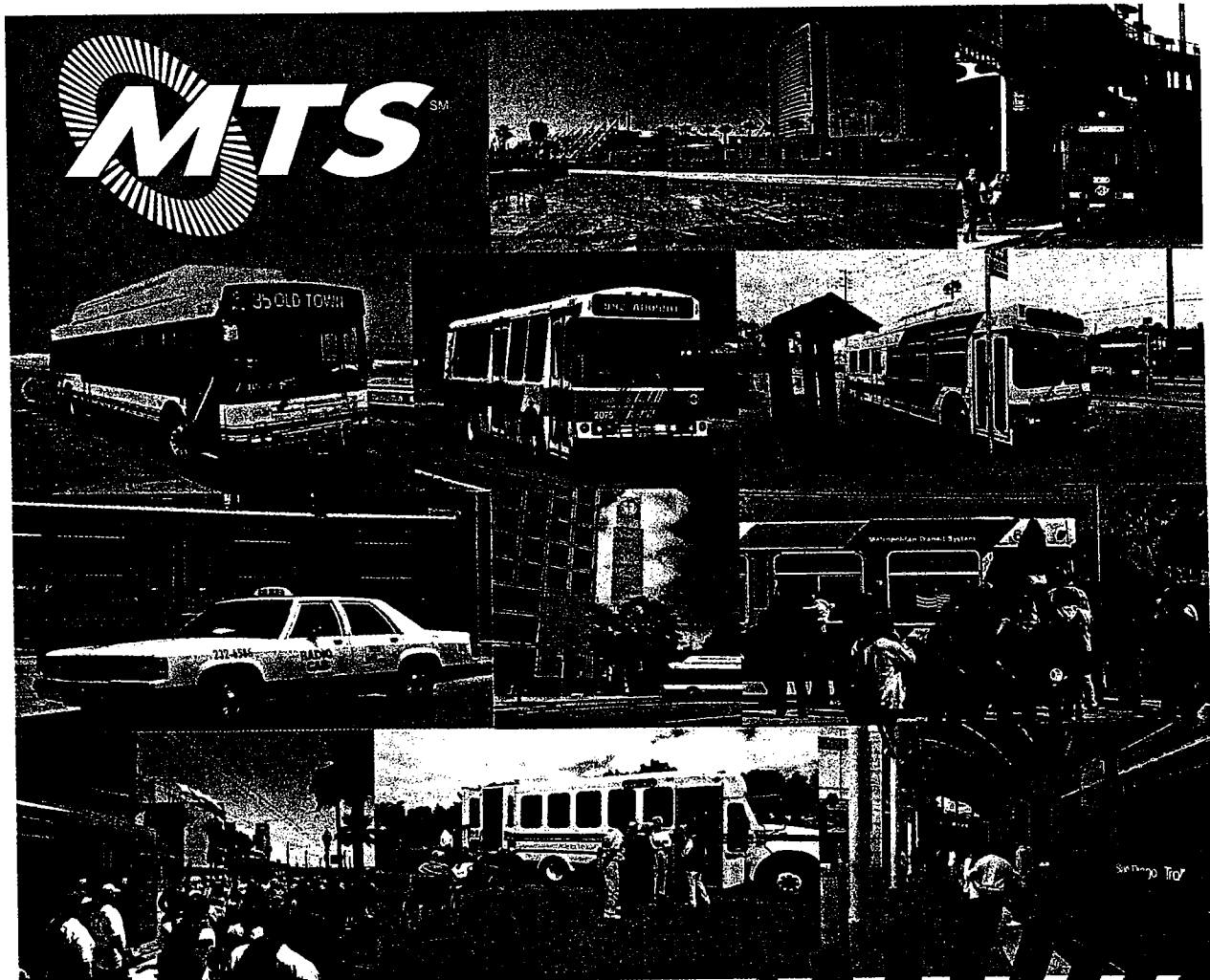


COMPREHENSIVE
ANNUAL FINANCIAL REPORT



FOR THE FISCAL YEAR ENDED JUNE 30, 2004
SAN DIEGO METROPOLITAN TRANSIT SYSTEM
SAN DIEGO, CALIFORNIA





SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Comprehensive Annual Financial Report

June 30, 2004

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INTRODUCTORY SECTION

This Section Contains the Following Subsections:

- Letter of Transmittal
- Listing of Board of Directors and Management

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June 16, 2006

The Board of Directors and Transit Riders
San Diego Metropolitan
Transit System:

The comprehensive annual financial report of the San Diego Metropolitan Transit System (MTS) for the fiscal year ended June 30, 2004 is hereby submitted. Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with management. Management of MTS is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of MTS are protected from loss, theft, or misuse and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP). The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived and (2) the valuation of costs and benefits requires estimates and judgments by management. As management, we assert that, to the best of our knowledge and belief, this financial report is complete and reliable in all material respects.

State statutes require an annual audit by independent certified public accountants. The firm of KPMG LLP has been retained to meet this requirement. The goal of the independent audit was to provide reasonable assurance that the financial statements of MTS for the fiscal year ended June 30, 2004 are free of material misstatement. The independent audit involved 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; and evaluating the overall financial statement presentation. The independent auditors concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that MTS' financial statements for the fiscal year ended June 30, 2004 are fairly presented, in all material respects, in conformity with GAAP. The independent auditors' report is presented as the first component of the financial section of this report.

The independent audit also was designed to meet the requirements of a broader, federally mandated "Single Audit" to meet the special needs of federal grantor agencies. The standards governing Single Audit engagements require the independent auditor to report not only on the fair presentation of the financial statements, but also on the audited government's internal controls and compliance with legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal awards. The reports related specifically to the Single Audit are issued under separate cover.

MTS maintains budgetary controls, the objective of which is to ensure compliance with the provisions embodied in the annual appropriated budget approved by the board of directors. Activities of the General Fund, Special Revenue Funds, Debt Service Funds, and Capital Projects Fund are included in the annual appropriated budgets. Comprehensive multiyear financial plans, adopted when major projects are approved for the final design and construction phase, provide project-length budgetary control in the Capital Projects Fund. The portion of costs expected to be incurred on each project during the fiscal year is included in the annual operating budget. The level of budgetary control (that is, the level at which expenditures cannot legally exceed the appropriated amount) is established by line item within an individual fund. The Chief Executive Officer has the authority to transfer up to \$25,000 between line items. MTS also maintains an encumbrance accounting system as one technique of accomplishing budgetary control. Encumbered amounts lapse at year end. However, encumbrances are evaluated and may be reappropriated as part of the following year's budget.

GAAP require that management provide a narrative introduction, overview, and analysis to accompany the financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The MD&A can be found immediately following the report of the independent auditors.

Reporting Entity

The San Diego Metropolitan Transit System was created effective January 26, 1976 to provide the policy setting and overall management coordination of the public transportation system in the San Diego metropolitan service area. This service area encompasses approximately 1.96 million people residing in a 570 square mile area of San Diego County, including the Cities of Chula Vista, Coronado, El Cajon, Imperial Beach, La Mesa, Lemon Grove, National City, Poway, Santee, and San Diego and the unincorporated area of the County of San Diego. A number of fixed-route operating entities provide the service and have banded together to form a federation of transit service providers called the Metropolitan Transit System (MTS). The purpose of the MTS is to provide coordinated routes, fares, and transfers among the different operating entities.

MTS' mission statement, adopted by the board of directors, is to enhance the personal mobility of San Diego metropolitan area residents and visitors by:

- Obtaining maximum benefit for every dollar spent
- Being the community's major public transportation advocate
- Increasing public transportation usage per capita
- Taking a customer-oriented approach
- Offering high-quality public transportation services
- Responding to the community's socio-economic interests.

Effective January 1, 2003, Senate Bill 1703 (SB 1703) took effect, which consolidated the planning, programming, project development, and construction activities of the San Diego Association of Governments (SANDAG), MTS, and North San Diego County Transit Development Board (NCTD) within SANDAG. The legislation called for an initial transfer of the planning and programming functions from MTS to SANDAG by July 1, 2003 and a subsequent transfer of the project development and construction functions by January 30, 2004. Now that the consolidation is complete, MTS' focus has shifted to transit service operations, as SANDAG, in its newly configured role, is responsible for all other facets of

transportation planning, programming, and development. MTS has one voting member on the nine-member Transportation Committee within SANDAG. The Transportation Committee assumed the responsibility and decision-making for all transportation-related planning, programming, and development activities. In accordance with the legislation, the planning and programming functions were transferred to SANDAG on July 1, 2003, and the project development and construction activities were transferred to SANDAG on October 13, 2003.

MTS is effectively an umbrella agency. MTS owns the assets of San Diego Trolley, Inc. (SDTI) and San Diego Transit Corporation (SDTC), the area's two largest transit operators. These two transit units were formed under California law as not-for-profit public corporations and function as operating subsidiaries of MTS. SDTI and SDTC are considered component units and are blended component units for financial reporting purposes. SDTI operates two Light Rail Transit (LRT) routes, the Blue Line from the Mission San Diego Station to San Ysidro at the International Border and the Orange Line from the Imperial and 12th Bayside Platform through Centre City and then east to Santee. In July 2005, The Mission Valley Extension, known as the Green Line, began service. With this addition of 5.8 miles of track, SDTI now operates on a total of 54.3 miles of track. SDTC operates 29 routes with an active fleet of 275 buses.

The relationship between MTS and the transit operating subsidiaries, SDTI and SDTC, is formally established through operating agreements and MTS-adopted corporate policies. These agreements and corporate policies specify the roles and responsibilities of each of the organizations and outline the procedures in numerous functional areas, including auditing and budgeting, fare setting, marketing and public information, revenue-producing advertising, service contracts, and programming of federal, state, and local subsidies. The MTS board of directors has the policy-setting responsibility for the operation and development of MTS' transit operating subsidiaries as well as for the planning and approval of capital expenditures by or on behalf of these entities. The day-to-day operating functions, labor matters, and maintenance of facilities are managed by the individual transit operators.

Starting in July of 2004 and continuing forward, MTS has begun to centralize and consolidate many functions within SDTI and SDTC. These include Planning, Human Resources, Finance, and Purchasing. This is a gradual process that has been ongoing and will continue for some time.

In addition, MTS owns the San Diego and Arizona Eastern Railway Company (SD&AE), a not-for-profit railroad holding company entrusted with assets which include 108 miles of rail line and over 2,000 acres of property. MTS has a contract with the San Diego and Imperial Valley Railway Co. (SDIV) for the operation of freight rail services over the SD&AE rail line. MTS provides no subsidy to SDIV, but does receive a portion of its gross revenue. SD&AE is considered a component unit and a blended component unit for financial reporting purposes.

In addition to the bus routes operated by SDTC, MTS is financially accountable for the operation of certain other bus routes. MTS contracts with an outside party for the operation of these bus routes. The contracts require full operation and maintenance of the bus services. These contract services are accounted for in the Other Contracted Services Enterprise Fund for financial reporting purposes. Effective July 1, 2002, the responsibility for operating the County Transit System (CTS) was transferred from the County of San Diego to MTS. CTS operating services are combined with the Other Contracted Services Enterprise Fund for financial reporting purposes.

MTS also is financially accountable for the operation of Taxicab Administration services, which includes regulating the issuance of taxi and jitney service permits in the Cities of San Diego, El Cajon, Imperial Beach, Lemon Grove, National City, Poway, and Santee. Taxicab Administration is accounted for in an Enterprise Fund for financial reporting purposes.

The MTS board of directors is comprised of 15 members with four appointed from the San Diego City Council, one appointed from the San Diego County Board of Supervisors, one appointed from each city council of Chula Vista, Coronado, El Cajon, Imperial Beach, La Mesa, Lemon Grove, National City, Poway, and Santee, and one elected by other Board members to serve as Chairman.

Economic Condition and Outlook

Operations

Historically, the San Diego region has enjoyed strong economic expansion, outpacing both the state and national economies. San Diego's gross regional product (GRP), the estimated total value of the region's economy, was estimated at \$131.6 billion for 2004. This was a growth of 3.9%, better than the state but less than the national average. Despite the positive economic indicators, MTS-area fixed-route ridership declined by 2.0% during FY04. The opening of Petco Park in April 2004 has brought additional riders in the system. The opening of the Mission Valley East line is expected to add another large component of daily ridership.

The principal local source of operating subsidy for MTS' transit programs is Transportation Development Act (TDA) funding. One-fourth percent of the local sales tax in each California county is dedicated to transportation purposes.

On a local level, area voters approved a one-half cent transportation sales tax in 1987, called TransNet. One-third of the sales tax proceeds is allocated for transit purposes which is further divided between MTS and North County Transit District (MTS' counterpart in North San Diego County) based on the proportion of the population within the area of each jurisdiction. Prior to FY 2004, 80% of the transit TransNet funds had to be used for expansion of the light rail system. The remaining 20% could be used for operations after funding a reduced-price pass program for seniors, disabled, and youth, which is capped at \$5.5 million. As a result of operating budget pressures, the ratio was changed in June 2003 so that up to 40% of the TransNet program can be used for operations (increased from 20%). The current TransNet sales tax expires in 2008. A reauthorization measure was approved by voters in November 2004 extending the TransNet sales tax for 40 additional years. This has removed a major potential funding problem that would have occurred in 2008 and beyond.

Major Initiatives

With the changes brought about by SB 1703, the MTS focus is now clearly on operations rather than development. Specifically, this is providing quality, efficient, and reliable service to customers using resources to maximum effect. Two major challenges are to align operating costs with recurring revenues and rebuild the capital program in order to be able to replace aging infrastructure.

One of the tools MTS is currently using is a Comprehensive Operational Analysis (COA), the first in MTS history. The purpose of the COA is to assess its ridership and route structure on a comprehensive basis. This assessment is allowing MTS to better align its operations in all areas. The benefits are at least two fold. First it better matches riders with where they want to go offering opportunities for increased ridership and better service to customers and the larger community. Second, it acts as a priority guide for providing service. In doing so, various service levels can be effectively evaluated to coincide with available recurring revenues. Matching the proper service level to available recurring revenues eliminates structural deficits that have produced challenges for MTS for the last few years.

The Mission Valley East (MVE) LRT Line opened in July 2005. It extends 5.8 miles between Interstate 15 in Mission Valley to Baltimore Drive in La Mesa primarily along the I-8 corridor. It has added four stations and the first tunnel for MTS. In opening Mission Valley East, a new green line service was initiated. This consists of previous blue stations from Old Town to Mission San Diego and the four new stations to form the new green line.

Financial Management

Debt Administration

Capital Leases – MTS has two capitalized lease obligations with current year debt service of \$3.2 million. Both the lease obligations are a result of a joint venture arrangement whereby the joint venture issued certificates of participation (COPs) and MTS services the debt through lease payments.

The 1990 \$41,020,000 COP issue, which related to the acquisition of 130 replacement buses, was refinanced with the California Transit Finance Corporation in February 2002, at which time it received an underlying rating of A1 from Moody's Investors Service based solely on the strength of MTS. On the COP issue which related to the construction of the MTS Tower, the rating, which was based on the strength of the joint venture and the primary lessor (the County of San Diego), was Aaa by Moody's Investors Service and AAA by Standard & Poor's Corporation.

Finance Obligations – MTS has four finance obligations. Total debt service for FY 04 was \$2.9 million. The finance obligations are the result of Light Rail Vehicle (LRV) sale/leaseback and lease/leaseback transactions, and issuance of Certificates of Participation to fund the automated fare collection project and the regional transit management project. In each case, proceeds from these transactions were placed into various investments that mature at values sufficient to cover all remaining obligations as well as amounts necessary to exercise the repurchase options where applicable.

Cash Management

To facilitate optimum management of MTS' resources, cash in all the individual funds is combined to form a pool of cash for short-term investment, except for restricted funds, which are generally held by outside custodians on behalf of capital projects and enterprise funds. MTS' funds are invested in accordance with its written policy, which is consistent with the California Government Code 53600. MTS uses the services of an outside investment management firm to handle the daily investment activities. Further details of MTS' cash and investments at June 30, 2004 are set forth in note 4 to the financial statements.

Risk Management

MTS (including Taxicab Administration and Other Contracted Services), SDTI, and SDTC are protected against the adverse consequences of material or financial loss through a balanced program of risk retention and the purchase of commercial insurance. MTS, SDTI, and SDTC are insured for liability, property, and workers' compensation claims under a combined insurance program. Claims in excess of the various deductibles and self-insured retention amounts which range from \$50,000 to \$2,000,000, are insured with commercial carriers up to \$75,000,000 for liability and up to \$400,000,000 for property damage. At June 30, 2004, MTS was holding investments of \$2,000,000 which have been designated by the MTS board of directors for purposes of funding future claims liabilities of MTS, SDTI, and SDTC.

Other Information

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to MTS for its comprehensive annual financial report for the fiscal year ended June 30, 2003. This was the eleventh consecutive year that MTS has received this prestigious award. The Certificate of Achievement is the highest form of recognition for excellence in state and local government financial reporting. In order to be awarded a Certificate of Achievement, MTS must publish an easily readable and efficiently organized comprehensive annual financial report which conforms to program standards. This report satisfied both generally accepted accounting principles and applicable legal requirements. The Certificate of Achievement is valid for a period of one year only.

Acknowledgments

The preparation of this report was accomplished with the cooperation of MTS' management and staff. We express our appreciation to the staff members who contributed to the preparation of this report.

Respectfully submitted,



Paul Jablonski
Chief Executive Officer



Cliff Telfer
Chief Financial Officer

Board of Directors

Members	Board position (elected position)
Leon Williams	Chairman, since 1/76 to 1/83; 1/85 to present
Jerry Rindone	Vice Chairman, since 7/91 (Councilmember, City of Chula Vista)
Toni Atkins	Board Member, since 12/02 (Deputy Mayor, City of San Diego)
Thomas E. Clabby	Board Member, since 6/96 (Councilmember, City of Lemon Grove)
Robert Emery	Chair, Pro Tem, since 7/85 (Councilmember, City of Poway)
Ruth Sterling	Board Member, since 12/00 (Councilmember, City of La Mesa)
Mark Lewis	Board Member, since 12/98 to 4/00, 12/02 (Mayor, City of El Cajon)
Brian Maienschein	Board Member, since 12/00 (Councilmember, City of San Diego)
Harry Mathis	Ex Officio, 12/94 to 12/00, 10/03 to present
Shirley Kaltenborn	Ex Officio, 12/94 to 12/00, 10/03 to present
Phil Monroe	Board Member, since 4/02 (Councilmember, City of Coronado)
Ron Morrison	Board Member, since 6/04 (Councilmember, National City)
Ron Roberts	Board Member, since 12/89 (County Board of Supervisors)
Diane Rose	Board Member, since 1/03 (Mayor, City of Imperial Beach)
Hal Ryan	Board Member, since 1/04 (Councilmember, City of Santee)
Charles Lewis	Board Member, since 7/03 (Councilmember, City of San Diego)
Michael Zucchet	Board Member, since 09/03 (Councilmember, City of San Diego)

MTS Management

Staff	Position
Paul Jablonski	Chief Executive Officer, as of January 2004
Tiffany Lorenzen	General Counsel
Claire Spielberg	Chief Operations Officer, Bus (SDTC)
Cliff Telfer	Interim Chief Financial Officer
Peter Tereschuck	President-General Manager, Rail (SDTI)
Dan Bossert	Director, Information Technology
Conan Chung	Director, Planning
Susan Hafner	Director, Multimodal Operations
Judith Leitner	Interim Director, Marketing and Community Relations
Jeff Stumbo	Director, Human Resources

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FINANCIAL SECTION

This Section Contains the Following Subsections:

Independent Auditors' Report
Management's Discussion And Analysis
Financial Statements
Required Supplementary Information
Capital Assets used in the Operations of Governmental Funds

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KPMG LLP
Suite 700
600 Anton Boulevard
Costa Mesa, CA 92626-7651

Independent Auditors' Report

The Board of Directors
San Diego Metropolitan Transit System:

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the San Diego Metropolitan Transit System (MTS) as of and for the year ended June 30, 2004, which collectively comprise MTS' financial statements, as listed in the table of contents. These financial statements are the responsibility of MTS' management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit 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 audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the San Diego Metropolitan Transit System as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof and the respective budgetary comparison for the General Fund and Subsidiary Pass-Through Fund and the TransNet Fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in note 1(a), MTS business type activities net assets as of June 30, 2003 were restated as MTS changed the components of its reporting entity.

The Management's Discussion and Analysis on pages 12 through 25, and Required Supplementary Information – Funded Status of Pension Plans on page 70, are not a required part of the financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise MTS' financial statements. The introductory section, the capital assets used in the operation of governmental funds information, and statistical section are presented for purposes of additional analysis and are not a required part of the financial statements. The capital assets used in the operation of governmental funds information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, are fairly stated, in all material respects, in relation to the financial statements taken as a whole. The information in the introductory and statistical sections has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on it.

KPMG LLP

June 16, 2006

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Management's Discussion and Analysis

June 30, 2004

The following discussion and analysis of the financial performance of the San Diego Metropolitan Transit System (MTS) is intended to provide an overview of MTS' financial activities for the fiscal year ended June 30, 2004. This information should be used in conjunction with the Letter of Transmittal, which can be found on pages 1 through 6 of this report.

Financial Highlights

- Net assets, as reported in the statement of net assets, totaled \$1,144,742,959 as of June 30, 2004. Of this amount, \$(52,072,512) is unrestricted deficit. Total net assets increased by \$10,788,268.
- As of June 30, 2004, MTS' governmental funds reported combined ending fund balances of \$205,685,597, an increase of \$23,043,444 in comparison with the prior year. Of this amount, \$25,345,574 is available for spending at MTS' discretion (unreserved fund balance).
- For the year ended June 30, 2004, the combined farebox recovery ratio (the measure of the ability to recover operating costs through fare revenue) for San Diego Trolley, Inc., San Diego Transit Corporation, and MTS Contracted Services was 37.7%, compared to 39.7% for the previous year. A number of factors have brought about this decrease, principally the MTS-area ridership decrease.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to MTS' financial statements. MTS' financial statements comprise three components: 1) governmentwide financial statements, 2) fund financial statements, and 3) notes to financial statements. This report also contains other supplementary information in addition to the financial statements themselves.

Governmentwide financial statements. The governmentwide financial statements are designed to provide readers with a broad overview of MTS' finances in a manner similar to a private-sector business.

The statement of net assets presents information on all of MTS' 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 whether the financial position of MTS is improving or deteriorating.

The statement of activities presents information showing how the government's net assets changed during the most recent fiscal year. 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. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., earned but unused vacation leave).

Both of the governmentwide financial statements distinguish functions of MTS that are principally supported by grant revenue and subsidies (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of MTS include general government, transit support activities and transit operations funding. The business-type activities of MTS include transit services that are operated on a contracted basis with third parties and the taxicab regulatory function. In addition, the governmentwide financial statements include not only MTS itself (*known as the primary government*), but also two legally separate transit operators and one legally separate freight railway, for which MTS is financially accountable: San Diego Trolley, Inc. (SDTI), San Diego Transit Corporation (SDTC), and San Diego and Arizona Eastern Railway Company (SD&AE).

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Management's Discussion and Analysis

June 30, 2004

The governmentwide financial statements can be found on pages 28 through 31 of this report.

Fund financial statements. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. MTS uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of MTS can be divided into two categories: governmental funds and proprietary funds.

Governmental funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the governmentwide financial statements. However, unlike the governmentwide financial statements, governmental fund financial statements focus on *near-term inflows and outflows* of spendable resources, as well as on *balances of spendable resources available* at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the governmentwide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for governmental activities in the governmentwide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

MTS maintains five individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund, the Subsidy Pass-Through Special Revenue Fund, the TransNet Special Revenue Fund, the Capital Projects Fund, and the Debt Service Fund, all of which are considered to be major funds.

MTS adopts an annual appropriated budget for the General Fund, the Special Revenue Funds, and the Capital Projects Fund. A budgetary comparison statement has been provided for the General Fund and major Special Revenue Funds to demonstrate compliance with the budget.

The basic governmental fund financial statements can be found on pages 32 through 38 of this report.

Proprietary funds. *Enterprise funds* (a proprietary fund type) are used to report the same functions presented as *business-type activities* in the governmentwide financial statements. MTS uses enterprise funds to account for its Taxicab Administration and Other Contracted Services, as well as SDTI, SDTC, and SD&AE

Proprietary funds provide the same type of information as the governmentwide financial statements, only in more detail. The proprietary fund financial statements provide separate information for SDTI, SDTC, and Other Contracted Services, a major fund of MTS. Taxicab Administration and SD&AE are reported together as nonmajor proprietary funds of MTS. In addition, MTS prepares individual financial statements for SDTI and SDTC.

The basic proprietary fund financial statements can be found on pages 39 through 41 of this report.

Notes to financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the governmentwide and fund financial statements. The notes to financial statements can be found on pages 43 through 69 of this report.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Management's Discussion and Analysis

June 30, 2004

Other information. In addition to the financial statements and accompanying notes, this report also presents certain required supplementary information concerning MTS' progress in funding its obligation to provide pension benefits to its employees. Required supplementary information can be found on page 71 of this report.

Governmentwide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of MTS, assets exceeded liabilities by \$1,145 million at the close of the most recent fiscal year.

The largest portion of MTS' net assets reflects the investment in capital assets, net of related debt (\$9.4 million). Most of the investment in capital assets is comprised of trolley system assets, buses, and construction in progress totaling \$446 million, of which the largest project currently under construction is the Mission Valley East light rail extension (currently \$414 million). The capital assets that are represented by the construction in progress will be used to provide services to citizens; consequently, these assets are *not* available for future spending.

Net assets for business-type activities as reported in FY 2003 and FY 2004 are not comparable because MTS changed its reporting entity in 2004. In prior years, SDTI and SDTC were presented as discretely presented component units with net assets of \$676 million and were not included in the business-type activities statement of net assets. (See note 1(a) in the accompanying notes to the financial statements).

	Governmental activities June 30, 2004	Business-type activities June 30, 2004	Total June 30, 2004
Current and other assets	\$ 291,422,800	22,624,145	314,046,945
Capital assets	<u>475,542,475</u>	<u>692,096,401</u>	<u>1,167,638,876</u>
Total assets	<u>766,965,275</u>	<u>714,720,546</u>	<u>1,481,685,821</u>
Long-term liabilities outstanding	195,220,525	18,188,986	213,409,511
Other liabilities	<u>93,343,856</u>	<u>30,189,495</u>	<u>123,533,351</u>
Total liabilities	<u>288,564,381</u>	<u>48,378,481</u>	<u>336,942,862</u>
Net assets (deficit):			
Invested in capital assets, net of related debt	466,166,119	692,096,401	1,158,262,520
Restricted	38,552,951	—	38,552,951
Unrestricted	<u>(26,318,176)</u>	<u>(25,754,336)</u>	<u>(52,072,512)</u>
Total net assets	<u>\$ 478,400,894</u>	<u>666,342,065</u>	<u>1,144,742,959</u>

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Management's Discussion and Analysis

June 30, 2004

The \$50.6 million decrease in net assets for business-type activities during FY 2004 was due largely to current year net operating losses related to depreciation expense, reduced ridership, increased pension costs, and disposal of obsolete buses with a net book value of \$5.4 million.

	Governmental activities <u>June 30, 2003</u>	Business-type activities <u>June 30, 2003</u>	Total <u>June 30, 2003</u>
Current and other assets	\$ 230,641,772	6,441,944	237,083,716
Capital assets	<u>409,195,745</u>	<u>40,524,197</u>	<u>449,719,942</u>
Total assets	<u>639,837,517</u>	<u>46,966,141</u>	<u>686,803,658</u>
Long-term liabilities outstanding	167,945,094	—	167,945,094
Other liabilities	<u>54,859,879</u>	<u>6,327,870</u>	<u>61,187,749</u>
Total liabilities	<u>222,804,973</u>	<u>6,327,870</u>	<u>229,132,843</u>
Net assets (deficit):			
Invested in capital assets, net of related debt	398,988,253	40,524,197	439,512,450
Restricted	16,739,379	—	16,739,379
Unrestricted	<u>1,304,912</u>	<u>114,074</u>	<u>1,418,986</u>
Total net assets	<u>\$ 417,032,544</u>	<u>40,638,271</u>	<u>457,670,815</u>

An additional portion of MTS' June 30, 2004 net assets, \$38.6 million (3.4%), represents resources that are subject to external restrictions on how they may be used. The remaining balance of *unrestricted net assets (deficit)* (\$52.1 million) represents decreases in net assets related to operating losses at SDTI and SDTC and increased borrowing at MTS.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Management's Discussion and Analysis

June 30, 2004

Governmental Activities. Governmental activities increased MTS' net assets by \$10 million. Key elements of this increase are as follows:

	2004		
	Governmental activities	Business-type activities	Total
Revenues:			
Program revenues:			
Charges for services	\$ —	65,708,920	65,708,920
Operating grants and contributions	78,201,891	93,410,080	171,611,971
Capital grants and contributions	144,901,439	—	144,901,439
General revenues:			
Interest income	6,288,711	—	6,288,711
Indirect cost recovery	2,456,925	—	2,456,925
Total revenues	<u>231,848,966</u>	<u>159,119,000</u>	<u>390,967,966</u>
Expenses:			
General government	6,340,093	—	6,340,093
Transit support activities	803,816	—	803,816
Transit operations funding	76,521,882	—	76,521,882
Transit planning	225,020	—	225,020
Transit capital funding	16,764,717	—	16,764,717
Interest on long-term debt	8,151,473	—	8,151,473
Transportation	—	213,767,994	213,767,994
Total expenses	<u>108,807,001</u>	<u>213,767,994</u>	<u>322,574,995</u>
Increase (decrease) in net assets before capital contributions and transfers	123,041,965	(54,648,994)	68,392,971
Capital contributions	128,356	3,565,912	3,694,268
Transfers	(493,000)	493,000	—
Extraordinary item	(61,308,971)	—	(61,308,971)
Increase in net assets	61,368,350	(50,590,082)	10,778,268
Net assets – July 1, 2003, as restated	<u>417,032,544</u>	<u>716,932,147</u>	<u>1,133,964,691</u>
Net assets – June 30, 2004	<u>\$ 478,400,894</u>	<u>666,342,065</u>	<u>1,144,742,959</u>

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Management's Discussion and Analysis

June 30, 2004

Capital and operating grants and contributions continue to be a major portion of the revenue used to fund transit operations and capital projects. Reported business-type activities for FY 2003 and FY 2004 are not comparable due to the change in MTS' reporting entity in FY 2004. (See note 1 (a) in the accompanying notes to the financial statements). Variances between FY 2004 and FY 2003 governmental activities are attributable to capital funding decreases related to the nearing completion of the Mission Valley East extension and the transfer of construction projects in process to SANDAG pursuant to the provisions of SB 1703.

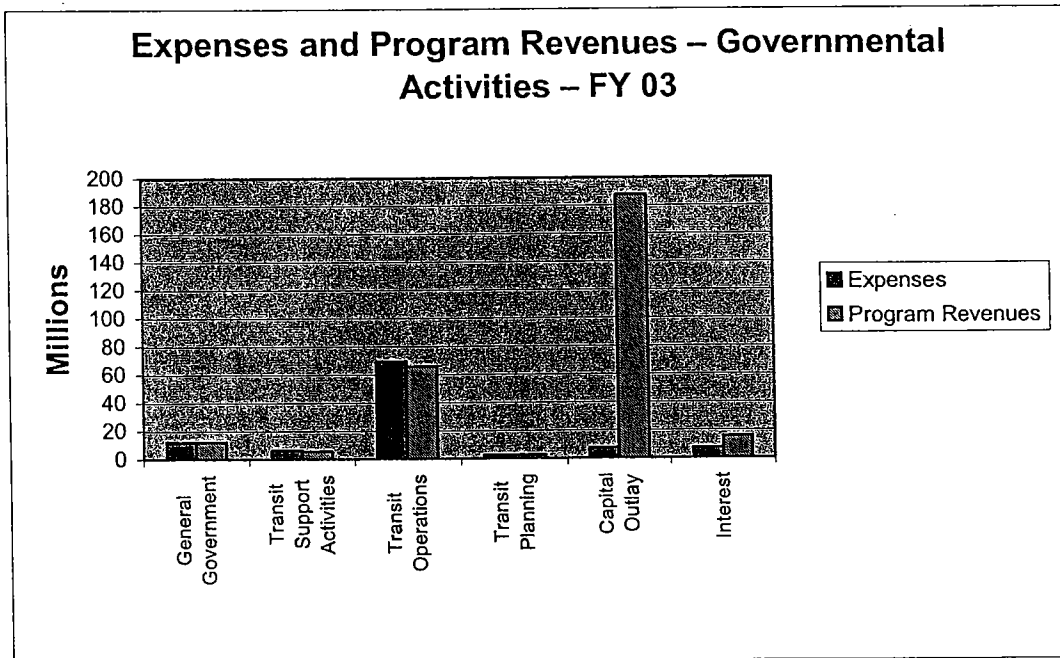
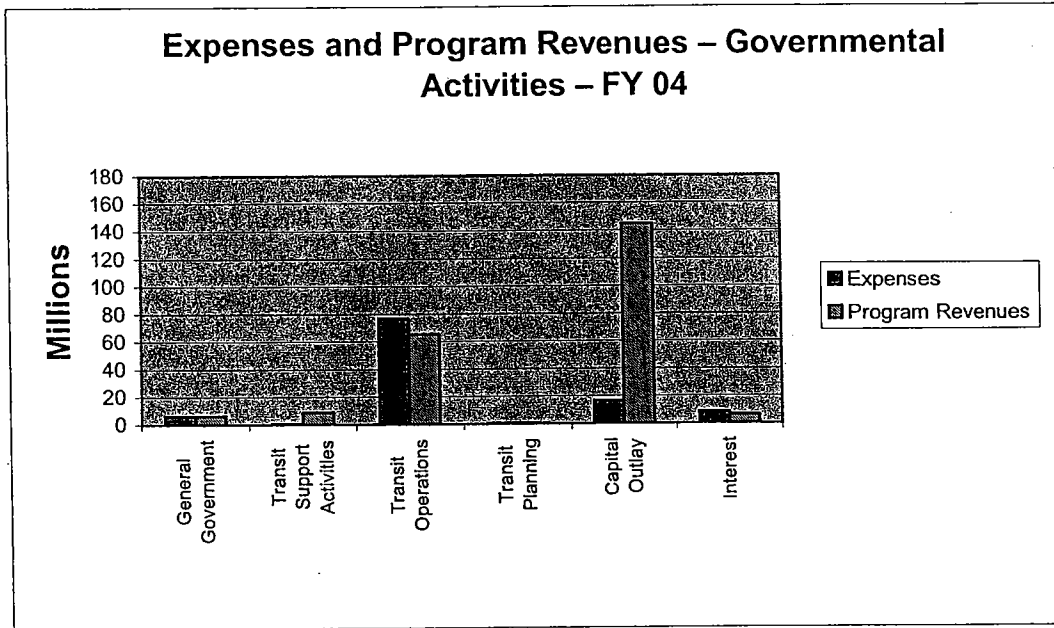
	2003		
	Governmental activities	Business-type activities	Total
Revenues:			
Program revenues:			
Charges for services	\$ —	15,771,282	15,771,282
Operating grants and contributions	80,861,844	30,266,537	111,128,381
Capital grants and contributions	187,649,330	—	187,649,330
General revenues:			
Interest income	15,812,371	—	15,812,371
Indirect cost recovery	5,556,123	—	5,556,123
Total revenues	289,879,668	46,037,819	335,917,487
Expenses:			
General government	12,356,944	—	12,356,944
Transit support activities	6,639,390	—	6,639,390
Transit operations funding	69,343,923	—	69,343,923
Transit planning	2,827,540	—	2,827,540
Transit capital funding	7,724,461	—	7,724,461
Interest on long-term debt	7,647,986	—	7,647,986
Transportation	—	51,096,119	51,096,119
Total expenses	106,540,244	51,096,119	157,636,363
Increase (decrease) in net assets before capital contributions and transfers	183,339,424	(5,058,300)	178,281,124
Capital contributions	(1,887,128)	12,729,734	10,842,606
Transfers	(928,249)	928,249	—
Increase in net assets	180,524,047	8,599,683	189,123,730
Net assets – July 1, 2002	236,508,497	32,038,588	268,547,085
Net assets – June 30, 2003 *	\$ 417,032,544	40,638,271	457,670,815

* These net assets do not include the net assets of SDTI and SDTC as these entities were presented as discretely presented component units during the year ended June 30, 2003. (See note 1(a) in the accompanying notes to the financial statements).

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Management's Discussion and Analysis

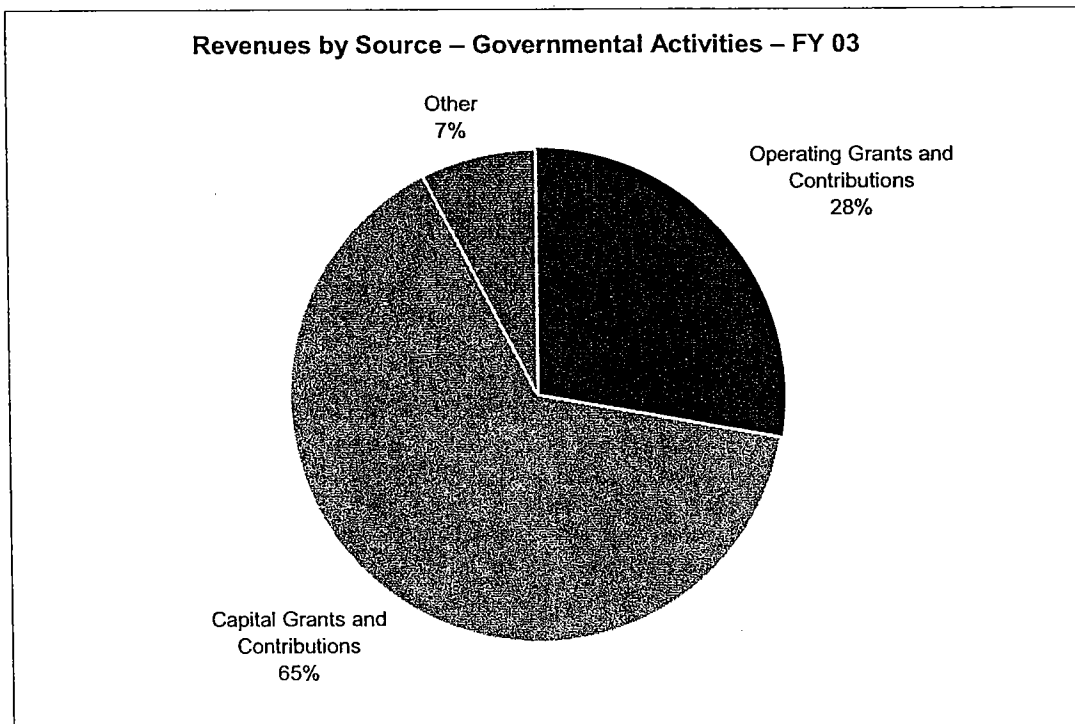
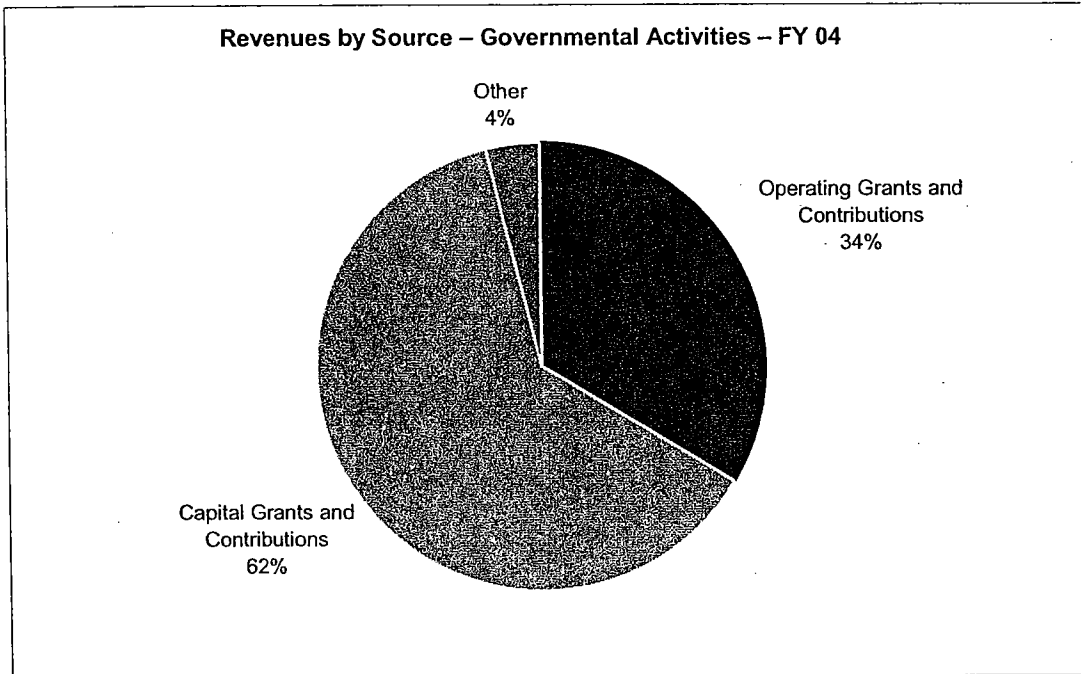
June 30, 2004



SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Management's Discussion and Analysis

June 30, 2004

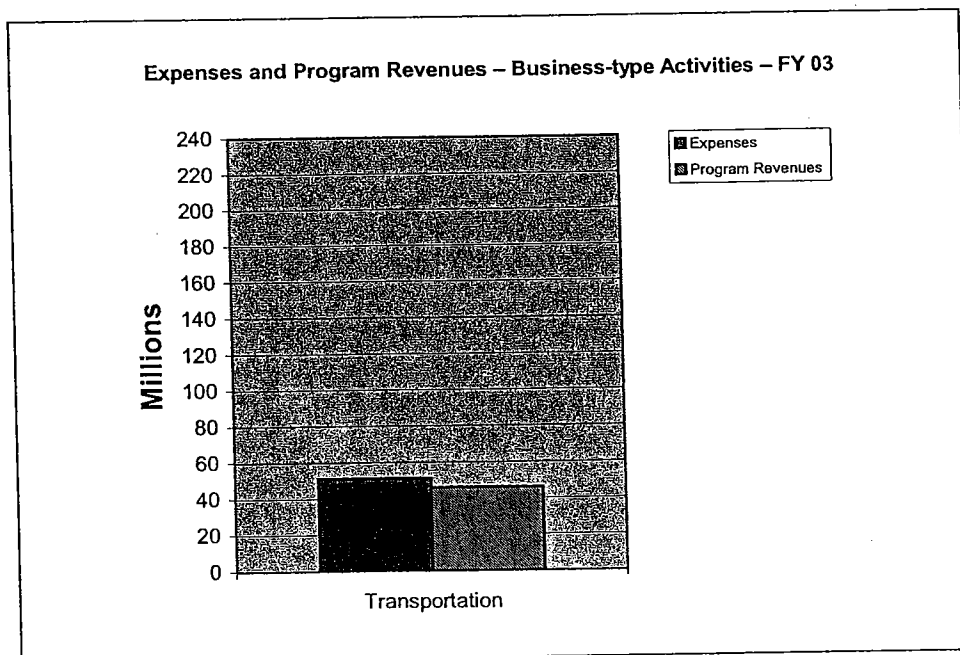
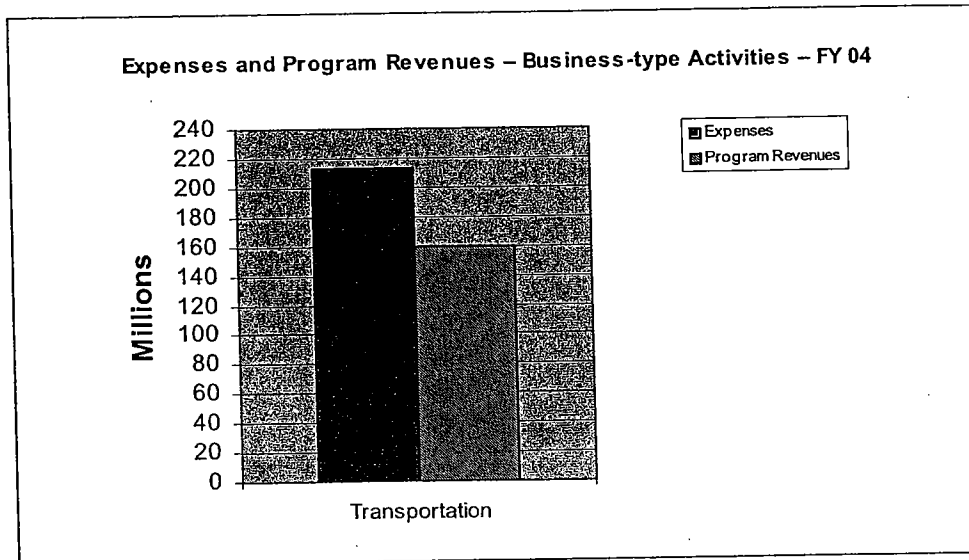


SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Management's Discussion and Analysis

June 30, 2004

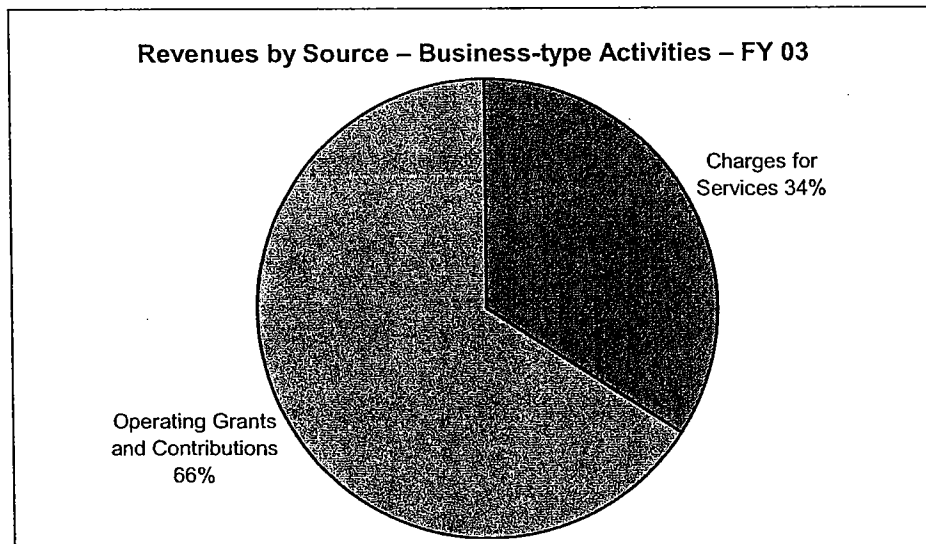
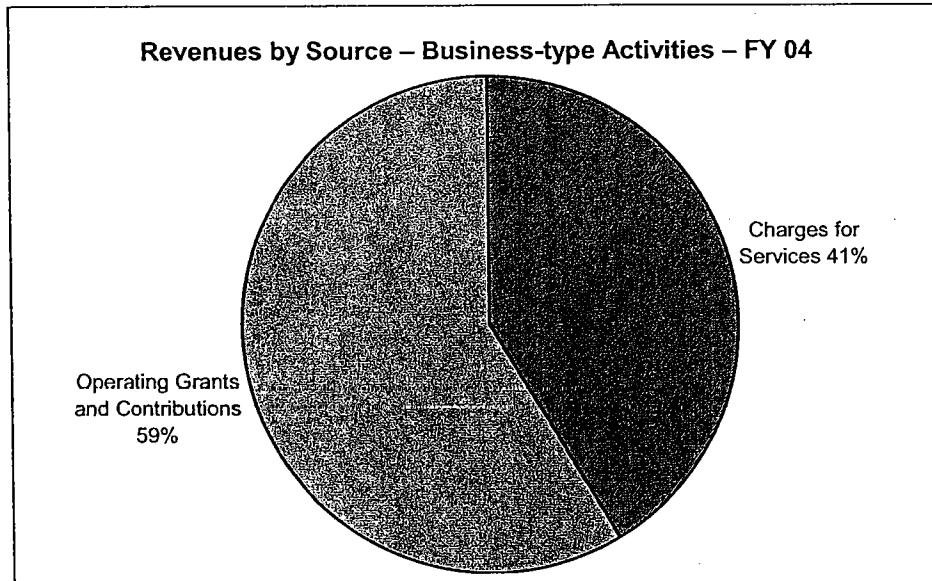
Business-type Activities. In FY 2004, the business-type activities consist of private contracting of bus service, the taxicab regulatory function, SDTI, SDTC, and SD&AE. In FY 2003, business-type activities included only private contracting of bus service and the taxicab regulatory function.



SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Management's Discussion and Analysis

June 30, 2004



- Operating grants and contributions continue to fund the majority of the business-type activities, with fare revenues funding the balance.
- Net assets attributable to MTS' business-type activities decreased to \$666.3 million from \$716.9 million.

Financial Analysis of the Government's Funds

As noted earlier, MTS uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Management's Discussion and Analysis

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Governmental funds. The focus of MTS' *governmental funds* is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing MTS' financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. As of the end of the current fiscal year, MTS' governmental funds reported combined ending fund balances of \$205.7 million, an increase of 12.6% in comparison with the prior year.

The General Fund is the chief operating fund of MTS. At the end of each fiscal year, MTS transfers any excess funds in the General Fund to the Subsidy Pass-Through Special Revenue Fund where it is deposited in the MTS Contingency Reserve (part of unreserved fund balance of the Subsidy Pass-Through Special Revenue Fund). Therefore, at the end of the current year, there was no undesignated unreserved fund balance in the General Fund.

The fund balance of MTS' General Fund increased by \$531 thousand.

The Subsidy Pass-Through Fund is a special revenue fund used to account for the subsidy funds collected on behalf of and passed through to the component units. It is also used to account for the fund balance reserves maintained for capital replacement and other purposes. The Subsidy Pass-Through Fund has a total fund balance of \$19.0 million, of which \$31 thousand is considered reserved because of third-party legal restrictions. The remainder \$19.0 million is unreserved, of which \$10.3 million is designated by the MTS Board for specific uses. The net decrease in the fund balance during the current year was \$11.0 million. The funds were used during the current year for operating purposes and for the local match to federal capital grants.

The TransNet Fund is a special revenue fund used to account for the funds received pursuant to the one-half cent local sales tax increase resulting from the passage of Proposition A by area voters in 1987. The TransNet Fund has a total fund balance of \$23.8 million, all of which is considered unreserved, designated. The net increase in the fund balance during the current year was \$11.8 million attributable to the timing of TransNet receipts and related expenditures.

The Capital Projects Fund is used to account for all the capital projects undertaken by MTS. The Capital Projects Fund has a total negative fund balance of \$17.7 million. The negative fund balance is attributed to funds spent on the Automated Fare Collection project that were funded on a cash basis through the MTS contingency reserve. In October 2003, debt was issued to pay for this project, and the proceeds were recorded in the debt service fund.

The Debt Service Fund is used to account for all the debt service incurred by MTS. The ending fund balance was \$179.9 million, all of which is restricted for debt service purposes and is therefore considered reserved. The net increase in the fund balance during the current year was \$31.9 million as a result of the issuance of new debt.

Proprietary funds. MTS' proprietary funds provide the same type of information found in the governmentwide financial statements, but in more detail.

The net assets balance of the Other Contracted Services Fund is approximately \$36.8 million, most of which is invested in fixed assets. The remainder \$118,775 is unrestricted. The total reduction in net assets for Other Contracted Services is approximately \$3.8 million attributable to depreciation expense totaling \$4.2 million for the current year.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Management's Discussion and Analysis

June 30, 2004

The net assets balance in SDTI is \$581 million, \$587 million of which is invested in fixed assets and the remaining \$(6.3) million deficit is unrestricted. The total reduction in net assets for 2004 is approximately \$30 million, consisting primarily of depreciation expense. The net assets balance in SDTC is \$47.6 million, \$67.6 million of which is invested in fixed assets, and the remaining \$(19.9) million deficit is unrestricted. The total reduction in net assets for 2004 is approximately \$17 million due to reduced ridership, increased pension costs, and disposal of obsolete buses with a net book value of \$5.4 million.

The net assets balance in nonmajor funds is \$816 thousand, \$475 thousand of which is invested in fixed assets and the remaining \$341 thousand is unrestricted. The total increase in net assets for 2004 is \$306 thousand due to the one-time receipt of additional fees in the Taxicab administration fund related to changes in ownership assessments.

General Fund Budgetary Highlights

Differences between the General Fund original budget and the final amended budget were \$3,026,775 (decrease in appropriations) and can be summarized as follows:

- \$2,648,775 decrease in personnel expenditures in general government activities
- \$378,000 decreases in transit support activities.

Capital Asset and Debt Administration

Capital Assets. MTS' investment in capital assets for its governmental and business-type activities as of June 30, 2004 amounts to \$1,168 million (net of accumulated depreciation). This investment in capital assets includes land, buildings, vehicles, equipment, and construction in progress. The total increase in MTS' investment in capital assets for the current fiscal year was 15.6% increase for governmental activities.

Major capital asset events during the current fiscal year included the following:

- Construction continued on the Mission Valley East light rail extension with \$119.9 million expended in the current fiscal year, bringing the total construction in progress for this project to \$413.9 million.
- Construction continued on the 12th and Market Station Retrofit with \$7.2 million expended in the current fiscal year, bringing the total construction in progress for this project to \$7.9 million.
- Construction continued on the San Ysidro Intermodal Transportation Center with \$8.4 million expended in the current fiscal year, bringing the total construction in progress for this project to \$23.2 million.
- Due to the implementation of Senate Bill 1703, \$68.9 million in construction projects were transferred to SANDAG.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Management's Discussion and Analysis

June 30, 2004

Capital Assets
(Net of depreciation)

	2003		
	Governmental activities	Business-type activities	Total
Land	\$ 21,957,196	167,054,480	\$ 189,011,676
Buildings	7,334,221	338,899,110	346,233,331
Vehicles	62,464	181,363,974	181,426,438
Equipment	219,202	4,778,837	4,998,039
Construction in progress	445,969,392	—	445,969,392
	<u>475,542,475</u>	<u>692,096,401</u>	<u>1,167,638,876</u>

Capital assets for business-type activities are not comparable to the amounts reported in FY 2003, which did not include SDTI and SDTC. (See note 1(a) in the accompanying notes to the financial statements).

	2003		
	Governmental activities	Business-type activities	Total
Land	\$ 21,957,196	809,692	\$ 22,766,888
Buildings	7,752,648	3,647,871	11,400,519
Vehicles	102,259	35,762,199	35,864,458
Equipment	192,462	304,435	496,897
Construction in progress	379,191,180	—	379,191,180
	<u>409,195,745</u>	<u>40,524,197</u>	<u>449,719,942</u>

Additional information on MTS' capital assets can be found in note 5 to the financial statements.

Long-term debt. At the end of the current fiscal year, MTS had two capital lease obligations outstanding in the amount of \$10.3 million. In addition, MTS has four finance obligations outstanding relating to one sale/leaseback transaction entered into in 1990, one lease/leaseback transaction entered into in 1995, and certificates of participation issued in 2002 and 2004, for a total obligation of \$190.0 million. With the lease/leaseback transactions, MTS placed funds on deposit which, together with the interest earned on the deposits, will be sufficient to cover the amounts due under the finance obligations. MTS entered into a finance obligation in October 2002 for \$17.8 million to finance a regional transit management system to provide intelligent transportation system and radio communication services. In October 2003, MTS entered into a finance obligation for \$32.9 million to finance the regional automated fare collection system project.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Management's Discussion and Analysis

June 30, 2004

Bond Ratings

Moody's Investor's service provided an intrinsic rating for the Regional Transit Management System certificates of participation at Aaa in 2002, for the Automated Fare Collection certificates of participation at Aaa in 2003, and for the Revenue Anticipation Notes at MIG-1 in 2004.

Additional information on MTS' long-term debt can be found in note 7 to the financial statements.

Requests for Information

This financial report is designed to provide a general overview of MTS' finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Chief Financial Officer, MTS, 1255 Imperial Avenue, Suite 1000, San Diego, CA 92101.

FINANCIAL STATEMENTS

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Statement of Net Assets

June 30, 2004

Assets	Primary government		
	Governmental activities	Business-type activities	Total
Current assets:			
Cash and cash equivalents	\$ 8,424,832	999,142	9,423,974
Investments	13,394,921	—	13,394,921
Accounts and other receivables	502,675	4,265,127	4,767,802
Accounts receivable from other governments	97,955,185	3,170,736	101,125,921
Allowance for uncollectible accounts receivable	—	(684,692)	(684,692)
Internal balances	(6,131,381)	6,131,381	—
Materials and supplies inventory	—	7,272,909	7,272,909
Prepaid items and other assets	727,216	1,460,905	2,188,121
Cash and cash equivalents designated for self-insurance programs	244,996	—	244,996
Total current assets	115,118,444	22,615,508	137,733,952
Restricted assets:			
Cash and certificates of deposit restricted for capital support	13,092,724	8,637	13,101,361
Cash and cash equivalents restricted for debt service	10,665,046	—	10,665,046
Investments restricted for debt service	151,641,239	—	151,641,239
Total restricted assets	175,399,009	8,637	175,407,646
Noncurrent assets:			
Deferred issuance costs	905,347	—	905,347
Capital assets (net of accumulated depreciation)	475,542,475	692,096,401	1,167,638,876
Total noncurrent assets	476,447,822	692,096,401	1,168,544,223
Total assets	766,965,275	714,720,546	1,481,685,821

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Statement of Net Assets

June 30, 2004

Liabilities	Primary government		
	Governmental activities	Business-type activities	Total
Current liabilities:			
Accounts payable	\$ 48,199,189	11,763,861	59,963,050
Accrued expenses	110,342	4,953,039	5,063,381
Compensated absences payable, current portion	159,991	3,852,066	4,012,057
Retentions payable	546,819	10,000	556,819
Notes payable	20,000,000	—	20,000,000
Current portion of long-term debt	5,819,127	—	5,819,127
Accrued interest payable	166,860	—	166,860
Outstanding fare tokens and tickets	—	632,437	632,437
Accrued damage, injury, and employee claims, current portion	2,716,203	7,270,330	9,986,533
Deferred revenue	2,532,601	1,699,125	4,231,726
Total current liabilities	80,251,132	30,180,858	110,431,990
Liabilities payable from restricted assets:			
Retentions payable	13,092,724	—	13,092,724
Long-term debt	162,306,285	—	162,306,285
Capital support funds	—	8,637	8,637
Total liabilities payable from restricted assets	175,399,009	8,637	175,407,646
Noncurrent liabilities:			
Compensated absences payable, net of current portion	180,416	7,436,408	7,616,824
Accrued damage, injury, and employee claims, net of current portion	—	10,752,578	10,752,578
Long-term debt, net of current portion	32,733,824	—	32,733,824
Total noncurrent liabilities	32,914,240	18,188,986	51,103,226
Total liabilities	288,564,381	48,378,481	336,942,862
Net Assets			
Invested in capital assets, net of related debt	463,491,969	692,096,401	1,155,588,370
Restricted for:			
Debt service	38,552,951	—	38,552,951
Unrestricted	(26,318,176)	(25,754,336)	(52,072,512)
Total net assets	\$ 475,726,744	666,342,065	1,142,068,809

See accompanying notes to financial statements.

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SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Statement of Activities

Year ended June 30, 2004

Functions/Programs	Program revenues				Net (expense) revenue and changes in net assets		
	Expenses	Charges for services	Operating grants and contributions	Capital grants and contributions	Governmental activities	Business-type activities	Total
Primary government:							
Governmental activities:							
General government	\$ 6,340,093	—	6,315,098	—	(24,995)	—	(24,995)
Transit support activities	771,256	—	8,780,000	—	8,008,744	—	8,008,744
Transit operations funding	76,521,882	—	62,881,773	—	(13,640,109)	—	(13,640,109)
Transit planning	225,020	—	225,020	—	—	—	—
Transit capital funding—SANDAG projects	16,764,717	—	—	144,901,439	128,136,722	—	128,136,722
Interest on long-term debt	8,151,473	—	—	—	(8,151,473)	—	(8,151,473)
Total governmental activities	108,774,441	—	78,201,891	144,901,439	114,328,889	—	114,328,889
Business-type activities:							
Transportation	213,767,994	65,708,920	93,377,520	—	—	(54,681,554)	(54,681,554)
Total business-type activities	213,767,994	65,708,920	93,377,520	—	—	(54,681,554)	(54,681,554)
Total primary government	322,542,435	65,708,920	171,579,411	144,901,439	114,328,889	(54,681,554)	59,647,335
General revenues:							
Advertising and other funds	—	—	—	—	—	—	—
Interest income	—	—	—	—	6,288,711	—	6,288,711
Indirect cost recovery	—	—	—	—	2,456,925	—	2,456,925
Capital contributions	—	—	—	—	128,356	3,565,912	3,694,268
Transfers	—	—	—	—	(525,560)	525,560	—
Total general revenues and transfers	—	—	—	—	8,348,432	4,091,472	12,439,904
Extraordinary items – see note 16	—	—	—	—	(61,308,971)	—	(61,308,971)
Change in net assets	—	—	—	—	61,368,350	(50,590,082)	10,778,268
Net assets, beginning of year (as restated – note 1(a))	—	—	—	—	417,032,544	716,932,147	1,133,964,691
Net assets, end of year	\$ 478,400,894	—	—	—	\$ 478,400,894	666,342,065	\$ 1,144,742,959

See accompanying notes to basic financial statements.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Balance Sheet

Governmental Funds

June 30, 2004

Assets	General Fund	Subsidy Pass-Through Fund	TransNet Fund	Capital Projects Fund	Debt Service Fund	Total governmental funds
Cash and cash equivalents	7,763,281	637,312	24,239	—	—	8,424,832
Investments	—	—	13,394,921	—	—	13,394,921
Cash and certificates of deposit restricted for capital support	—	—	—	13,092,724	—	13,092,724
Accounts and other receivables	264,447	64,501	—	70,305	103,422	502,675
Accounts receivable from other governments	139,843	16,352,629	28,713	81,434,000	—	97,955,185
Due from other funds	14,791,408	4,819,124	44,968,331	—	17,522,188	82,101,051
Prepaid items and other assets	—	—	—	563	—	563
Cash and cash equivalents restricted for debt service	—	—	—	—	10,665,046	10,665,046
Investments restricted for debt service	—	—	—	—	151,641,239	151,641,239
Cash and cash equivalents designated for self-insurance programs	244,996	—	—	—	—	244,996
Total assets	<u>23,580,447</u>	<u>21,873,566</u>	<u>58,416,204</u>	<u>94,597,592</u>	<u>179,931,895</u>	<u>378,399,704</u>

See accompanying notes to financial statements.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Balance Sheet

Governmental Funds

June 30, 2004

Liabilities and Fund Balances	General Fund	Subsidy Pass-Through Fund	TransNet Fund	Capital Projects Fund	Debt Service Fund	Total governmental funds
Accounts payable	\$ 2,768,830	8,327	34,573,337	10,848,695	—	48,199,189
Accrued liabilities	110,342	—	—	—	—	110,342
Retentions payable	—	—	—	13,639,543	—	13,639,543
Due to other funds	34,272	374,513	—	87,823,647	—	88,232,432
Due to component units	—	—	—	—	—	—
Outstanding fare tokens and tickets	20,000,000	—	—	—	—	20,000,000
Revenue anticipation notes payable	45,535	2,487,066	—	—	—	2,532,601
Deferred revenue	22,958,979	2,869,906	34,573,337	112,311,885	—	172,714,107
Total liabilities						
Fund balances:						
Reserved for:						
Prepaid expenses	376,472	—	—	563	—	377,035
Debt service	—	—	—	—	179,931,895	179,931,895
Insurance	—	—	—	—	—	—
Taxicab administration	—	31,093	—	—	—	31,093
Unreserved:						
Designated in Special Revenue Funds	244,996	10,275,228	23,842,867	—	—	34,363,091
Undesignated in General Fund	—	—	—	(17,714,856)	—	(9,017,517)
Undesignated in Special Revenue Funds	621,468	8,697,339	—	(17,714,293)	179,931,895	205,685,597
Total fund balances	<u>621,468</u>	<u>19,003,660</u>	<u>23,842,867</u>	<u>(17,714,293)</u>	<u>179,931,895</u>	<u>205,685,597</u>
Total liabilities and fund balances	<u>\$ 23,580,447</u>	<u>21,873,566</u>	<u>58,416,204</u>	<u>94,597,592</u>	<u>179,931,895</u>	<u>378,399,704</u>
				\$ 205,685,597		

Fund balances -- total governmental funds
Amounts reported for governmental activities in the statement of net assets are different because:

- Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.
- Other long-term assets are not available to pay for current-period expenditures and therefore are deferred in the funds.
- Long-term liabilities, including debt payable, are not due and payable in the current period and therefore are not reported in the funds

Net assets of governmental activities

475,542,475
1,255,528
<u>(204,082,706)</u>
<u>\$ 478,400,894</u>

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds
 Year ended June 30, 2004

	General Fund	Subsidy Pass-Through Fund	Pass/Ticket Sales Distribution	TransNet Fund	Capital Projects Fund	Debt Service Fund	Total Governmental Funds
Revenues:							
Federal funds	\$ 177,885	27,854,260	—	—	69,654,463	—	97,686,608
State funds	—	—	—	—	7,375,316	—	7,375,316
Local Transportation Development Act funds	5,475,771	29,620,165	—	—	—	—	35,095,936
TransNet funds	—	—	—	74,979,244	—	—	74,979,244
City of San Diego	—	278,000	—	—	—	—	278,000
State Transit Assistance funds	—	4,437,008	—	—	—	—	4,437,008
Other funds	886,462	692,340	—	—	877,298	795,118	3,251,218
Interest income	157,200	169,506	—	—	—	5,962,005	6,288,711
Indirect cost recovery	2,456,925	—	—	—	—	—	2,456,925
Total revenues	9,154,243	63,051,279	—	74,979,244	77,907,077	6,757,123	231,848,966
Expenditures:							
Current:							
General government	6,230,646	—	—	—	—	5,496	6,236,142
Transit support activities	725,412	45,844	—	—	—	—	771,256
Transit operations funding	—	76,521,882	—	—	—	—	76,521,882
Transit planning	225,020	—	—	—	—	—	225,020
Debt service:	—	—	—	—	—	6,155,682	6,155,682
Principal	—	—	—	—	—	8,336,843	8,336,843
Interest	—	—	—	—	—	681,765	681,765
Debt issuance costs	—	—	—	—	—	—	—
Capital outlay:	—	—	—	—	117,244,909	—	117,244,909
Light Rail Transit system extensions	—	—	—	—	32,507,296	—	32,507,296
Major Light Rail Transit system capital improvements	—	—	—	—	—	—	—
Major Bus capital improvements	—	—	—	—	—	—	—
Operations capital	—	—	—	—	—	—	—
Total expenditures	7,181,078	76,567,726	—	—	149,752,205	15,179,786	248,680,795
Excess (deficiency) of revenues over (under) expenditures	1,973,165	(13,516,447)	—	74,979,244	(71,845,128)	(8,422,663)	(16,831,829)
Other financing sources (uses):							
Proceeds of long-term debt	—	9,186,482	—	—	—	32,826,377	32,826,377
Transfers in	—	(6,711,064)	—	(63,187,435)	54,130,835	7,497,765	70,815,082
Transfers out	(1,442,143)	—	—	—	—	—	(71,340,642)
Total other financing sources (uses)	(1,442,143)	2,475,418	—	(63,187,435)	54,130,835	40,324,142	32,300,817
Extraordinary items-equity (deficit) disposition due to Senate Bill 1703 (see note 16)							
Net change in fund balances	531,022	(11,041,029)	(312,496)	11,791,809	7,886,952	31,901,479	7,574,456
Fund balances, beginning of year	90,446	30,044,689	312,496	12,051,058	(7,886,952)	148,030,416	23,043,444
Fund balances, end of year	\$ 621,468	\$ 19,003,660	—	23,842,867	(17,714,293)	179,931,895	182,642,153

See accompanying notes to financial statements.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances of Governmental Funds
to the Statement of Activities

Year ended June 30, 2004

Amounts reported for governmental activities in the statement of activities (page 31) are different because:

Net change in fund balances—total governmental funds (page 34)	\$ 23,043,444
Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. In the current year, \$16.8 million paid to fund capital projects in process currently owned by SANDAG was reported as an expense. This is the amount by which capital outlays exceeded depreciation in the current period.	63,672,578
The issuance of long-term debt (e.g., bonds, leases) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets. Also, governmental funds report the effect of issuance costs, premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities. This amount is the net effect of these differences in the treatment of long-term debt and related items.	(25,945,076)
Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.	<u>597,404</u>
Change in net assets of governmental activities (page 31)	<u>\$ 61,368,350</u>

See accompanying notes to financial statements.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

General Fund

Statement of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual

Year ended June 30, 2004

	Budgeted amounts		Actual amounts	Variance with final budget – positive (negative)
	Original	Final		
Revenues:				
Federal funds	\$ —	—	177,885	177,885
State funds	—	—	—	—
Local Transportation Development Act funds	8,009,536	5,463,796	5,475,771	11,975
Other funds	992,000	942,000	886,462	(55,538)
Interest income	—	—	157,200	157,200
Indirect cost recovery	4,500,000	2,350,000	2,456,925	106,925
Total revenues	<u>13,501,536</u>	<u>8,755,796</u>	<u>9,154,243</u>	<u>398,447</u>
Expenditures:				
Current:				
General government:				
Personnel	7,100,000	4,513,025	4,668,491	(155,466)
Board of directors	135,000	141,000	109,265	31,735
Professional services	295,000	295,000	337,300	(42,300)
Insurance	848,000	848,000	470,253	377,747
Rent	1,170,000	1,170,000	321,464	848,536
Other general office expenditures	376,200	308,400	281,337	27,063
Miscellaneous	207,000	207,000	42,536	164,464
Transit support activities	1,120,000	742,000	725,412	16,588
Transit planning	393,000	393,000	225,020	167,980
Total expenditures	<u>11,644,200</u>	<u>8,617,425</u>	<u>7,181,078</u>	<u>1,436,347</u>
Excess (deficiency) of revenues over expenditures	<u>1,857,336</u>	<u>138,371</u>	<u>1,973,165</u>	<u>1,834,794</u>
Other financing sources (uses):				
Transfers in	1,950,000	1,950,000	—	(1,950,000)
Transfers out	(2,781,200)	(2,402,771)	(1,442,143)	960,628
Total other financing sources and uses	<u>(831,200)</u>	<u>(452,771)</u>	<u>(1,442,143)</u>	<u>(989,372)</u>
Net change in fund balances	<u>\$ 1,026,136</u>	<u>(314,400)</u>	<u>531,022</u>	<u>845,422</u>
Fund balances, beginning			90,446	
Fund balances, ending			<u>\$ 621,468</u>	

See accompanying notes to financial statements.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Subsidy Pass-Through Fund

Statement of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual

Year ended June 30, 2004

	Budgeted amounts		Actual amounts	Variance with final budget – positive (negative)
	Original	Final		
Revenues:				
Federal funds	\$ 23,784,262	23,784,262	27,854,260	4,069,998
State funds	468,000	468,000	—	(468,000)
Local Transportation Development Act funds	29,467,489	29,607,870	29,620,165	12,295
City of San Diego	428,918	428,918	278,000	(150,918)
State Transportation Assistance funds	4,776,412	4,776,412	4,437,008	(339,404)
Other funds	2,097,883	2,092,883	692,340	(1,400,543)
Interest income	—	—	169,506	169,506
Total revenues	61,022,964	61,158,345	63,051,279	1,892,934
Expenditures:				
Current:				
Transit support activities	—	—	45,844	(45,844)
Transit operations funding	73,493,179	73,488,179	76,521,882	(3,033,703)
Total expenditures	73,493,179	73,488,179	76,567,726	(3,079,547)
Deficiency of revenues under expenditures	(12,470,215)	(12,329,834)	(13,516,447)	(1,186,613)
Other financing sources (uses):				
Transfers in	2,781,200	2,781,200	9,186,482	6,405,282
Transfers out	(7,450,000)	(7,450,000)	(6,711,064)	738,936
Total other financing sources and uses	(4,668,800)	(4,668,800)	2,475,418	7,144,218
Net change in fund balances	\$ (17,139,015)	(16,998,634)	(11,041,029)	5,957,605
Fund balances, beginning			30,044,689	
Fund balances, ending			\$ 19,003,660	

See accompanying notes to financial statements.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

TransNet Fund

Statement of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual

Year ended June 30, 2004

	<u>Budgeted amounts</u>		<u>Actual amounts</u>	<u>Variance with final budget – positive (negative)</u>
	<u>Original</u>	<u>Final</u>		
Revenues:				
TransNet funds	\$ 119,184,000	104,998,000	74,979,244	(30,018,756)
Other financing sources (uses):				
Transfers out	<u>(119,184,000)</u>	<u>(104,998,000)</u>	<u>(63,187,435)</u>	<u>41,810,565</u>
Net change in fund balances	\$ <u>—</u>	<u>—</u>	11,791,809	<u>11,791,809</u>
Fund balances, beginning			<u>12,051,058</u>	
Fund balances, ending			\$ <u>23,842,867</u>	

See accompanying notes to financial statements.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Proprietary Funds

Statement of Net Assets

June 30, 2004

Assets	Business-type Activities—Enterprise Funds				Totals
	Other contracted services	San Diego Transit Corporation	San Diego Trolley Incorporated	Non-major	
Current assets:					
Cash and cash equivalents	\$ —	842,962	140,308	15,872	999,142
MTS public support funds receivable	—	—	—	—	—
Accounts and other receivables	—	3,720,656	543,751	720	4,265,127
Accounts receivable from other governments	3,162,021	—	—	8,715	3,170,736
Allowance for uncollectible accounts receivable	(684,692)	—	—	—	(684,692)
Due from other funds	6,709,103	173,633	338,603	308,907	7,530,246
Materials and supplies inventory	—	2,062,298	5,210,611	—	7,272,909
Prepaid expenses	—	759,468	628,068	73,369	1,460,905
Total current assets	9,186,432	7,559,017	6,861,341	407,583	24,014,373
Cash and cash equivalents restricted for capital support	—	8,637	—	—	8,637
Noncurrent assets:					
Capital assets (net of accumulated depreciation)	36,695,955	67,569,871	587,355,912	474,663	692,096,401
Total noncurrent assets	36,695,955	67,569,871	587,355,912	474,663	692,096,401
Total assets	45,882,387	75,137,525	594,217,253	882,246	716,119,411
Liabilities					
Current liabilities:					
Accounts payable	7,355,049	491,251	3,891,691	25,870	11,763,861
Accrued expenses	—	2,418,297	2,534,742	—	4,953,039
Retentions payable	10,000	—	—	—	10,000
Due to other funds	3,483	670,107	684,788	40,487	1,398,865
Compensated absences payable, current portion	—	3,810,791	41,275	—	3,852,066
Outstanding fare tokens and tickets	—	632,437	—	—	632,437
Accrued damage, injury, and employee claims, current portion	—	4,250,234	3,020,096	—	7,270,330
Deferred revenue	1,699,125	—	—	—	1,699,125
Total current liabilities	9,067,657	12,273,117	10,172,592	66,357	31,579,723
Noncurrent liabilities:					
Compensated absences payable, net of current portion	—	5,599,327	1,837,081	—	7,436,408
Accrued damage, injury, and employee claims, net of current portion	—	9,628,674	1,123,904	—	10,752,578
Capital support funds	—	8,637	—	—	8,637
Total noncurrent liabilities	—	15,236,638	2,960,985	—	18,197,623
Total liabilities	9,067,657	27,509,755	13,133,577	66,357	49,777,346
Net assets					
Invested in capital assets, net of related debt	36,695,955	67,569,871	587,355,912	474,663	692,096,401
Unrestricted	118,775	(19,942,101)	(6,272,236)	341,226	(25,754,336)
Total net assets	\$ 36,814,730	47,627,770	581,083,676	815,889	666,342,065

See accompanying notes to financial statements.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Statement of Revenues, Expenditures, and Changes in Fund Net Assets
Proprietary Funds
Year ended June 30, 2004

Assets	Business-type Activities—Enterprise Funds				Totals
	Other contracted services	San Diego Transit Corporation	San Diego Trolley Incorporated	Nonmajor	
Operating revenues:					
Passenger revenue	\$ 17,171,945	22,500,658	24,196,943	—	63,869,546
Permits and other fees	2,686	—	—	963,569	966,255
Advertising	—	674,562	—	139,787	814,349
Charter	—	58,770	—	—	58,770
Total operating revenues	<u>17,174,631</u>	<u>23,233,990</u>	<u>24,196,943</u>	<u>1,103,356</u>	<u>65,708,920</u>
Operating expenses:					
Operators' wages and other transportation expenses	—	41,012,263	32,632,940	—	73,645,203
Contracted services	49,325,795	—	—	—	49,325,795
Pension costs	—	6,017,793	—	—	6,017,793
Maintenance	—	15,670,783	7,384,933	—	23,055,716
General and administrative expenses	—	12,825,217	3,697,273	—	16,522,490
Depreciation	4,186,574	7,729,829	31,655,405	21,373	43,593,181
Administration	799,280	—	—	808,536	1,607,816
Total operating expenses	<u>54,311,649</u>	<u>83,255,885</u>	<u>75,370,551</u>	<u>829,909</u>	<u>213,767,994</u>
Operating income (loss)	<u>(37,137,018)</u>	<u>(60,021,895)</u>	<u>(51,173,608)</u>	<u>273,447</u>	<u>(148,059,074)</u>
Public support and nonoperating revenues:					
Local transportation fund	30,250,810	16,764,272	8,182,427	—	55,197,509
Federal funds	584,262	14,400,000	8,800,000	—	23,784,262
Other local support	1,282,784	13,235,130	362,212	—	14,880,126
State funds	339,404	3,864,884	500,588	—	4,704,876
Miscellaneous	—	94,899	257,000	—	351,899
Investment income	—	45,677	—	51	45,728
Loss on disposal of assets	—	(5,586,880)	—	—	(5,586,880)
Total public support and nonoperating revenues	<u>32,457,260</u>	<u>42,817,982</u>	<u>18,102,227</u>	<u>51</u>	<u>93,377,520</u>
Net income (loss) before operating transfers and contribution of property and equipment	<u>(4,679,758)</u>	<u>(17,203,913)</u>	<u>(33,071,381)</u>	<u>273,498</u>	<u>(54,681,554)</u>
Capital contributions of property and equipment	363,954	112,776	3,089,182	—	3,565,912
Transfers in	493,000	—	—	32,560	525,560
Change in net assets	<u>(3,822,804)</u>	<u>(17,091,137)</u>	<u>(29,982,199)</u>	<u>306,058</u>	<u>(50,590,082)</u>
Total net assets, beginning of year as restated (see note 1(a))	<u>40,637,534</u>	<u>64,718,907</u>	<u>611,065,875</u>	<u>509,831</u>	<u>716,932,147</u>
Total net assets, end of year	<u>\$ 36,814,730</u>	<u>47,627,770</u>	<u>581,083,676</u>	<u>815,889</u>	<u>666,342,065</u>

See accompanying notes to financial statements.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Statement of Cash Flows

Proprietary Funds

Year ended June 30, 2004

	Business-type Activities—Enterprise Funds				Totals
	Other contracted services	San Diego Transit Corporation	San Diego Trolley Incorporated	Nonmajor	
Cash flows from operating activities:					
Receipts from customers and users	\$ 15,710,245	21,882,187	24,217,856	762,687	62,572,975
Payments to suppliers	(48,660,505)	(16,613,797)	(20,663,585)	(802,659)	(86,740,546)
Payments to employees	—	(46,850,120)	(21,340,268)	—	(68,190,388)
Payments for damage, injury, and employee claim:	—	(8,101,311)	—	—	(8,101,311)
Net cash used in operating activities	(32,950,260)	(49,683,041)	(17,785,997)	(39,972)	(100,459,270)
Cash flows from noncapital financing activities:					
Interest income	—	45,677	—	51	45,728
Transfers	493,000	—	—	—	493,000
Public support funds received	32,457,260	49,760,871	17,926,305	32,560	100,176,996
Net cash provided by noncapital financing activities	32,950,260	49,806,548	17,926,305	32,611	100,715,724
Cash flows from capital and related financing activities:					
Decrease in work in progress	—	4,486	—	—	4,486
Payments made through capital support fund	—	(6,000)	—	—	(6,000)
Net cash used in capital and related financing activities	—	(1,514)	—	—	(1,514)
Net increase (decrease) in cash and cash equivalents	—	121,993	140,308	(7,361)	254,940
Cash and cash equivalents, beginning of year	—	729,606	—	23,233	752,839
Cash and cash equivalents, end of year	\$ —	851,599	140,308	15,872	1,007,779
Operating income (loss)	\$ (37,137,018)	(60,021,895)	(51,173,608)	273,448	(148,059,073)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:					
Depreciation	4,186,574	7,729,829	31,655,405	21,373	43,593,181
(Increase) decrease in:					
Accounts and other receivables	—	(1,500,537)	20,913	—	(1,479,624)
Accounts receivable from other governmental entities	(1,781,659)	—	—	(2,772)	(1,784,431)
Due from other funds	(1,661,758)	—	—	(257,120)	(1,918,878)
Due from component units	—	—	—	—	—
Materials and supplies inventory	—	(28,509)	(333,951)	—	(362,460)
Prepaid expenses	—	414,029	389,484	(73,369)	730,144
Increase (decrease) in:					
Accounts payable	1,464,570	452,697	(1,552,911)	(1,532)	362,824
Accrued expenses	—	(236,501)	1,800,904	—	1,564,403
Compensated absences payable	—	4,356,385	65,761	—	4,422,146
Outstanding fare tokens and tickets	—	148,735	—	—	148,735
Accrued damage, injury, and employee claim:	—	(997,274)	1,342,006	—	344,732
Allowance for uncollectible accounts receivable	684,692	—	—	—	684,692
Deferred revenue	1,294,339	—	—	—	1,294,339
Total adjustments	4,186,758	10,338,854	33,387,611	(313,420)	47,599,803
Net cash used in operating activities	\$ (32,950,260)	(49,683,041)	(17,785,997)	(39,972)	(100,459,270)

Supplemental noncash disclosures:

During the year, \$112,776 and \$3,089,182 in capital assets were contributed by the government funds and the San Diego County Transit System to San Diego Transit Corporation and San Diego Trolley, Inc, respectively

See accompanying notes to financial statements.

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SAN DIEGO METROPOLITAN TRANSIT DEVELOPMENT BOARD

Notes to Financial Statements

June 30, 2004

(1) Summary of Significant Accounting Policies

The financial statements of the San Diego Metropolitan Transit System (MTS) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of MTS' accounting policies are described below.

(a) Reporting Entity

MTS was formed on January 26, 1976 by passage of California Senate Bill 101 to plan, construct, and operate (or let contracts to operate) exclusive public mass transit guideways in the urbanized south coastal area of San Diego County. MTS has certain responsibilities for near-term transportation planning and administration of federal and state transportation funds within the area under its jurisdiction. The board of directors of MTS consists of 15 members composed of four appointees from the San Diego City Council, one appointee from each City Council of Chula Vista, Coronado, El Cajon, Imperial Beach, La Mesa, Lemon Grove, National City, Poway, and Santee, one appointee from the San Diego County Board of Supervisors, and a chairman elected by the other 14 members.

On January 1, 2003, Senate Bill 1703 (SB 1703) became effective. SB 1703 required the consolidation of the planning and programming functions of the MTS and the North San Diego County Transit Development Board (NCTD) into the San Diego Association of Governments (SANDAG) in an initial transfer to take place prior to July 1, 2003. SB 1703 also required the consolidation of the project development and construction functions of MTS and NCTD into SANDAG in a subsequent transfer to take place prior to January 30, 2004. The initial transfer occurred on July 1, 2003, and the subsequent transfer occurred on October 13, 2003. With these actions, employees were transferred from MTS and NCTD to SANDAG, and certain planning, development, and construction functions were also transferred. As a result, MTS' activities in the future will be focused on operating the public transit system in the metropolitan area. In addition to the consolidation required by SB 1703, MTS dissolved the board of directors of San Diego Transit Corporation (SDTC) and board of directors of San Diego Trolley, Inc. (SDTI). MTS now acts in that capacity for all three agencies, MTS, SDTC, and SDTI. In FY 2004, SDTC and SDTI are presented as blended component units. The beginning business-type activities net assets as of June 30, 2003 have been restated as follows:

Balance at June 30, 2003, as previously reported	\$ 40,638,271
Balance of discretely presented component units at June 30, 2003	<u>676,293,876</u>
Balance at June 30, 2003, as restated	<u>\$ 716,932,147</u>

As required by GAAP, these financial statements present MTS and its component units, entities for which MTS is considered to be financially accountable. MTS presents blended component units. Blended component units, although legally separate entities, are, in substance, part of MTS' operations.

SAN DIEGO METROPOLITAN TRANSIT DEVELOPMENT BOARD

Notes to Financial Statements

June 30, 2004

Included within the reporting entity as blended component units:

San Diego Transit Corporation: On July 1, 1985, MTS purchased the assets used by and acquired sole ownership of San Diego Transit Corporation (SDTC) from the City of San Diego for \$1. SDTC is a California not-for-profit corporation. SDTC has entered into an operating agreement with MTS to operate a public transportation bus system in the City of San Diego and certain regional routes within MTS' jurisdictions. The agreement extends through June 30, 2005. MTS has the option to extend this agreement if exercised prior to the termination date. SDTC continues to provide local service to a number of adjoining cities under pre-existing contracts. Purchases or construction of bus capital items are made by MTS with whom title remains, and are contributed to SDTC upon completion of a project or when individually purchased by MTS. SDTC's assets, liabilities, net assets, revenues, and expenses are included in MTS' financial statements as a blended component unit. This agency has the same governing board as MTS and provides services directly to the public. Individual financial statements can be obtained from SDTC's administrative offices at 100 Sixteenth Street, P.O. Box 122511, San Diego, CA 92101-2511.

San Diego Trolley, Inc.: San Diego Trolley, Inc. (SDTI) is a California not-for-profit corporation organized by MTS in August 1980. SDTI was created to operate and maintain the Light Rail Transit (LRT) system pursuant to an operating agreement with MTS. The agreement extends through June 30, 2005. MTS has the option to extend this agreement if exercised prior to the termination date. Purchases or construction of LRT capital items are made by MTS with whom title remains, and are contributed to SDTI upon completion of a project or when individually purchased by MTS. SDTI's assets, liabilities, net assets, revenues, and expenses are included in MTS' financial statements as a blended component unit. This agency has the same governing board as MTS and provides services directly to the public. Individual financial statements can be obtained from SDTI's administrative offices at 1255 Imperial Avenue, Suite 900, San Diego, CA 92101.

San Diego and Arizona Eastern Railway Company: MTS purchased the San Diego and Arizona Eastern Railway Company (SD&AE) in 1979. SDTI operates on a portion of the line and a private operator provides freight service on a portion of the line. Purchases of capital items are made by MTS with whom title remains, and are contributed to SD&AE when purchased by MTS. SD&AE's assets, liabilities, net assets, revenues, and expenses are included in MTS' financial statements as a blended component unit. This agency has a separate governing board, which is appointed by MTS. Separate financial statements are not available.

(b) *Governmentwide and Fund Financial Statements*

The governmentwide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the activities of the primary government and its component units. Interfund activity, except for transfers and interfund receivables and payables, has been removed from these statements. Governmental activities, which normally are supported by intergovernmental revenues, are reported separately from business-type activities which rely, to a significant extent, on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants

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who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Other items not properly included among program revenues are reported instead as general revenues.

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and individual proprietary funds are reported as separate columns in the fund financial statements.

(c) *Measurement Focus, Basis of Accounting, and Financial Statement Presentation*

The governmentwide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as all eligibility requirements have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified-accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within one year at the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Interest associated with the current fiscal period is considered to be susceptible to accrual and so has been recognized as revenue of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by MTS.

MTS receives funding primarily from the following revenue sources:

Federal Transit Administration (FTA) revenues are funded by a federal gas tax and revenues of the federal general fund. MTS receives Sections 5309 and 5307 grants which are earmarked for capital assistance and preventive maintenance.

State funding is received primarily from the Traffic Congestion Relief Program (TCRP), State Transit Assistance (STA) revenues, and the Transportation Enhancement Activities Program (TEAP). STA funds come from the Public Transportation Account, which derives its revenues from the state sales tax on gasoline. TCRP and TEAP funds are derived from the federal general fund.

Transportation Development Act (TDA) revenues provide funding support for public transit operators and for nonmotorized transportation projects. The revenue comes from one-quarter of a percent of the total 7.75% sales tax assessed in the region. San Diego Association of Governments (SANDAG) is the agency responsible for apportionment of these funds within the San Diego region.

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TransNet funds are derived from the Proposition A one-half cent local transportation sales tax, which was approved by area voters in November 1987. The resulting ordinance allocated one third of the sales tax proceeds for transit purposes, which are further divided between MTS and North County Transit District based on the proportion of the population within the area of each jurisdiction. TransNet funds are also apportioned by SANDAG.

MTS reports the following major governmental funds:

The General Fund is MTS' primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund. Revenues are primarily derived from FTA and local TDA funds. Expenditures are primarily expended for functions of the general government, transit planning, and transit support activities including marketing.

The special revenue Subsidy Pass-Through Fund accounts for the activities and the subsidy resources collected on behalf of and passed through to the component units. This fund also accounts for the fund balance reserves maintained for capital replacement and other purposes. Revenues are primarily derived from FTA, STA, and local TDA funds. Expenditures are primarily these federal, state, and local funds being passed through to component units and other transit operators.

The special revenue TransNet Fund accounts for the activities and resources received pursuant to the one-half cent local sales tax. These revenues are transferred to other funds, which are expended for rail capital, reduced-price monthly transit passes for seniors, the disabled, and youth, and subsidizing any reduction in federal and state operating funds. Remaining moneys can be expended for service expansion and extensions.

The Capital Projects Fund accounts for the resources and the activities of MTS to provide for Light Rail Transit (LRT) extensions, major LRT/bus capital improvements, and operations capital/replacement. Revenues are primarily derived from FTA and state capital grants and other local income for transit capital funding. Expenditures are expended for capital outlay including LRT extensions, major LRT capital improvements, major bus capital improvements, and operations capital.

The Debt Service Fund accounts for the resources accumulated and payments made for principal and interest on the long-term general obligation debt of MTS. Revenues are derived from interest earned on the restricted cash, cash equivalents, and investments accumulated for the payment of the debt service. Expenditures are payments for the debt service.

MTS reports the following major proprietary funds:

The Other Contracted Services Fund is an enterprise fund used to account for the operation of certain bus routes that have been competitively bid and are operated by MTS through contracts with outside parties. Revenues are primarily derived from passenger fare revenue and federal, state, and local operating grants. Expenses are primarily payments to contracted bus operators for the operation of certain bus routes. Effective July 1, 2002, the responsibility for operating the County Transit System (CTS) was transferred from the County of San Diego to MTS.

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SDTI and SDTC are not-for-profit corporations that provide bus and LRT services. These agencies share governing boards with MTS and are, therefore, presented as blended component units in the Business-type activities section of the Statement of Net Assets and the Statement of Activities.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed in both the governmentwide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The government has elected not to follow subsequent private-sector guidance.

As a general rule, the effect of interfund activity has been eliminated from the governmentwide financial statements. Exceptions to this general rule are lending/borrowing of pooled cash between the proprietary funds and various other functions of the government. Elimination of this lending/borrowing would distort the assets for governmental activities and business-type activities in the statement of net assets.

Proprietary funds are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. Proprietary funds include enterprise funds, which are used to account for those operations that are financed and operated in a manner similar to private business or where MTS has decided that the determination of revenues earned, costs incurred, and/or net income is necessary for management accountability.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of SDTI, SDTC, and Other Contract Services Enterprise Fund are charges to customers for public transportation services. The principal operating revenues of the Taxicab Administration Enterprise Fund are charges for the issuance of taxi and jitney service permits. The principal operating revenues for SD&AE are lease income and right-of-entry permit fees. Operating expenses for enterprise funds include the cost of services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is MTS' policy to use restricted resources first, then unrestricted resources as they are needed.

(d) Budgets

Annual appropriated budgets are adopted for all governmental fund types. All annual appropriations lapse at year end. Budgets are prepared on the modified accrual basis of accounting consistent with GAAP.

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Encumbrances represent commitments related to unperformed contracts for goods or services. Encumbrance accounting, under which purchase orders, contracts, and other commitments for the expenditure of resources are recorded to reserve that portion of the applicable appropriation, is utilized in the governmental funds. Encumbrances lapse at year end and may be reappropriated in the following year.

(e) Deposits and Investments

Investments of pooled cash consist primarily of bankers' acceptances, certificates of deposit, pooled investment funds, liquidity funds, governmental bonds, and commercial paper. Investments are stated at fair value which is based on quoted market price. Interest income earned as a result of investing is distributed to the appropriate funds using a formula based on the average investment balance of each fund. Money market investments and participating interest earning investment contracts that have a remaining maturity at the time of purchase of one year or less are reported at amortized cost, which approximates fair value.

For purposes of the statement of cash flows, all highly liquid temporary investments purchased with a maturity of three months or less are considered cash equivalents.

(f) Receivables and Payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year is referred to as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the governmentwide financial statements as "internal balances."

(g) Parts and Supplies Inventories

Component unit inventories are valued at the lower of cost or market (spare LRT parts) and the lower of average cost or market (materials and supplies for buses), using the first-in, first-out (FIFO) method. Inventory contributed by MTS to SDTI is recorded at MTS' cost. The costs of governmental fund type inventories are recorded as expenditures when purchased.

(h) Prepaid Items

Payments made to vendors for services that will benefit periods beyond June 30, 2004 are recorded as prepaid items in both governmentwide and fund financial statements.

(i) Capital Assets

Capital assets, which include land and right-of-way, buildings and infrastructure assets, vehicles, and equipment, are reported in the applicable governmental or business-type activities columns in the governmentwide financial statements and proprietary fund financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's life are not capitalized. Major outlays for capital assets and improvements are

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recorded as expenditures of the governmental funds and as assets in the governmentwide financial statements. Legal title of all SDTC property and equipment was transferred from the City of San Diego to MTS effective with MTS' purchase of SDTC on July 1, 1985. SDTC has recorded these assets at net book value in order to reflect SDTC's custodial accountability for the assets. Legal title of all County Transit System (CTS) property and equipment was transferred from the County of San Diego to MTS effective with MTS's acquisition of CTS on July 1, 2002. MTS has recorded these assets at net book value.

Under the operating agreements between MTS and SDTC and SDTI, SDTC and SDTI are required to pay a license fee to MTS for the use of certain fixed assets. Due to SDTC's and SDTI's continued shortage of operating funds sufficient to cover recurring expenditures, the payment of these fees is considered remote, and therefore, these amounts were not recorded in the accompanying financial statements.

Buildings, vehicles, and equipment of the primary government, as well as the component units, are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings	32
Vehicles	5 to 30
Equipment	3 to 20

(j) Construction in Progress

Costs incurred for construction associated with the LRT system are expended in the governmental fund types of MTS and capitalized as construction in progress in the governmentwide financial statements until such time as they are complete and operational. Upon completion, they are contributed to SDTI to reflect SDTI's custodial accountability for the assets. Depreciation commences at the time of contribution. Assets acquired through capital leases are capitalized in the governmentwide financial statements.

(k) Compensated Absences

It is MTS' policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since MTS does not have a policy to pay any amounts when employees separate from service with MTS. All vacation pay is accrued when incurred in the governmentwide and proprietary fund type financial statements. A liability for these amounts is reported in governmental funds only if they have matured.

(l) Long-term Obligations

In the governmentwide financial statements and in the proprietary fund type financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable statement of net assets. Debt premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the debt using the straight-line method. Debt payable is reported net of the applicable

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bond premium or discount. Debt issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize debt premiums and discounts, as well as debt issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

(m) Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative plans for future use of financial resources.

(n) Refunding of Debt

Gains or losses occurring from advance refundings of debt of the governmental funds have been deferred and are being amortized into expense using the straight-line method over the original remaining life of the old debt or the life of the new debt, whichever is less.

(o) 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 certain 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 expenditures during the reporting period. Actual results could differ from these estimates.

(2) Legal Compliance – Budgets

The following are MTS' procedures in establishing the annual budget:

1. In June of each year, the Director of Finance and Administration submits to the board of directors a proposed operating and capital projects budget for the following fiscal year.
2. Public hearings are conducted to obtain comments.
3. The budget is legally enacted through passage of a resolution.

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The General Manager is authorized to transfer budgeted amounts up to \$25,000 between line items without prior board approval. However, all increases in the authorized budget and transfers of budgeted amounts greater than \$25,000 must be approved in advance by MTS' board. Expenditures may not exceed budgeted appropriations at the line item level which are detailed by object (i.e., personnel, insurance, rent, etc.). MTS made supplemental budget appropriations during the year as follows:

General Fund	\$ (3,026,775)
Subsidy Pass-Through Special Revenue Fund	(5,000)

(3) Reconciliation of Governmentwide and Fund Financial Statements

(a) *Explanation of Certain Differences Between the Governmental Fund Balance Sheet and the Governmentwide Statement of Net Assets*

The governmental fund balance sheet includes a reconciliation between fund balance – total governmental funds and net assets – governmental activities as reported in the governmentwide statement of net assets. One element of that reconciliation explains that “other long-term assets are not available to pay for current-period expenditures and, therefore, are deferred in the funds.” The details of this \$1,255,528 difference are as follows:

Prepaid interest	\$ 350,181
Deferred issuance costs	<u>905,347</u>
Net adjustment to increase fund balance – total governmental funds to arrive at net assets – governmental activities	\$ <u><u>1,255,528</u></u>

Another element of that reconciliation explains that “long-term liabilities, including debt payable, are not due and payable in the current period and therefore are not reported in the funds.” The details of this \$(204,082,706) difference are as follows:

Compensated absences payable	\$ (340,407)
Claims payable	(2,716,203)
Long-term debt	(200,247,734)
Accrued interest payable	(166,860)
Premium of debt payable	<u>(611,502)</u>
Net adjustment to reduce fund balance – total governmental funds to arrive at net assets – governmental activities	\$ <u><u>(204,082,706)</u></u>

(b) *Explanation of Certain Differences Between the Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances and the Governmentwide Statement of Activities*

The governmental fund statement of revenues, expenditures, and changes in fund balances includes a reconciliation between net changes in fund balances – total governmental funds and changes in net assets of governmental activities as reported in the governmentwide statement of activities. One

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element of that reconciliation explains that, "governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. In the current year, \$16.8 million paid to fund capital projects in progress owned by SANDAG was reported as an expense." The details of this \$63,672,578 difference are as follows:

Transit capital funding expense	\$ 149,752,205
Contributed capital	128,357
Less:	
Current year payments for SANDAG projects	(16,764,717)
Construction in progress transferred to SANDAG	(68,883,427)
Depreciation expense	<u>(559,840)</u>
Net adjustment to increase net changes in fund balances – total governmental funds to arrive at changes in net assets – governmental activities	\$ <u><u>63,672,578</u></u>

Another element of that reconciliation states that, "the issuance of long-term debt (e.g., bonds, leases) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets. Also, governmental funds report the effect of issuance costs, premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities." The details of this \$(25,945,075) difference are as follows:

Interest expense	\$ 315,920
Principal repayment	6,155,682
Amortization expense – deferred issuance costs	(130,551)
Issuance of debt	(32,850,000)
Debt issuance costs	<u>563,873</u>
Net adjustment to increase net changes in fund balances – total governmental funds to arrive at changes in net assets – governmental activities	\$ <u><u>(25,945,076)</u></u>

Another element of that reconciliation states that, "Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds." The details of this \$597,404 difference are as follows:

Compensated absences	\$ 403,081
Claims	<u>194,323</u>
Net adjustment to decrease net changes in fund balances – total governmental funds to arrive at changes in net assets – governmental activities	\$ <u><u>597,404</u></u>

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(4) Cash, Cash Equivalents, and Investments

To facilitate optimum management of MTS' resources, cash resources of the individual funds are combined to form a pool of cash for short-term investment, except for restricted funds which are generally held by outside custodians on behalf of Capital Projects and Enterprise Funds.

Deposits with Financial Institutions: At June 30, 2004, the primary government had deposits in financial institutions with a bank balance and a carrying amount of \$10,096,591 and \$8,178,295, respectively, of which \$100,000 was covered by federal depository insurance. The remaining uninsured deposits are with financial institutions which are individually legally required to have government deposits collateralized with government securities held by the pledging financial institution's trust department in the government's name. The market value of such pledged securities must equal at least 110% of the government's deposits. The difference between the carrying amount and the bank balance represents items in transit in the normal course of business. MTS has not experienced any losses to date on its deposits with financial institutions.

Bank Investment Contracts: During the year ended June 30, 1996, MTS entered into a bank investment contract which bears interest at a fixed rate. The bank investment contract is a component of the 1995 LRV lease/leaseback finance obligation described more fully in note 7. The earnings and the principal of the bank investment contract will be used to make the debt service payments on the related finance obligation. The value of the bank investment contract as of June 30, 2004 was \$90,568,409, which is not covered by federal depository insurance.

Investments: The primary government is responsible for investing its temporary surplus cash in accordance with the written investment policy which is consistent with the California Government Code 53600. Within the context of these limitations, permissible investments include:

1. Securities of the U.S. government
2. Small Business Administration loans
3. Negotiable certificates of deposit issued by commercial banks or savings and loans with FDIC, Security Investment Protection Corporation (SIPC), or Savings Association Insurance Fund (SAIF) insurance, or with full collateralization
4. Nonnegotiable time deposits issued by banks or savings and loans which meet the requirements for investment in negotiable certificates of deposit
5. Bankers' acceptances
6. Commercial paper rated A-1 by Standard and Poor's Corporation or P1 by Moody's Investor Services, Inc.
7. Repurchase agreements with banks and other board-evaluated parties
8. Local Agency Investment Fund (LAIF) established by the State Treasurer
9. San Diego County Pooled Money Fund

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10. Prudential Bache Liquidity Fund

11. Passbook savings or money market demand deposits with an FDIC, SIPC, or SAIF insured financial institution.

The investments that are represented by specific identifiable investment securities are classified as to credit risk by the three categories described below:

Category 1: Insured or registered, with securities held by MTS or its agent, in MTS' name.

Category 2: Uninsured and unregistered, with securities held by the counterparty's trust department or agent, in MTS' name.

Category 3: Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent, but not in MTS' name.

Following are the cash, cash equivalents, and investments held by the primary government at June 30, 2004, classified by category of risk.

	Category			Not required to be categorized	Carrying amount at fair value
	1	2	3		
Local Agency Investment Fund	\$ —	—	—	1,474,874	1,474,874
Deposits with financial institutions				8,178,295	8,178,295
Other cash fund (imprest, revolving)				200	200
Highmark Money Market	—	—	—	24,239	24,239
Money market	—	—	—	12,441,680	12,441,680
Money market (Retention Trust)	—	—	—	13,092,724	13,092,724
Bank Investment Contract	—	—	—	90,568,409	90,568,409
Corporate notes	4,429,088	—	—	—	4,429,088
U.S. Treasury notes	7,995,057	—	—	—	7,995,057
Federal Home Loan Mortgage	8,179,268	—	—	—	8,179,268
Federal National Mortgage					
Association	6,826,107	—	—	—	6,826,107
Federal Home Loan Bank	7,927,446	—	—	—	7,927,446
U.S. Treasury strips	22,737,835	—	—	—	22,737,835
Refco Zero Coupon Bonds	14,596,315	—	—	—	14,596,315
Total cash and investments	\$ 72,691,116	—	—	125,780,421	198,471,537

Monies invested in derivatives through the State Pool are considered immaterial..

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(5) Capital Assets

Primary Government

A summary of changes in capital assets for governmental activities is as follows:

	<u>Balance, June 30, 2003</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance, June 30, 2004</u>
Capital assets, not being depreciated:				
Land and right-of-way	\$ 21,957,196	—	—	21,957,196
Construction-in-progress	<u>379,191,180</u>	<u>135,661,639</u>	<u>(68,883,427)</u>	<u>445,969,392</u>
Total capital assets, not being depreciated	<u>401,148,376</u>	<u>135,661,639</u>	<u>(68,883,427)</u>	<u>467,926,588</u>
Capital assets, being depreciated:				
Buildings and structures	13,387,570	—	—	13,387,570
Vehicles	229,003	—	—	229,003
Office equipment and furniture	<u>1,176,520</u>	<u>128,356</u>	<u>—</u>	<u>1,304,876</u>
Total capital assets, being depreciated	<u>14,793,093</u>	<u>128,356</u>	<u>—</u>	<u>14,921,449</u>
Less accumulated depreciation for:				
Buildings and structures	(5,634,920)	(418,429)	—	(6,053,349)
Vehicles	(126,744)	(39,795)	—	(166,539)
Office equipment and furniture	<u>(984,058)</u>	<u>(101,616)</u>	<u>—</u>	<u>(1,085,674)</u>
Total accumulated depreciation	<u>(6,745,722)</u>	<u>(559,840)</u>	<u>—</u>	<u>(7,305,562)</u>
Total capital assets, being depreciated, net	<u>8,047,371</u>	<u>(431,484)</u>	<u>—</u>	<u>7,615,887</u>
Governmental activities capital assets, net	<u>\$ 409,195,747</u>	<u>135,230,155</u>	<u>(68,883,427)</u>	<u>475,542,475</u>

Construction projects in progress totaling \$68.8 million were transferred to SANDAG during 2004 pursuant to the terms of SB 1703 (see note 16 in the accompanying notes to the financial statements).

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A summary of changes in capital assets for business-type activities is as follows:

	<u>Balance, 6/30/2003, as previously stated</u>	<u>Restatement adjustments (note 1(a))</u>	<u>Balance, June 30, 2003, as restated</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance, June 30, 2004</u>
Capital assets not being depreciated:						
Land and right-of-way	\$ 809,692	166,244,788	167,054,480	—	—	167,054,480
Construction in progress	—	4,486	4,486	—	(4,486)	—
Capital assets, being depreciated:						
Buildings and structures	5,061,626	626,286,769	631,348,395	2,140,813	(954,513)	632,534,695
Vehicles and buses	49,877,986	289,278,799	339,156,785	575,242	(25,942,693)	313,789,334
Equipment and other	760,860	25,999,900	26,760,760	849,856	(4,367,857)	23,242,759
Total capital assets, being depreciated	<u>55,700,472</u>	<u>941,565,468</u>	<u>997,265,940</u>	<u>3,565,911</u>	<u>(31,265,063)</u>	<u>969,566,788</u>
Less accumulated depreciation for:						
Buildings and structures	(1,413,755)	(266,520,207)	(267,933,962)	(25,663,463)	919,074	(292,678,351)
Vehicles and buses	(14,115,787)	(122,864,952)	(136,980,739)	(16,923,294)	20,517,553	(133,386,480)
Equipment and other	(456,425)	(21,238,743)	(21,695,168)	(1,006,424)	4,241,556	(18,460,036)
Total accumulated depreciation	<u>(15,985,967)</u>	<u>(410,623,902)</u>	<u>(426,609,869)</u>	<u>(43,593,181)</u>	<u>25,678,183</u>	<u>(444,524,867)</u>
Total capital assets, being depreciated, net	<u>39,714,505</u>	<u>530,941,566</u>	<u>570,656,071</u>	<u>(40,027,270)</u>	<u>(5,586,880)</u>	<u>525,041,921</u>
Business-type activities – capital assets, net	\$ <u>40,524,197</u>	<u>697,190,840</u>	<u>737,715,037</u>	<u>(40,027,270)</u>	<u>(5,591,366)</u>	<u>692,096,401</u>

Depreciation expense was charged to functions of the primary government as follows:

Governmental activities:	
General government	\$ 559,840
Business-type activities:	
Other contracted services	\$ 4,186,574
Taxicab administration	1,874
SDTC	7,729,829
SDTI	31,655,405
SD&AE	19,499
Total depreciation expense – business-type activities	\$ <u>43,593,181</u>

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June 30, 2004

Construction Commitments

Construction in progress is comprised of the following at June 30, 2004:

	Expended through June 30, 2004	Contractually committed
Mission Valley East	\$ 413,938,978	60,115,427
San Ysidro Intermodal Transit Center	23,213,544	1,791,655
Orange Line-Blue Line Connection	849,466	54,655
12th and Market Station Retrofit	7,892,372	1,103,725
12th Avenue Corridor Improvements	75,032	—
Total construction in progress	\$ 445,969,392	63,065,462

Risk Management

MTS (including SDTI, SDTC, SD&AE, Taxicab Administration and Other Contracted Services) is self-insured for liability claims under a combined insurance program to a maximum of \$2,000,000 per occurrence. Amounts in excess of the self-insurance retention limits for public liability are covered by excess insurance by MTS through commercial insurance carriers up to \$75,000,000. MTS, SDTI, and SDTC purchase all-risk (excluding quake) insurance coverage for property damage up to \$400,000,000 per occurrence with deductibles ranging from \$25,000 to \$50,000, depending on the peril involved. In addition, MTS, SDTC, and SDTI are self-insured for costs arising from employee workers' compensation claims, employee practices liability, and public official errors and omissions liability to a maximum of \$1,000,000 per occurrence. Amounts in excess of \$1,000,000 are covered by insurance companies up to \$75,000,000. SDTC and MTS are self-insured for unemployment claims. SDTC and SDTI have policies for crime coverage through commercial insurance.

Claims expenditures and liabilities in connection with these self-insurance programs are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported based upon past experience, modified for current trends and information. Claim payments did not exceed insurance coverage in any of the past three years.

Fiscal year	Beginning of fiscal year	Current year claims and changes in estimates	Claim payments	End of fiscal year liability
MTS:				
2002 - 2003	\$ 17,226,338	3,456,054	(6,797,187)	13,885,205
2003 - 2004	13,885,205	9,050,404	(4,870,648)	18,064,961
	\$ 31,111,543	12,506,458	(11,667,835)	31,950,166

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Notes to Financial Statements

June 30, 2004

At June 30, 2004, General Fund investments of \$244,996 were held for purposes of funding the future claims liabilities of MTS, SDTI, and SDTC. As a result, \$244,996 of the General Fund balance is designated for payment of future claims liabilities.

(6) Notes Payable

During the year, MTS issued revenue anticipation notes for operating cash flow needs. The notes are general obligations of MTS and are payable from taxes, cash receipts, and other moneys of MTS. The notes pay interest at 2.0% and are due January 1, 2005. Short-term activity for the year ended June 30, 2004 is summarized below.

	<u>Beginning balance</u>	<u>Proceeds</u>	<u>Repayment</u>	<u>Ending balance</u>
Revenue anticipation notes	\$ —	20,000,000	—	20,000,000

(7) Long-term Debt

(a) Capital Leases

The County of San Diego (the County) has a master lease agreement with the MTS Joint Powers Agency (Agency) for the lease of the MTS Tower building. MTS entered into a sublease agreement with the County for a portion (27.61%) of the MTS Tower building. The sublease is classified as a capital lease because 27.61% of the title transfers to MTS at the end of the County's master lease. The master lease terminates on November 1, 2086; however, the County has the option to terminate the agreement on November 1, 2041 and each tenth anniversary thereafter.

In December 1990, MTS entered into a lease agreement with the Agency for 130 replacement buses. The lease was refinanced in February 2000 with the California Transit Finance Corporation (CTFC), a nonprofit, public benefit corporation created by the California Transit Association to provide assistance to transit entities in financing capital improvements. The lease is classified as a capital lease because title transfers to MTS when the lease terminates in December 2004. The buses are recorded by SDTC.

The assets acquired through capital leases are as follows:

	<u>Governmental activities</u>	<u>Business-type activities</u>
Building – MTS Tower	\$ 12,091,981	—
Less accumulated depreciation	(5,857,053)	—
Vehicles – buses	—	28,112,330
Less accumulated depreciation	—	(21,225,759)
Total	\$ <u>6,234,928</u>	<u>6,886,571</u>

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Following is a summary of future minimum payments under capital leases as of June 30, 2004:

	Governmental activities
Year ending June 30:	
2005	\$ 1,862,449
2006	846,165
2007	847,778
2008	847,750
2009	847,005
2010-2014	4,230,802
2015-2019	4,221,643
2020-2024	<u>844,376</u>
Total minimum lease payments	14,547,968
Less amount representing interest	<u>(4,201,612)</u>
Present value of minimum lease payments	\$ <u><u>10,346,356</u></u>

(b) Finance Obligations

1990 LRV Sale/Leaseback – In fiscal year 1990, MTS entered into an agreement to sell 41 light rail vehicles (LRVs) and simultaneously entered into a lease agreement with the purchaser to lease them back. MTS received proceeds of approximately \$52.3 million, of which it used approximately \$46.4 million to prepay future lease payments. This prepayment amount covers lease payments through the year 2004 and into 2005. MTS invested \$3,680,449 of the proceeds into government zero coupon bonds. These bonds mature at values sufficient to cover all remaining lease payments due under the lease agreement as well as amounts necessary to exercise the repurchase options. On June 30, 1990, MTS exercised its option to repurchase the vehicles. As of June 30, 2004, the remaining future obligations total \$15,878,727.

	Principal	Interest
2005	\$ —	—
2006	—	—
2007	2,703,929	—
2008	9,351,404	—
2009	<u>3,823,394</u>	—
	\$ <u><u>15,878,727</u></u>	<u><u>—</u></u>

1995 LRV Lease/Leaseback – In fiscal year 1996, MTS entered into a master lease to lease 52 light rail vehicles to an investor and then simultaneously entered into a sublease agreement to lease them back. MTS received prepayments of the master lease from the investor of approximately \$102.7 million, of which it used approximately \$90.7 million to place two investments which will be

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used to make the interest and principal payments on the finance obligation. MTS placed \$78.8 million in a fixed rate deposit and invested \$11.9 million in government zero coupon bonds. The interest earned on the deposit, together with the principal amount of the deposit and the maturities of the zero-coupon bonds, is sufficient to cover the amounts due under the finance obligation. As of June 30, 2004, the remaining future obligations total \$126,702,651.

	<u>Principal</u>	<u>Interest</u>
Year ending June 30:		
2005	\$ 927,889	6,672,734
2006	999,244	6,598,651
2007	1,076,086	6,518,871
2008	1,158,836	6,432,956
2009	1,247,951	6,340,434
2010–2014	7,835,643	30,045,260
2015–2019	57,412,147	25,866,428
2020–2024	43,105,910	14,211,017
2025–2026	12,938,945	604,846
	<u>\$ 126,702,651</u>	<u>103,291,197</u>

For the above lease transactions, MTS is obligated to insure and maintain the equipment. The lease agreements also provide for MTS' right to continued use and control of the equipment. For the 1990 LRV sale/leaseback and the 1995 LRV lease/leaseback, MTS also has agreed to indemnify the lessor from any taxes imposed by the United States taxing authorities.

The LRVs acquired under the various finance obligations have been transferred to and are recorded by SDTI.

2002 San Diego Regional Transit Management System Project – In fiscal year 2003, MTS issued \$17,485,000 of Certificates of Participation (COP) for governmental activities through the California Transit Finance Corporation for the purpose of financing a regional transit radio communications project. The COPs pay interest at rates ranging from 2 to 3% and mature on December 1, 2007. As of June 30, 2004, the outstanding balance is \$14,470,000.

	<u>Principal</u>	<u>Interest</u>
Year ending June 30:		
2005	\$ 3,485,000	364,400
2006	3,555,000	276,225
2007	3,660,000	168,000
2008	3,770,000	56,550
	<u>\$ 14,470,000</u>	<u>865,175</u>

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2004 Regional Fare Collection Project – In fiscal year 2004, MTS issued \$32,850,000 of COP for governmental activities through the California Transit Finance Corporation for the purpose of financing a regional fare collection project. The COPs pay interest at rates ranging from 2 to 3.3 % and mature on November 1, 2009. As of June 30, 2004, the outstanding balance is \$32,850,000.

	<u>Principal</u>	<u>Interest</u>
Year ending June 30:		
2005	\$ —	840,435
2006	6,785,000	772,585
2007	6,910,000	632,180
2008	6,545,000	477,813
2009	6,710,000	295,350
2010–2014	5,900,000	97,350
	<u>\$ 32,850,000</u>	<u>3,115,713</u>

Following is a summary of all payments due under these finance obligations for the next five years and thereafter:

	<u>Principal</u>	<u>Interest</u>
Year ending June 30:		
2005	\$ 4,412,889	7,877,569
2006	14,043,173	7,647,461
2007	20,997,490	7,319,051
2008	15,297,230	6,967,318
2009	7,957,951	6,635,784
2010–2014	13,735,643	30,142,610
2015–2019	57,412,147	25,866,428
2020–2024	43,105,910	14,211,017
2025–2026	12,938,945	604,846
	<u>\$ 189,901,378</u>	<u>107,272,084</u>

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(c) Changes in Long-term Obligations

Following is a summary of changes in long-term obligations for the year ended June 30, 2004:

	<u>Balance at June 30, 2003</u>	<u>Additions and net increases</u>	<u>Reductions and net decreases</u>	<u>Balance at June 30, 2004</u>	<u>Amounts due within one year</u>
Governmental activities:					
Debt payable:					
Capitalized lease obligations	\$ 13,554,647	—	(3,208,291)	10,346,356	1,406,238
Finance obligation	159,998,768	32,850,000	(2,947,390)	189,901,378	4,412,889
Deferred amounts for issuance premium	<u>700,594</u>	<u>—</u>	<u>(89,092)</u>	<u>611,502</u>	<u>—</u>
Total debt payable	174,254,009	32,850,000	(6,244,773)	200,859,236	5,819,127
Compensated absences payable	743,488	—	(403,081)	340,407	159,991
Claims payable	<u>236,376</u>	<u>—</u>	<u>(194,323)</u>	<u>42,053</u>	<u>42,053</u>
Governmental activities long-term obligations	\$ <u>175,233,873</u>	<u>32,850,000</u>	<u>(6,842,177)</u>	<u>201,241,696</u>	<u>6,021,171</u>

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For the governmental activities, compensated absences are liquidated by the General Fund as follows:

	<u>Balance at June 30, 2003</u>	<u>Additions and net increases</u>	<u>Reductions and net decreases</u>	<u>Balance at June 30, 2004</u>	<u>Amounts due within one year</u>
Business-type activities:					
San Diego Transit Corporation:					
Compensated absences payable	\$ 9,083,080	327,039	—	9,410,119	3,810,791
Claims payable	10,846,835	7,246,400	(4,214,327)	13,878,908	4,250,234
San Diego Transit Corporation long-term obligations	19,929,915	7,573,439	(4,214,327)	23,289,027	8,061,025
San Diego Trolley, Inc.:					
Compensated absences payable	1,812,595	65,761	—	1,878,356	41,275
Claims payable	2,801,994	1,892,126	(550,120)	4,144,000	3,020,096
San Diego Trolley, Inc. long-term obligations	4,614,589	1,957,887	(550,120)	6,022,356	3,061,371
Business-type activities long-term obligations	\$ 24,544,504	9,531,326	(4,764,447)	29,311,383	11,122,396

(8) Interfund Transactions

MTS receives operating and capital assistance from federal, state, and local sources for the benefit of SDTI, SDTC, and Other Contracted services. These funds are recorded as revenue in a special revenue fund and then reported as an expenditure when transferred to these entities. Interfund receivable and payable balances, including amounts due from and to component units, at June 30, 2004 were as follows:

Due to/from primary government and component units	Due from							Total
	General Fund	Subsidy Pass-Through Fund	Capital Projects Fund	Other Contracted Services	SDTC	SDTI	SD&AE	
Due to:								
General Fund	\$ —	—	13,729,723	—	670,107	391,578	—	14,791,408
Subsidy Pass-Through Fund	—	—	4,525,914	—	—	293,210	—	4,819,124
TransNet	—	—	44,968,331	—	—	—	—	44,968,331
Contract Services	—	—	6,709,103	—	—	—	—	6,709,103
Taxicab Administration	—	—	308,907	—	—	—	—	308,907
Debt Service	—	—	17,481,701	—	—	—	40,487	17,522,188
SDTC	31,838	141,277	—	518	—	—	—	173,633
SDTI	2,434	233,236	99,968	2,965	—	—	—	338,603
Total	\$ 34,272	374,513	87,823,647	3,483	670,107	684,788	40,487	89,631,297

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(9) Contingencies

MTS, SDTC, and SDTI have been named in certain legal actions pending at June 30, 2004. Although the outcome of these lawsuits is not presently determinable, in the opinion of management of MTS, SDTC, and SDTI, based in part on the advice of counsel, the resolution of these matters is not expected to have a material adverse effect on the financial position or results of operations of MTS, SDTC, or SDTI or is adequately covered by insurance.

Grant funds received by MTS are subject to audit and adjustment by the grantor agencies. Such audits could lead to requests for reimbursements to the grantor agencies for expenditures disallowed under the terms of the grant. The management of MTS believes that such disallowances, if any, will not be significant.

During 1986, MTS entered into an agreement with another company to sell the tax benefits related to six trolley cars. Simultaneously, MTS entered into a lease agreement with the purchaser to lease the six trolley cars. Certain terms of the agreement call for repayment to the purchaser/lessor if the tax consequences of the agreement are lost or changed due to changes in the Internal Revenue Code. The amount of repayment is essentially the portion of the proceeds relating to the tax benefits lost by the purchaser/lessor. The Tax Reform Act of 1986 may cause an amount to be repaid to the purchaser/lessor. Such amount may range from zero to approximately \$1,294,000 and cannot be determined until MTS is notified of any repayment due. No repayment has been requested to date.

(10) Reserves

The reservations of fund balances of MTS' governmental funds at June 30, 2004 consist of:

	<u>Reserved</u>	<u>Designated</u>
Major Governmental Funds:		
General Fund:		
Prepaid expenses	\$ 376,472	—
Insurance	—	244,996
Subsidy Pass-Through Special Revenue Fund:		
Contingency	—	7,623,431
Billboard – San Diego	—	257,156
Billboard – Chula Vista	—	410,151
Land management	—	257,000
SD&AE	—	1,128,461
Disaster relief	—	105,010
MTS Tower building	—	494,019
Taxicab Administration capital replacement	31,093	—
TransNet Fund	—	23,842,867
Capital Projects Fund prepaid expenses	563	—
	<u>\$ 408,128</u>	<u>34,363,091</u>

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Board policy requires a minimum funding level of \$2,000,000 in the contingency reserve and \$2,000,000 in the insurance reserve. When these reserves fall below the minimum funding level, Board policy requires replenishment in the following budget cycle.

(11) Postemployment Healthcare Benefits

In 1992, pursuant to requirements of the state retirement system in which MTS participates, MTS adopted a policy to provide postretirement healthcare benefits to all retired employees through the California Public Employees Retirement System. Contributions range from \$123 to \$230 monthly per employee, depending upon the number of dependents insured, and increase at an annual rate of 5% of the monthly contribution for active employees. The expenditure is recorded when paid. Total payments for the year ended June 30, 2004 were \$12,258. There are six retirees currently receiving postemployment healthcare benefits.

(12) Employee Retirement Systems

(a) *MTS and SDTI*

Plan Description and Provisions

MTS and SDTI's defined-benefit pension plans provide retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. The plans are part of the Public Agency portion of the California Public Employees Retirement System (PERS), an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for participating public entities within the State of California. A menu of benefit provisions as well as other requirements is established by State statutes within the Public Employees' Retirement Law. MTS and SDTI select optional benefit provisions from the benefit menu by contract with PERS and adopt those benefits through local ordinance. Copies of the PERS annual financial report may be obtained from the PERS Executive Office - 400 P Street, Sacramento, CA 95814.

Funding Policy

All employees working the equivalent of 1,000 hours per year are eligible to participate as members of PERS. MTS and SDTI employees are eligible to retire at age 50 with at least five years of service. Annual retirement benefits are determined based on age at retirement, the length of membership service, and the amount of earnings based on the highest 12 consecutive months average. PERS also provides death and disability benefits. PERS issues a separate comprehensive annual financial report.

The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by PERS. MTS and SDTI employees are required to make contributions equal to 7% of gross pay for employees who are not covered by Social Security and 7% of gross pay after the first \$133.33 per month for employees who pay Social Security tax. MTS and SDTI are required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the PERS Board of Administration. In 2003, MTS paid the entire employee contribution for all employees, and SDTI paid the entire employee contribution for management and supervisory employees who were hired before June 30, 1988. For management and supervisory employees hired after June 30, 1988, SDTI paid half the employee contribution until their

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third anniversary, after which SDTI pays their full contribution. Prior to January 1, 1992, SDTI paid half the employee contribution for nonmanagerial employees. As of January 1, 1992, the nonmanagerial employees pay the entire contribution.

Annual Pension Cost

For fiscal year 2004, the MTS' and SDTI's annual required employer contributions were \$0 and \$727,000, respectively. The required contribution for fiscal year 2004 was determined as part of the June 30, 2004 actuarial valuation using the Entry Age Actuarial Cost Method with the contributions determined as a percent of pay. The actuarial assumptions included (a) 8.25% investment rate of return (net of administrative expenses); (b) projected salary increases from 3.75% to 14.2% depending on age, service, and type of employment; (c) 3.75% payroll growth adjustment; (d) 3.5% inflation adjustment; and (e) a merit scale varying by duration of employment coupled with an assumed annual inflation component of 3.5% and an annual production growth of 0.25%. The actuarial value of the assets of both plans was determined using a technique that smoothes the effect of short-term volatility in the market value of investments over a two-to five-year period depending on the size of investment gains and/or losses. MTS' and SDTI's unfunded actuarial accrued liability (or excess assets) is being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at June 30, 2004 was 10 years for MTS and 4 years for SDTI.

Trend information for MTS (in 000s) is as follows:

	<u>Annual pension cost (APC)</u>	<u>Percentage of APC contributed</u>	<u>Net pension obligation</u>
Fiscal year ended June 30:			
2002	\$ —	100%	\$ —
2003	—	100	—
2004	—	100	—

Trend information for SDTI (in 000s) is as follows:

	<u>Annual pension cost (APC)</u>	<u>Percentage of APC contributed</u>	<u>Net pension obligation</u>
Fiscal year ended June 30:			
2002	\$ 175	100%	\$ —
2003	398	100	—
2004	727	100	—

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(b) SDTC

Plan Description

All of SDTC's full-time employees and certain part-time noncontract employees who have completed one year of service in which they have worked at least 1,000 hours of service, and certain part-time contract employees participate in the San Diego Transit Corporation Employee Retirement Plan (the Plan), a single-employer public employee retirement plan. SDTC issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. The financial report may be obtained by writing to San Diego Transit Corporation, P.O. Box 122511, San Diego, CA 92112-2511.

Funding Status and Progress

SDTC makes annual contributions equal to an actuarially computed amount that includes normal cost and an amount for the amortization of unfunded accrued liabilities. Participants of the Plan are not allowed to contribute to the Plan. The valuation method used to calculate the contribution for the Plan is the Entry Age Normal Actuarial Cost Method which is a projected benefit cost method.

According to this cost method, the normal cost for an employee is the level amount which would fund the projected benefit if it were paid annually from date of eligibility until retirement. The significant actuarial assumptions used to compute the actuarially determined contribution requirements included (a) an actuarial interest rate (per annum) of 8.5% and (b) a projected salary increase of 3.5% per year.

Annual Pension Cost

For fiscal year ended June 30, 2004, the annual pension cost of \$6,017,793 for the pension plan was equal to SDTC's required and actual contributions. The required contribution was determined as part of the January 11, 2001 actuarial valuation using the entry age normal cost method. The actuarial assumptions included (a) an 8.5% investment rate of return and (b) a projected salary increase of 3.5%. Following is the most recent data available.

Trend information for SDTC (in 000s):

	<u>Annual pension cost (APC)</u>	<u>Percentage of APC contributed</u>	<u>Net pension obligation</u>
Fiscal year ended June 30:			
2002	\$ 3,068	100%	\$ —
2003	3,670	100	—
2004	6,018	100	—

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(13) Other Required Individual Fund Disclosures

SDTC and SDTI had unrestricted net deficits of \$19,942,101 and \$6,272,236, respectively, at June 30, 2004. The deficits are primarily a result of the timing difference between recognition of expenses on an accrual basis and when those expenses are funded by subsidy transfers. MTS expects that these deficits will be funded with future subsidies. The capital Projects fund had an unrestricted net deficit of \$17,714,856, which is the result of timing differences between capital project expenses and receipt of subsidy funding for those projects.

(14) Transfers

MTS made certain transfers between funds for the fiscal year ended June 30, 2004. Following is the detail:

<u>Transfer description</u>	<u>General Fund</u>	<u>Subsidy Pass-Through Fund</u>	<u>TransNet Fund</u>	<u>Total</u>
Subsidy Pass-Through Fund	\$ 406,482	—	8,780,000	9,186,482
Capital Projects Fund	216,400	—	53,914,435	54,130,835
Debt Service Fund	786,701	6,711,064	—	7,497,765
Total primary government	1,409,583	6,711,064	62,694,435	70,815,082
Contracted Services Fund	—	—	493,000	493,000
SD&AE	32,560	—	—	32,560
Total business-type activities	32,560	—	493,000	525,560
Net transfers	\$ 1,442,143	6,711,064	63,187,435	71,340,642

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June 30, 2004

(15) Extraordinary Events

Equity (Deficit) Disposition Due to Senate Bill 1703

On January 1, 2003, Senate Bill 1703 (SB 1703) became effective. SB 1703 required the consolidation of the planning and programming functions of MTS and NCTD into SANDAG in an initial transfer that took place July 1, 2003. As of July 1, 2003, certain functions and their net assets were transferred to SANDAG and their net assets (deficit) include the following at their carrying value, which approximated fair market value:

<u>Fund</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Net assets</u>
Pass/ticket sales distribution	\$ 4,954,242	4,641,746	312,496
Capital Projects Fund	7,811,406	15,698,358	(7,886,952)
Construction in progress	68,883,427	—	68,883,427
	<u>\$ 81,649,075</u>	<u>20,340,104</u>	<u>61,308,971</u>

Pass/ticket sales distribution function was transferred October 13, 2003. The entire year is reported in the financial statements of SANDAG. The total net assets transferred were \$312,496.

The project development and construction functions were transferred October 13, 2003. The entire year of activity is reported in the financial statements of SANDAG. The total net deficit transferred was \$(7,886,952).

Construction projects in progress as of June 30, 2003, totaling \$68,883,427, were transferred to SANDAG. As these projects are completed, they will be recorded at fair value as contributed capital to MTS.

(16) Subsequent Events

On October 26, 2004, MTS issued certain Taxable Pension Obligation Bonds (Bonds) in the amount of \$77,490,000, on behalf of SDTC, to reduce an unfunded actuarial liability to SDTC's pension plan. The obligation of MTS to make payments with respect to the Bonds under a Trust Agreement is an unconditional obligation of MTS and is an obligation imposed by law. The Bonds are payable from any and all legally available funds of MTS. The Bonds pay interest at rates ranging from 2.58% to 4.35% and mature in 2033.

SAN DIEGO METROPOLITAN TRANSIT DEVELOPMENT BOARD

Required Supplementary Information (Unaudited)

Funded Status of Pension Plans

June 30, 2002, 2003 and 2004

(In thousands)

MTS

<u>Valuation date</u>	<u>Entry age normal accrued liability</u>	<u>Actuarial value of assets</u>	<u>Unfunded liability (excess assets)</u>	<u>Funded status</u>	<u>Annual covered payroll</u>	<u>UAAL as a % of payroll</u>
6/30/02	\$ 16,455	15,403	1,052	93.6%	\$ 5,082	20.7%
6/30/03 Not available for individual plan	—	—	—	—	—	—
6/30/04 Not available for individual plan	—	—	—	—	—	—

SDTI

<u>Valuation date</u>	<u>Entry age normal accrued liability</u>	<u>Actuarial value of assets</u>	<u>Unfunded liability (excess assets)</u>	<u>Funded status</u>	<u>Annual covered payroll</u>	<u>UAAL as a % of payroll</u>
6/30/02	\$ 31,006	30,711	295	99.0%	\$ 16,532	1.8%
6/30/03	37,235	32,694	4,541	87.8	16,827	27.0
6/30/04	41,695	35,905	5,790	86.1	17,749	32.6

SDTC

<u>Valuation date</u>	<u>Entry age normal accrued liability</u>	<u>Actuarial value of assets</u>	<u>Unfunded liability (excess assets)</u>	<u>Funded status</u>	<u>Annual covered payroll</u>	<u>UAAL as a % of payroll</u>
6/30/02	\$ 119,778	74,860	44,918	62.5%	\$ 38,246	117.4%
6/30/03	125,584	56,331	69,253	44.9	34,945	198.2
6/30/04	132,307	78,667	53,640	59.5	36,237	148.0

See accompanying independent auditors' report.

CAPITAL ASSETS USED IN THE OPERATION OF GOVERNMENTAL FUNDS

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Capital Assets Used in the Operation of Governmental Funds
Comparative Schedules by Source
June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Governmental funds capital assets:		
Land and right-of-way	\$ 21,957,196	21,957,196
Construction-in-progress	445,969,392	379,191,180
Buildings and structures	13,387,570	13,387,570
Vehicles	229,003	229,003
Office equipment and furniture	1,304,876	1,176,520
	<u>482,848,037</u>	<u>415,941,469</u>
Less accumulated depreciation	<u>(7,305,562)</u>	<u>(6,745,722)</u>
Total governmental funds capital assets	<u>\$ 475,542,475</u>	<u>409,195,747</u>
Investments in governmental funds capital assets by source:		
General Fund	\$ 257,395	257,395
Capital Projects Fund	482,590,642	415,684,074
	<u>482,848,037</u>	<u>415,941,469</u>
Less accumulated depreciation	<u>(7,305,562)</u>	<u>(6,745,724)</u>
Total governmental funds capital assets	<u>\$ 475,542,475</u>	<u>409,195,745</u>

This schedule presents only the capital asset balances related to governmental funds.

See accompanying independent auditors' report.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Capital Assets Used in the Operation of Governmental Funds
Schedule by Function and Activity
June 30, 2004

	<u>Administration</u>	<u>Transportation facilities</u>	<u>Construction in progress</u>	<u>Total</u>
General government:				
Land and right-of-way	\$ —	21,957,196	—	21,957,196
Construction in progress	—	—	445,969,392	445,969,392
Buildings and structures	12,091,981	1,295,589	—	13,387,570
Vehicles	229,003	—	—	229,003
Office equipment and furniture	1,304,876	—	—	1,304,876
	<u>13,625,860</u>	<u>23,252,785</u>	<u>445,969,392</u>	<u>482,848,037</u>
Less accumulated depreciation	<u>(7,109,266)</u>	<u>(196,296)</u>	<u>—</u>	<u>(7,305,562)</u>
Total governmental funds capital assets	<u>\$ 6,516,594</u>	<u>23,056,489</u>	<u>445,969,392</u>	<u>475,542,475</u>

This schedule presents only the capital asset balances related to governmental funds.

See accompanying independent auditors' report.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Capital Assets Used in the Operation of Governmental Funds
Schedule of Changes by Function and Activity
Year ended June 30, 2004

Function	Governmental funds capital assets July 1, 2003	Additions	Deletions and transfers	Governmental funds capital assets June 30, 2004
General government:				
Administration	\$ 13,497,504	128,356	—	13,625,860
Transportation facilities	23,252,785	—	—	23,252,785
Construction in progress	379,191,180	135,789,995	(68,883,427)	446,097,748
	415,941,469	135,918,351	(68,883,427)	482,976,393
Less accumulated depreciation	(6,745,722)	(559,840)	—	(7,305,562)
Total governmental funds capital assets	\$ <u>409,195,747</u>	<u>135,358,511</u>	<u>(68,883,427)</u>	<u>475,670,831</u>

This schedule presents only the capital asset balances related to governmental funds.

See accompanying independent auditors' report.

SAN DIEGO METROPOLITAN TRANSIT DEVELOPMENT BOARD

Statistical Section

(Unaudited)

Statistical information differs from financial statements because it usually covers more than one fiscal year and may present nonaccounting data. This information reflects social and economic data and financial trends of MTS. The following statistical information does not reflect special revenue fund transactions, which consist primarily of operating subsidy transfers to SDTC and SDTI.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
 General Government Expenditures by Function (Unaudited)
 Last Ten Fiscal Years

<u>Fiscal year ended</u>	<u>General and administrative</u>	<u>Transit support activities</u>	<u>Planning</u>	<u>Capital projects</u>	<u>Debt service</u>	<u>Total</u>
1995	\$ 6,268,270	5,704,267	1,899,886	68,025,234	2,017,811	83,915,468
1996	7,183,463	6,336,820	1,732,561	148,418,023	7,763,882	171,434,749
1997	5,444,053	5,284,020	2,695,639	63,200,422	9,582,130	86,206,264
1998	5,568,831	5,156,373	3,396,431	52,073,523	14,898,963	81,094,121
1999	6,187,137	5,568,831	1,654,283	1,654,283	33,239,807	48,304,341
2000	6,423,991	5,713,078	1,963,378	44,636,884	11,356,393	70,093,724
2001	7,272,154	6,777,620	1,864,302	83,182,973	10,647,115	109,744,164
2002	7,872,787	6,492,277	2,903,922	139,374,693	10,457,783	167,101,462
2003	11,618,318	6,639,390	2,827,540	221,691,805	10,534,616	253,311,669
2004	6,236,142	771,256	225,020	149,752,205	15,174,290	172,158,913

Source: Financial statements includes all governmental funds except the transit operations funding passed through to transit operators.

See accompanying independent auditors' report.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

General Government Revenues by Source (Unaudited)

Last Ten Fiscal Years

<u>Fiscal year ended</u>	<u>Federal planning/operating funds</u>	<u>State/local operating/planning funds</u>	<u>Federal capital funds</u>	<u>State/local capital funds</u>	<u>Interest</u>	<u>Other</u>	<u>Total</u>
1995	\$ 1,956,063	3,861,839	4,469,510	54,538,288	4,641,244	4,149,454	73,616,398
1996	1,450,194	4,116,051	32,498,475	87,836,039	9,077,851	7,287,723	142,266,333
1997	2,434,053	4,676,944	7,434,540	91,497,161	13,021,314	4,185,743	123,249,755
1998	1,159,962	5,445,084	18,404,811	22,070,106	16,840,316	556,931	64,477,210
1999	1,192,499	1,159,962	9,208,416	9,208,416	10,075,046	740,290	31,584,629
2000	1,398,973	5,764,734	15,548,765	30,647,194	11,558,859	485,894	65,404,419
2001	1,267,398	6,205,087	46,021,014	42,757,765	15,334,845	861,573	112,447,682
2002	1,879,208	6,738,751	112,218,354	47,253,728	13,759,032	2,269,994	184,119,067
2003	2,234,289	7,252,279	153,807,095	45,079,415	15,812,371	1,394,338	225,579,787
2004	177,885	5,475,771	69,654,463	82,354,560	6,288,711	2,558,878	166,510,268

Source: Financial statements; does not include indirect cost reimbursement (\$2,456,925 for fiscal year ended June 30, 2004) or funds received on behalf of component units (\$62,869,255 for fiscal year ended June 30, 2004).

See accompanying independent auditors' report.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Component Units and Proprietary Funds

Expenses by Function (Unaudited)

Last Ten Fiscal Years

(In thousands)

<u>Fiscal year ended</u>	<u>Transportation</u>	<u>Repairs and maintenance</u>	<u>G & A</u>	<u>Pension</u>	<u>Depreciation</u>	<u>Personnel</u>	<u>Contracted services</u>
San Diego Transit Corporation:							
1995	5,136	3,536	3,918	1,726	5,135	41,868	2,066
1996	4,824	2,937	3,262	1,486	5,621	41,455	2,232
1997	4,621	4,824	3,837	3,837	5,612	42,693	2,291
1998	5,188	4,632	2,836	171	5,812	43,626	2,489
1999	4,636	5,198	3,208	862	5,836	47,840	2,633
2000	5,988	4,883	3,774	306	5,719	47,122	2,507
2001	6,588	4,737	6,466	2,425	6,069	48,710	2,829
2002	5,024	4,815	3,656	3,076	7,960	55,330	3,283
2003	7,505	6,167	1,608	3,144	9,114	48,455	—
2004	—	15,671	12,825	6,018	7,730	41,012	—
San Diego Trolley, Inc.:							
1995	2,745	2,616	4,138	683	12,123	9,736	—
1996	2,906	2,628	4,215	587	19,177	10,507	—
1997	3,552	2,870	4,020	(417)	22,114	13,125	—
1998	3,918	3,701	4,125	426	26,896	14,557	—
1999	4,234	4,339	7,089	210	31,196	16,253	—
2000	4,230	4,527	6,099	543	30,873	17,813	—
2001	7,605	5,247	5,592	452	33,153	18,589	—
2002	6,187	9,778	2,166	456	32,105	20,209	—
2003	6,563	9,496	3,312	398	31,831	20,632	—
2004	—	7,385	3,697	—	31,656	32,633	—
Nonmajor funds:							
1995	—	—	109	—	2	270	—
1996	—	—	111	—	3	276	—
1997	—	—	123	—	7	298	—
1998	—	—	110	—	7	338	—
1999	—	—	120	—	7	323	—
2000	—	—	136	—	7	403	—
2001	—	—	145	—	6	437	—
2002	—	—	147	—	2	389	—
2003	—	—	185	—	2	459	—
2004	—	—	—	—	21	809	—
MTDB – Contract Services:							
1995	—	—	113	—	17	—	5,076
1996	—	—	213	—	1,014	—	7,738
1997	—	—	260	—	1,499	—	10,103
1998	—	—	100	—	1,521	—	13,743
1999	—	—	276	—	1,481	—	15,456
2000	—	—	143	—	1,530	—	16,730
2001	—	—	145	—	2,066	—	22,096
2002	—	—	123	—	2,649	—	23,182
2003	—	—	530	—	4,130	—	45,790
2004	—	—	799	—	4,187	—	49,326

Source: Financial statements.

See accompanying independent auditors' report.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Component Units and Proprietary Funds

Revenues by Source (Unaudited)

Last Ten Fiscal Years

(In thousands)

<u>Fiscal year ended</u>	<u>Passenger Fares</u>	<u>Federal Operating Funds</u>	<u>State Operating Funds</u>	<u>Local Operating Funds</u>	<u>Federal / Local Capital Funds</u>	<u>Interest</u>	<u>Other</u>
San Diego Transit Corporation:							
1995	\$ 24,891	4,792	542	24,824	1,422	24	3,802
1996	24,923	2,774	1,140	23,345	487	2	3,663
1997	24,015	24,923	3,126	3,126	548	2	4,211
1998	24,571	3,525	3,469	21,978	1,063	20	3,990
1999	24,692	3,526	3,951	24,142	162	45	5,043
2000	24,100	3,620	4,046	29,210	73	106	5,390
2001	24,572	6,407	4,095	28,552	—	74	5,482
2002	25,914	7,675	6,901	25,130	1,390	104	5,357
2003	23,758	9,653	3,848	33,112	—	24	1,532
2004	22,501	14,400	3,865	29,999	—	46	828
San Diego Trolley, Inc.:							
1995	12,897	—	2,256	4,688	—	—	91
1996	14,119	668	2,134	1,111	—	—	2,818
1997	15,641	2,299	384	4,736	—	—	111
1998	18,589	3,714	484	4,851	—	—	175
1999	20,133	2,780	571	9,624	—	—	399
2000	20,941	1,980	530	7,338	—	—	327
2001	22,244	7,664	595	6,360	—	—	417
2002	22,158	2,810	872	10,833	—	—	1,038
2003	22,071	6,101	533	9,925	—	—	291
2004	24,197	8,800	501	8,545	—	—	257
Nonmajor funds:							
1995	—	—	—	—	—	—	452
1996	—	—	—	—	—	—	379
1997	—	—	—	—	—	—	415
1998	—	—	—	—	—	—	411
1999	—	—	—	—	—	—	478
2000	—	—	—	—	—	—	499
2001	—	—	—	—	—	—	490
2002	—	—	—	—	—	—	525
2003	—	—	—	—	—	—	650
2004	—	—	—	—	—	—	1,103
MTDB – Contract Services:							
1995	2,904	247	32	2,238	169	—	—
1996	3,556	523	68	3,911	306	—	—
1997	5,566	442	57	4,302	256	—	—
1998	6,626	376	197	6,538	519	—	—
1999	7,209	89	315	8,397	313	—	—
2000	7,392	170	45	8,848	301	—	—
2001	8,704	243	200	12,003	528	—	—
2002	10,346	331	433	11,731	—	—	—
2003	15,121	437	747	29,083	—	—	—
2004	17,172	584	339	31,534	—	—	3

Source: Financial statements.

See accompanying independent auditors' report.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Fare Structure (Unaudited)

Year ended June 30, 2004

Bus cash fares:		
Local	\$	1.75
Urban		2.25
Express		2.50 – 4.00
Senior/Disabled		1.00
Airport shuttle		2.25
Shuttles		1.00
Trolley cash fares:		
Downtown		1.25
1 Station		1.50
2 Stations		1.75
3 Stations		2.00
4–10 Stations		2.25
11–19 Stations		2.50
20+ Stations		3.00
Senior/Disabled		1.00
Bus and trolley monthly passes:		
Local/Urban Bus/Express/Trolley		56.00
Express Bus (multizones)		64.00 – 84.00
Senior/Disabled Bus and Trolley		14.00
Youth Bus and Trolley		28.00

Source: Uniform fare structure agreement.

See accompanying independent auditors' report.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Component Units and Major Proprietary Fund

Farebox Recovery Percentage (Unaudited)

Last Ten Fiscal Years

(In thousands)

	<u>San Diego Transit Corporation</u>	<u>San Diego Trolley, Inc.</u>	<u>MTDB – Contract Services</u>
Fiscal year ended:			
1995	44.90%	64.75%	53.93%
1996	46.39	67.74	44.38
1997	43.80	67.56	53.92
1998	43.77	43.75	47.07
1999	40.33	62.93	44.28
2000	39.45	63.39	45.13
2001	35.97	63.36	40.29
2002	36.24	57.64	44.39
2003	35.52	54.63	32.65
2004	29.79	55.35	34.26

Source: Financial statements; calculated as passenger revenue (including monthly pass sales which are recorded as a transfer), divided by operating expenses.

See accompanying independent auditors' report.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Demographic Statistics (Unaudited)

Last Ten Fiscal Years

	MTDB service area population (000 s) (1)	State of California population (000 s) (2)	United States population (000 s) (3)	MTDB median household income (4)	MTDB service area median age (5)	San Diego County average unemployment rate (6)
1995	1,922	31,617	266,278	\$ —	—	6.4%
1996	1,911	31,837	269,394	42,402	33	5.3
1997	1,934	32,207	272,647	43,522	33	4.2
1998	1,964	1,934	275,854	275,854	33	3.5
1999	2,009	33,140	279,040	44,049	33	3.1
2000	1,958	33,753	282,178	45,416	33	3.0
2001	1,989	34,431	285,094	44,196	32	3.2
2002	2,024	35,049	287,974	46,913	32	4.3
2003	2,053	35,612	290,810	48,238	33	4.3
2004	2,085	36,271	293,655	50,435	34	5.1

(1) Source: San Diego Association of Governments, estimates as of January 1 (Data prior to 2000 not adjusted for Census 2000).

(2) Source: California Department of Finance, estimates as of January 1.

(3) Source: US Census Bureau from 1990 Census (Numbers represent yearly population as of July 1).

(4) Source: San Diego Association of Governments (Median income is in 1999 dollars).

(5) Source: San Diego Association of Governments.

(6) Source: California Employment Development Department, unadjusted (San Diego County only).

See accompanying independent auditors' report.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Component Units and Major Proprietary Fund

Operating Statistics (Unaudited)

Last Ten Fiscal Years

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Operating cost:										
San Diego Transit	\$ 56,284,284	54,591,372	55,463,420	59,627,952	62,374,086	62,766,968	69,453,428	72,928,810	66,879,539	75,526,056
San Diego Trolley	19,914,946	20,842,211	23,150,851	26,480,208	31,990,492	33,033,489	35,114,080	38,444,185	40,400,891	43,715,146
MTDB-Contract Services	5,384,197	8,012,598	10,363,031	13,843,539	15,732,089	16,873,674	22,238,571	23,305,460	46,320,130	50,125,075
Farebox revenue:										
San Diego Transit	24,890,870	24,923,473	24,015,321	24,571,107	24,691,690	24,099,715	24,572,080	25,913,748	23,851,511	22,559,428
San Diego Trolley	12,896,511	14,119,409	15,641,407	18,589,024	20,132,617	20,940,890	22,244,487	22,157,906	22,071,207	24,196,943
MTDB Contract Services	2,903,882	3,555,998	5,566,311	6,626,819	7,209,561	7,407,862	8,704,329	10,345,867	15,121,333	17,171,945
Total passengers:										
San Diego Transit	32,290,301	32,991,673	32,494,227	34,656,185	34,648,168	35,041,982	34,029,926	31,923,576	28,966,424	25,545,374
San Diego Trolley	15,624,411	16,770,356	18,286,616	22,969,209	24,567,479	28,743,326	28,885,554	25,432,952	25,174,788	26,538,239
MTDB Contract Services	3,966,561	4,797,692	7,549,747	9,041,806	10,213,176	10,887,008	11,533,145	12,221,143	16,383,415	18,469,667
Revenue miles:										
San Diego Transit	11,116,676	10,699,631	10,777,370	11,482,788	11,506,097	11,761,369	11,585,666	11,285,546	10,867,305	10,348,010
San Diego Trolley	4,098,876	4,215,284	5,059,054	6,186,987	6,990,998	7,090,499	7,070,019	7,046,660	6,921,657	6,983,380
MTDB Contract Services	1,949,437	2,729,324	3,790,968	4,521,034	5,145,941	5,656,691	6,245,354	7,014,605	8,030,297	12,696,707
Subsidy/Total pass:										
San Diego Transit	0.97%	0.90%	0.97%	1.01%	1.09%	1.10%	1.32%	1.47%	1.49%	2.07%
San Diego Trolley	0.45	0.40	0.41	0.34	0.48	0.42	0.45	0.64	0.73	0.74
MTDB Contract Services	0.63	0.93	0.64	0.80	0.83	0.87	1.17	1.06	1.90	1.78

Source: MTDB Short Range Transit Plan FY 2003 - 2007 and audited financial statements

See accompanying independent auditors' report.

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