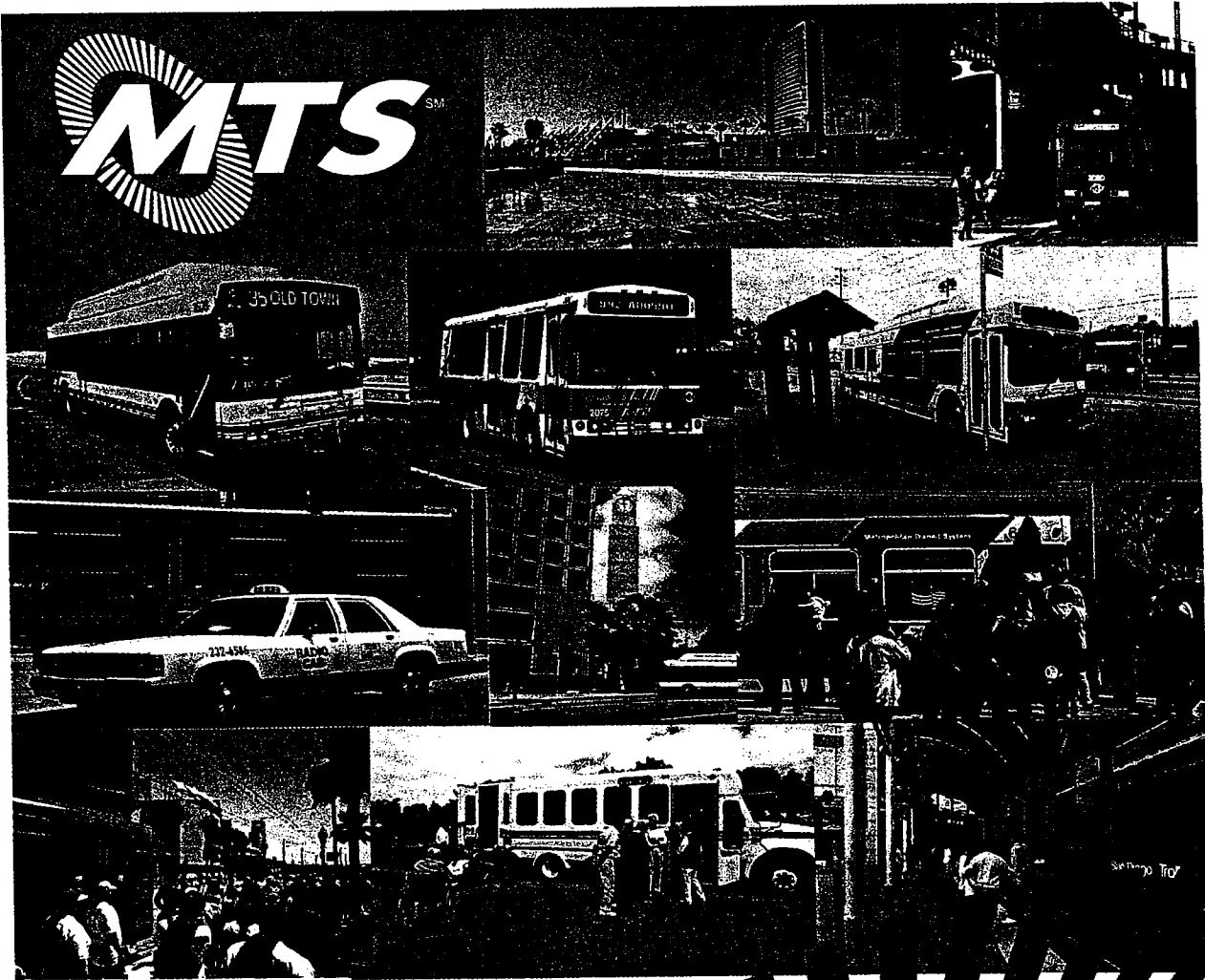


COMPREHENSIVE
ANNUAL FINANCIAL REPORT



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

Table of Contents

	Page
Introductory Section:	
Letter of Transmittal	1
Listing of Board of Directors and Management	7
Financial Section:	
Independent Auditors' Report	11
Management's Discussion and Analysis (Unaudited)	13
Financial Statements:	
Governmentwide Financial Statements:	
Statement of Net Assets	28
Statement of Activities	31
Fund Financial Statements:	
Balance Sheet – Governmental Funds	32
Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds	34
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities	35
Statement of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual – General Fund	36
Statement of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual – Subsidy Pass-Through Fund	37
Statement of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual – TransNet Fund	38
Statement of Net Assets – Proprietary Funds	39

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Comprehensive Annual Financial Report

June 30, 2004

Table of Contents

	Page
Statement of Revenues, Expenses, and Changes in Fund Net Assets – Proprietary Funds	40
Statement of Cash Flows – Proprietary Funds	41
Notes to Financial Statements	43
Required Supplementary Information – Funded Status of Pension Plans (Unaudited)	70
Capital Assets Used in the Operation of Governmental Funds:	
Comparative Schedules By Source	72
Schedule By Function and Activity	73
Schedule of Changes By Function and Activity	74
Statistical Section (Unaudited):	
Fund Information:	
General Government Expenditures by Function (Unaudited)	76
General Government Revenues by Source (Unaudited)	77
Expenses by Function – Component Units and Proprietary Funds (Unaudited)	78
Revenues by Source – Component Units and Proprietary Funds (Unaudited)	79
Fare Structure (Unaudited)	80
Farebox Recovery Percentages – Component Units and Major Proprietary Fund (Unaudited)	81
Demographic Statistics (Unaudited)	82
Operating Statistics – Component Units and Major Proprietary Fund (Unaudited)	83

INTRODUCTORY SECTION

This Section Contains the Following Subsections:

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

THIS PAGE INTENTIONALLY LEFT BLANK



1255 Imperial Avenue, Suite 1000
San Diego, CA 92101-7490
(619) 231-1466 • FAX (619) 234-3407

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

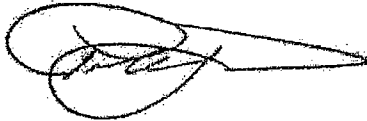
Awards

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

THIS PAGE INTENTIONALLY LEFT BLANK

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

THIS PAGE INTENTIONALLY LEFT BLANK



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).

