcadero Extension	6,729	—	(839)	—	5,890	(5,871)	19
Facilities Rehabilitation and Improvement	3,131	2,366	(1,266)	(3)	4,228	(4,197)	31
Financial Capacity Study	240	—	—	—	240	(240)	—
Fleet Plan Update	118	—	—	—	118	(118)	—
F-Market Transit Thoroughfare	4	—	—	—	4	(4)	—
Forest Hill Seepage and Seismic	14	—	(2)	—	12	(12)	—
Geneva Building Demolition	358	—	(8)	—	350	(350)	—
Historic Trolley Shed	20	230	(158)	—	92	(91)	1
Land Acquisition – Western Pacific Railroad Yard	29,700	300	(29,699)	—	301	(300)	1
LRV Modification	95	3	—	—	98	(98)	—
LRV Purchase	5,957	3,322	(4,576)	—	4,703	(4,657)	46
Major Transit Corridor	301	—	—	(301)	—	—	—
Metro Access Improvements	—	1	—	—	1	—	1
Mission Hotel Development	500	—	—	—	500	(500)	—
Muni Metro Turnback	5,541	—	(30)	—	5,511	(5,508)	3
Rail Replacement/Maintenance Equipment	430	—	(102)	(20)	308	(296)	12
Rail/OH Infrastructure Study	62	—	—	(59)	3	(3)	—
Diesel Bus Rehabilitation	—	3	(3)	—	—	—	—
Streetcar Rehabilitation	210	180	(332)	—	58	(57)	1
Trolley Overhead Reconstruction	—	59	—	—	59	(2)	57
Wood/Potrero Roof Replacement	962	455	(120)	—	1,297	(1,290)	7
Woods Division Renovation	1,542	—	9	(242)	1,309	(1,300)	9
Woods Seismic Study	33	—	—	—	33	(33)	—
Metro Subway Modification	—	345	(345)	—	—	—	—
Auto Vehicle Location & ETI Bus Lifts	—	2,725	(52)	—	2,673	(2,577)	96
Facilities Preservation Improvement Program-FPIP	—	3,695	—	—	3,695	(3,695)	—
Total capital grants	$ 79,646	79,409	(68,737)	(1,343)	88,975	(78,530)	10,445

(1) The grant receivable balances are for selected projects, and will not agree to the total grants receivable balance on MUNI's June 30, 2002 consolidated statement of net assets.

(Continued)

SAN FRANCISCO MUNICIPAL RAILWAY AND
SAN FRANCISCO MUNICIPAL RAILWAY IMPROVEMENT CORPORATION

Supplemental Schedule of Grants – San Francisco County Transportation Authority

Year ended June 30, 2002
(In thousands)

	Authorized grants as of July 1, 2001	New grants approved	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2002	Amounts not expended as of June 30, 2002	Grants receivable as of June 30, 2002
Operating grants:							
F-Line Operations and Maintenance	$ —	1,100	(1,100)	—	—	—	—
Graffiti Preventions	11	—	—	—	11	(11)	—
Capital Grant Staffing	164	381	(318)	—	227	(227)	—
Muni Metro Extension Operations and Maintenance	1,542	5,690	(7,015)	(217)	—	—	—
Paratransit Contract	—	9,661	(9,661)	—	—	—	—
Transit Preferential Streets	6	62	(61)	—	7	(7)	—
Trolley Bus Lifts Operations and Maintenance	86	380	(286)	(1)	179	(179)	—
Total operating grants	$ 1,809	17,274	(18,441)	(218)	424	(424)	—

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, 2002
(In thousands)

	Authorized grants as of July 1, 2001	New grants approved	Payments received	Expired/ rescinded grants	Authorized grants as of June 30, 2002	Amounts not expended as of June 30, 2002	Grants receivable as of June 30, 2002
Capital grants:							
Bay Area Air Quality Management District:							
Alternative Fuel Demonstration Project – R&D	$ 1,371	90	(1,297)	—	164	(81)	83
Bayview Town Center Study	27	—	(27)	—	—	—	—
Translink	58	—	—	(58)	—	—	—
Steuart and Mission Site	—	295	(295)	—	—	—	—
Lighting Retrofit	—	50	(50)	—	—	—	—
Total capital grants	$ 1,456	435	(1,669)	(58)	164	(81)	83

See accompanying independent auditors' report.