COMPREHENSIVE

ANNUAL FINANCIAL REPORT

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

SAN DIEGO, CALIFORNIA

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

SAN DIEGO, CALIFORNIA

Comprehensive Annual Financial Report

Year ended June 30, 2006

(With Independent Auditors' Report Thereon)

Prepared by Finance Department

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SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Comprehensive Annual Financial Report

Year ended June 30, 2006

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Comprehensive Annual Financial Report

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INTRODUCTORY

SECTION

Metropolitan Transit System

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San Diego MetropolitanTransit System
Board of Directors and Transit Riders:

The comprehensive annual financial report of the San Diego Metropolitan Transit System (MTS) for the fiscal year ended June 30, 2006 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 generally accepted accounting principles 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 Caporicci & Larson 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, 2006 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, 2006 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 was also 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 multi-year 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 2.19 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 three Light Rail Transit (LRT) routes, the Blue Line from the Mission San Diego Station to San Ysidro at the International Border, the Orange Line from the Imperial and 12th Bayside Platform through Centre City and then east to Santee, and the Mission Valley Extension, known as the Green Line, which began service in July 2005. 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 274 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 on-going 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 regions' economy was estimated at $151.1 billion for FY 2005 (most recent estimate available). This was a growth of 6.6% percent, better than the state and national averages. MTS-area fixed-route ridership increased during FY 2006. The opening of the Mission Valley East line in July 2005 has added a 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 from 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, which consists of previous blue line stations from Old Town to Mission San Diego and the four new stations.

FINANCIAL MANAGEMENT

Pension Funds

MTS and SDTI contract with the California Public Employees Retirement System (PERS) to provide retirement plans for their employees. The employees of SDTC participate in the San Diego Transit Corporation Employee Retirement Plan, a single-employer public employee retirement plan.

Debt Administration

Capital Leases – MTS has two capitalized lease obligations with current year debt service of $450 thousand. One lease obligation is the result of a joint venture arrangement whereby the joint venture issued certificates of participation (COPs), and MTS services the debt through lease payments. The other is a lease purchase agreement for the acquisition of telecommunications equipment.

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 06 was $14 million. Two finance obligations are the result of Light Rail Vehicle (LRV) sale/leaseback and lease/leaseback transactions. 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. In addition, MTS issued Certificates of Participation to fund the automated fare collection project in 2003 and the regional transit management project in 2002.

Pension Obligation Bonds – MTS issued Taxable Pension Obligation Bonds in 2004 to reduce the unfunded liability in the SDTC retirement plan. This obligation is reported by SDTC.

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, 2006 are set forth in Note 4 to the financial statements.

Risk Management

MTS (including Taxicab Administration, SD&AE, 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 $600,000,000 for property damage.

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

November 30, 2006

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Year ended June 30, 2006

BOARD OF DIRECTORS

Members	Board position (elected position)
Harry Mathis	Chairman, since 1/06
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)
Ernest Ewin	Board Member, since 03/05 (Councilmember, City of La Mesa)
Kevin Faulconer	Board Member, since 1/06 (Councilmember, City of San Diego)
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)
Fred McLean	Board Member, since1/06, (Councilmember, City of Imperial Beach)
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)
Hal Ryan	Board Member, since 1/04 (Councilmember, City of Santee)
Tony Young	Board Member, since 1/05 (Councilmember, City of San Diego)

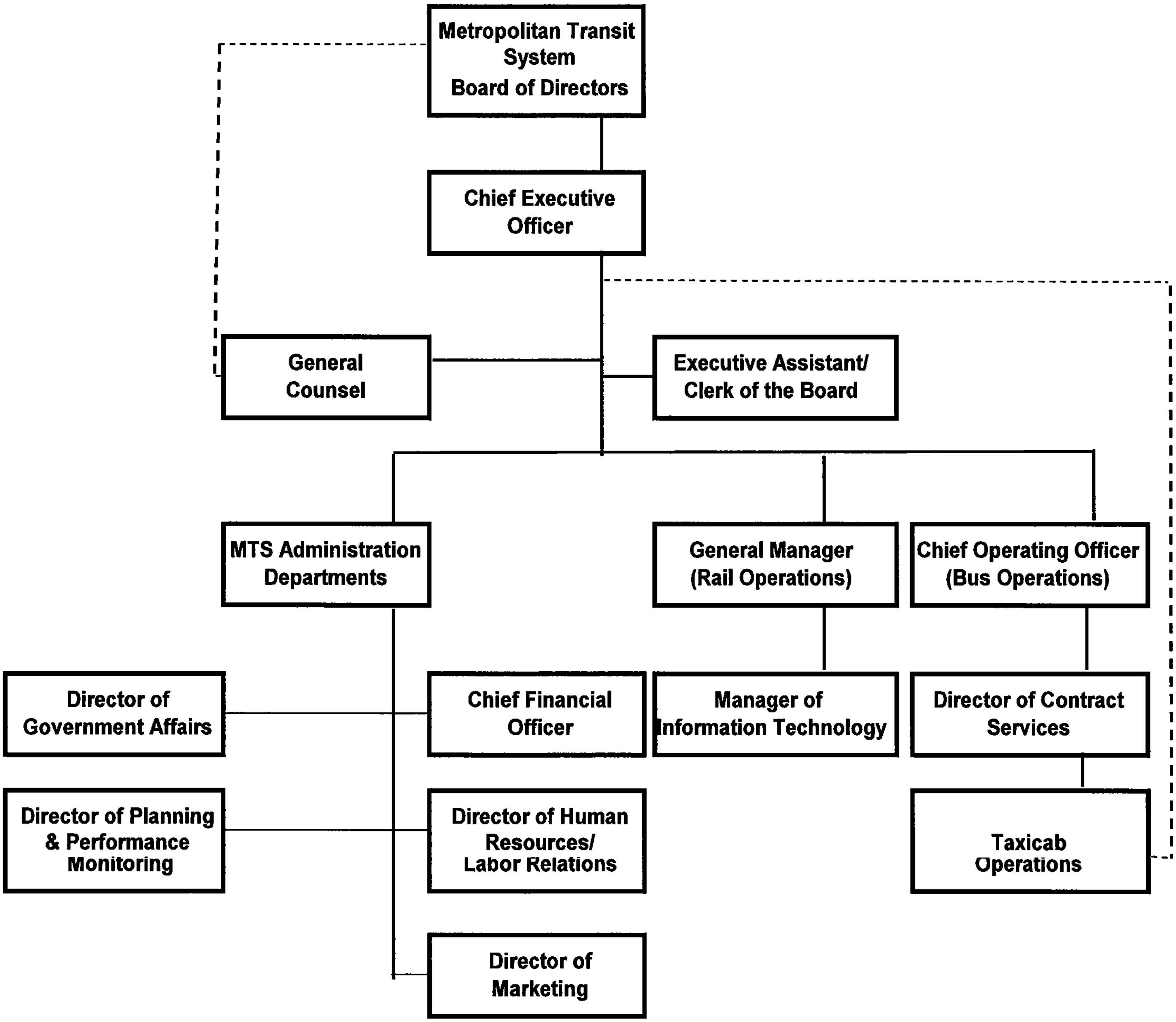
MTS MANAGEMENT

Staff	Position
Paul Jablonski	Chief Executive Officer, as of January 2004
Tiffany Lorenzen	General Counsel
Cliff Telfer	Chief Financial Officer
Claire Spielberg	Chief Operations Officer, Bus (SDTC)
Peter Tereschuck	President-General Manager, Rail (SDTI)
Conan Chung	Director, Planning and Performance Monitoring
Sharon Cooney	Director, Government Affairs and Community Relations
Susan Hafner	Director, Multimodal Operations City of San Diego
Robert Schupp	Director, Marketing and Communications
Jeff Stumbo	Director, Human Resources and Labor Relations

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Executive Level Organization Chart

Fiscal Year 2006



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FINANCIAL

SECTION

C&L
Caporicci & Larson
Certified Public Accountants

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
of the San Diego Metropolitan Transit System
San Diego, California

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, 2006, which collectively comprise MTS' basic financial statements as listed in the table of contents. These financial statements are the responsibility of MTS' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 basic financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic 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 MTS as of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with generally accepted accounting principles in the United States.

In accordance with *Government Auditing Standards,* we have also issued our report dated November 30, 2006, on our consideration of MTS' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

As described in Note 1 to the basic financial statements, MTS adopted the Governmental Accounting Standards Board Statements No. 44, *Economic Condition Reporting: the Statistical Section (an amendment of NCGA Statement 1),* No. 46, *Net Assets Restricted by Enabling Legislation (an amendment of GASB Statement No. 34)*, and No. 47, *Accounting for Termination Benefits.*

The accompanying Required Supplementary Information, such as Management's Discussion and Analysis, Budgetary Information and Schedule of Funding Progress of Defined Pension Plans, as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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.

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To the Board of Directors
of the San Diego Metropolitan Transit System
San Diego, California

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise MTS' basic financial statements. The accompanying Supplementary Information is presented for purpose of additional analysis and is not a required part of the basic financial statements. The Supplementary Information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. The Introductory and Statistical Sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Caporicci & Larson

San Diego, California
November 30, 2006

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Management's Discussion and Analysis

June 30, 2006

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, 2006. 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 $1,248 million as of June 30, 2006. Of this amount, $2.1 million is unrestricted. Total net assets decreased by $17.4 million.
- As of June 30, 2006, MTS' governmental funds reported combined ending fund balances of $182.5 million, a decrease of $5.3 million in comparison with an increase of $9.6 million the prior year. Of this amount, $4.1 million is unreserved.
- For the year ended June 30, 2006, 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 37.0%, compared to 35.5% for the previous year. A number of factors have brought about this increase, principally increased ridership and lower operating costs at San Diego Transit Corporation.

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) government-wide 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.

Government-wide financial statements. The government-wide 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 government-wide 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 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 government-wide 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 and Arizona Eastern Railway Company (SD&AE).

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 government-wide financial statements. However, unlike the government-wide 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 government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for governmental activities in the government-wide 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.

Proprietary funds. *Enterprise funds* (a proprietary fund type) are used to report the same functions presented as *business-type activities* in the government-wide 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 government-wide 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.

Notes to basic financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

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.

Government-Wide 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 $1,248 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. Most of the investment in capital assets is comprised of trolley system assets, buses, and construction-in-progress totaling $119.5 million, of which the largest projects currently under construction are the Automated Fare Collection System and the San Ysidro Intermodal Transit Center (currently $31.2 million and $27.5 million respectively). 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. In FY 2006 MTS transferred completed projects worth $483 million to SDTC, SDTI and Other Contracted Services Fund.

MTS has recorded prior period adjustments totaling $27,461,021 to properly state unearned revenue in Capital Projects and Debt Service Funds, and to properly state TransNet revenue in the TransNet Fund (see Note 15). SDTC has recorded a prior period adjustment totaling $704,362 to properly state the liability for compensated absences (see Note 15). All comparative schedules will be presented as restated by the prior period adjustment.

	Governmental Activities June 30, 2006	Governmental Activities (restated) June 30, 2005	Change
Current and other assets	$ 198,054,162	$ 257,977,676	$ (59,923,514)
Capital assets	154,290,529	615,618,669	(461,328,140)
Total assets	352,344,691	873,596,345	(521,251,654)
Long-term liabilities outstanding	173,812,181	220,449,815	(46,637,634)
Other liabilities	30,704,556	47,363,292	(16,658,736)
Total liabilities	204,516,737	267,813,107	(63,296,370)
Net assets (deficit):			
Invested in capital assets, net of related debt	111,959,506	420,667,651	(308,708,145)
Unrestricted	35,868,448	185,115,587	(149,247,139)
Total net assets	$ 147,827,954	$ 605,783,238	$ (457,955,284)

	Business-Type Activities June 30, 2006	Business-Type Activities (restated) June 30, 2005	Change
Current and other assets	$ 87,280,767	$ 94,064,838	$ (6,784,071)
Capital assets	1,134,242,639	695,486,022	438,756,617
Total assets	1,221,523,406	789,550,860	431,972,546
Long-term liabilities outstanding	95,630,429	97,828,047	(2,197,618)
Other liabilities	25,411,482	31,799,826	(6,388,344)
Total liabilities	121,041,911	129,627,873	(8,585,962)
Net assets (deficit):			
Invested in capital assets, net of related debt	1,134,242,639	695,486,022	438,756,617
Unrestricted	(33,761,144)	(35,563,034)	1,801,890
Total net assets	$ 1,100,481,495	$ 659,922,988	$ 440,558,507

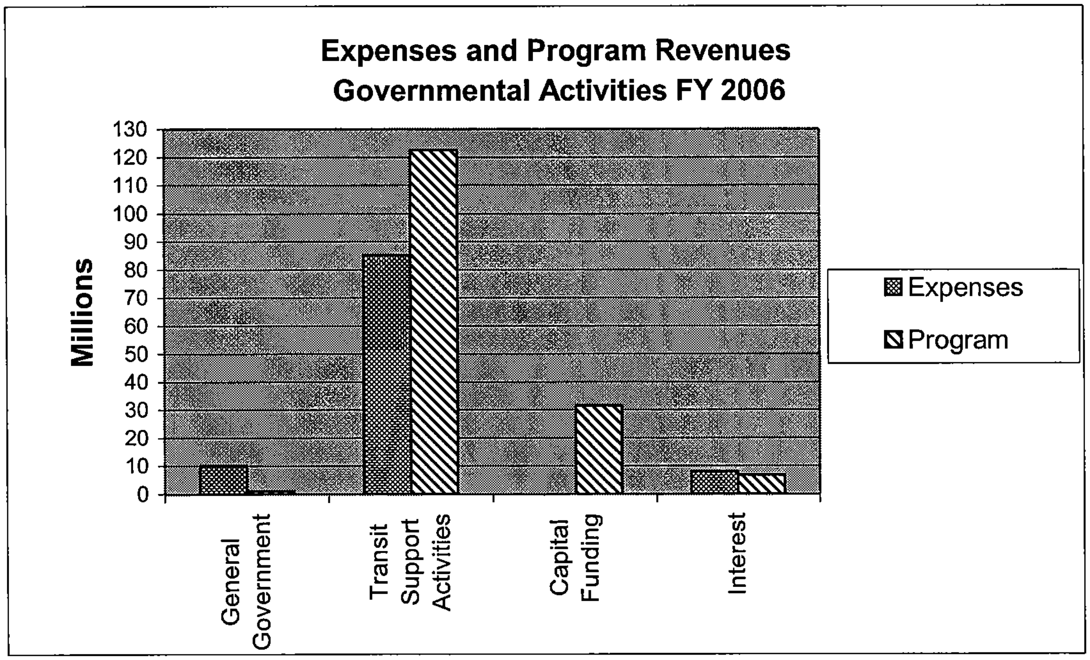
Governmental Activities. Governmental activities decreased MTS' net assets by $458 million. Key elements of this decrease are as follows:

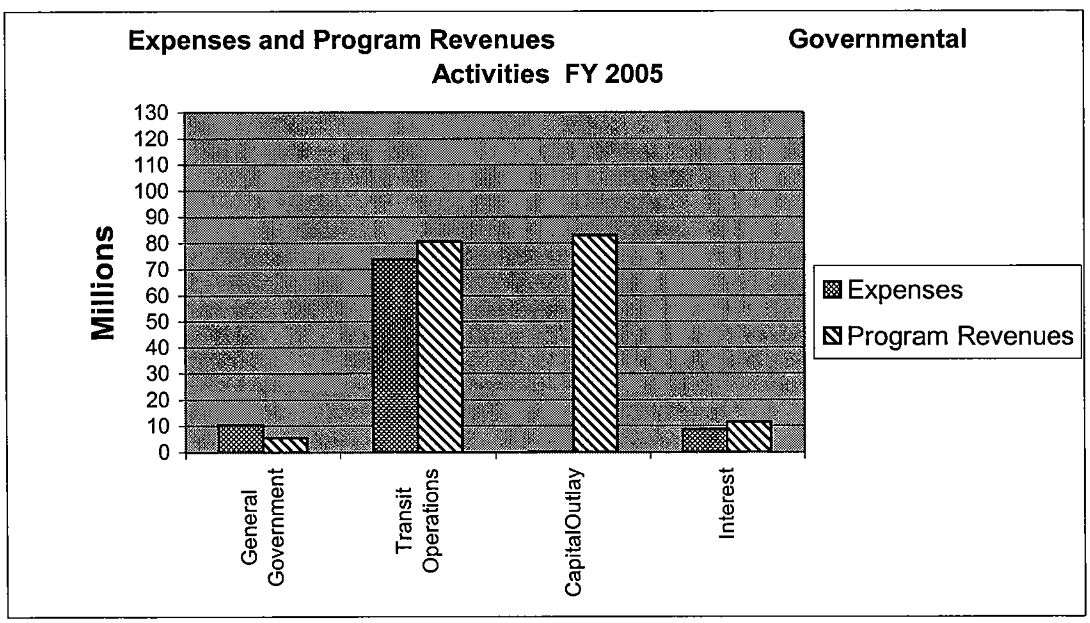
	2006 Governmental Activities	2005 Governmental Activities	Change
Revenues:			
Program revenues:			
Operating grants and contributions	$ 124,018,111	$ 86,270,079	$ 37,748,032
Capital grants and contributions	31,727,904	55,623,439	(23,895,535)
General revenues:			
Interest income	6,966,330	11,638,987	(4,672,657)
Indirect cost recovery	1,685,026	2,827,481	(1,142,455)
Total revenues	164,397,371	156,359,986	8,037,385
Expenses:			
General government	10,144,463	10,429,104	(284,641)
Transit operations funding	85,352,004	73,905,584	11,446,420
Transit capital funding	-	261,775	(261,775)
Misc office/other expense	34,502	-	34,502
Interest on long-term debt	8,136,111	8,669,729	(533,618)
Total expenses	103,667,080	93,266,192	10,400,888
Increase (decrease) in net assets before capital contributions and transfers	60,730,291	63,093,794	(2,363,503)
Capital contributions - SANDAG	895,826	946,278	(50,452)
Capital contributions - MTS	(483,169,381)	(21,679,153)	(461,490,228)
Transfers	(36,412,020)	(626,720)	(35,785,300)
Increase (decrease) in net assets	(457,955,284)	41,734,199	(499,689,483)
Net assets – Beginning of year as restated	605,783,238	564,049,039	41,734,199
Net assets – End of year	$ 147,827,954	$ 605,783,238	$ (457,955,284)

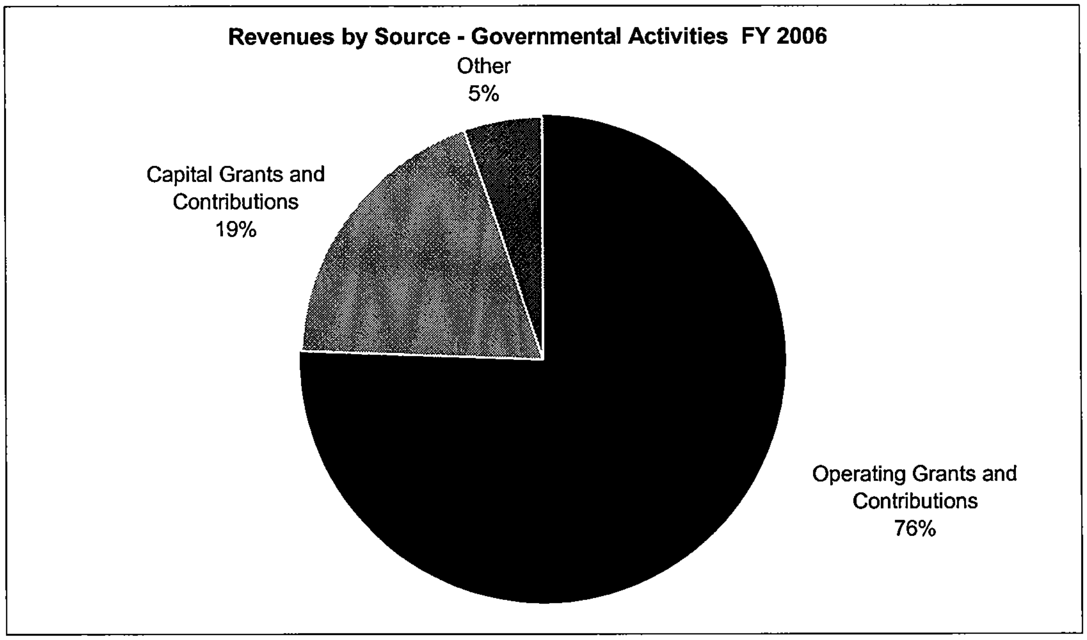
Capital and operating grants and contributions continue to be a major portion of the revenue used to fund transit operations and capital projects. Variances between FY 2006 and FY 2005 governmental activities are largely attributable to the $483 million contribution of completed capital projects to SDTC, SDTI and Other Contracted Services. The largest portion of this contribution, $481 million, consisted of the completed Mission Valley East project contributed to San Diego Trolley. In addition, there was a decrease in the current year subsidy for capital projects.

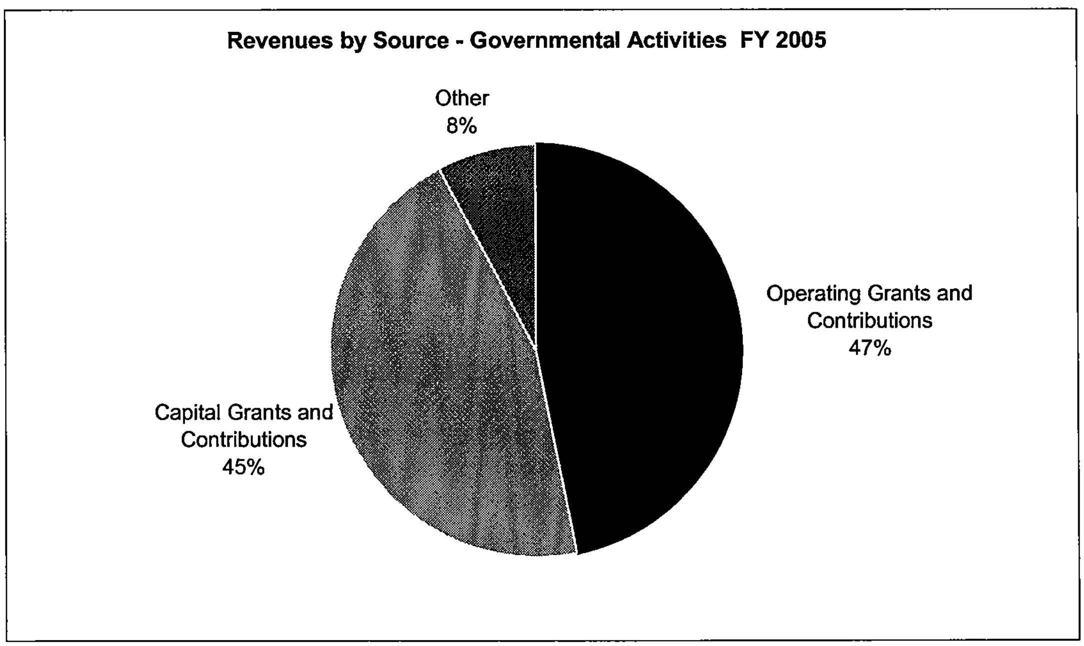
Variances between FY 2006 and 2005 business-type activities are due primarily to capital assets totaling $505 million contributed by MTS, SANDAG and others.

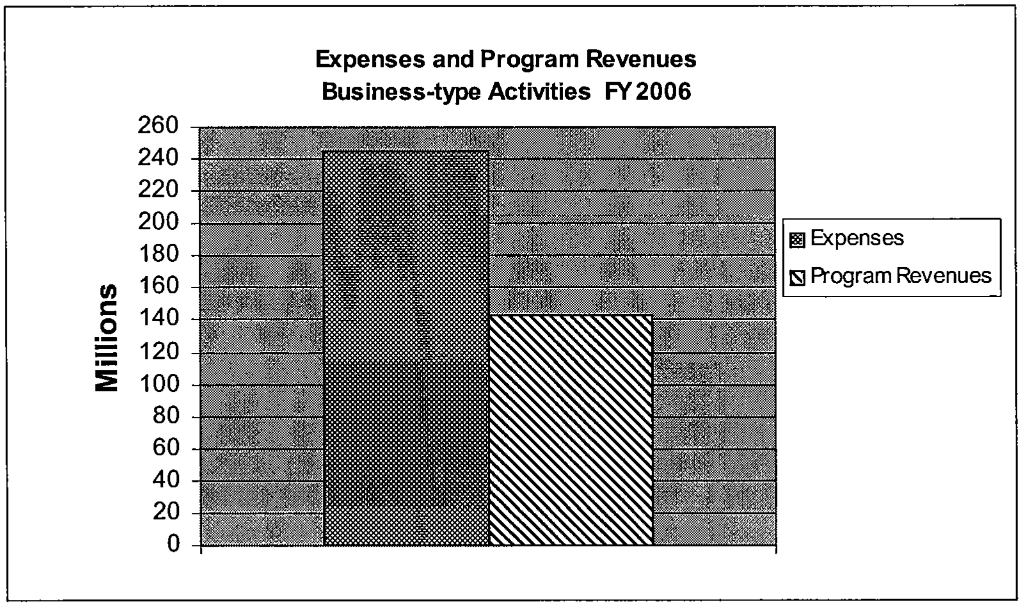
	2006 Business-Type Activities	2005 Business-Type Activities, as restated	Change
Revenues:			
Program revenues:			
Charges for services	$ 70,183,914	$ 66,055,549	$ 4,128,365
Operating grants and contributions	73,349,516	101,128,154	(27,778,638)
Total revenues	143,533,430	167,183,703	(23,650,273)
Expenses:			
Transportation	244,673,515	224,969,714	19,703,801
Total expenses	244,673,515	224,969,714	19,703,801
Increase (decrease) in net assets before capital contributions and transfers	(101,140,085)	(57,786,011)	(43,354,074)
Capital contributions-other	22,117,191	29,061,061	(6,943,870)
Capital contributions-MTS	483,169,381	21,679,153	461,490,228
Transfers	36,412,020	626,720	35,785,300
Increase in net assets	440,558,507	(6,419,077)	446,977,584
Net assets – beginning of year as restated	659,922,988	666,342,065	(6,419,077)
Net assets – end of year	$1,100,481,495	$ 659,922,988	$ 440,558,507

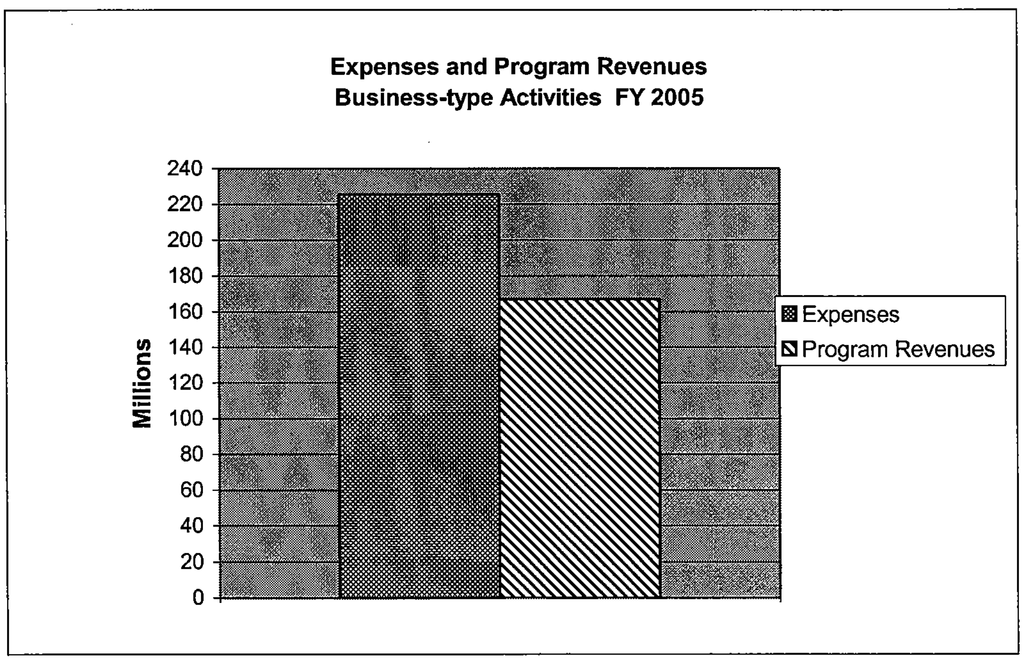

Expenses and Program Revenues
Governmental Activities FY 2006
Millions
130
120
110
100
90
80
70
60
50
40
30
20
10
0
General Government
Transit Support Activities
Capital Funding
Interest
Expenses
Program


Expenses and Program Revenues Governmental Activities FY 2005
Millions
130
120
110
100
90
80
70
60
50
40
30
20
10
0
General Government
Transit Operations
CapitalOutlay
Interest
Expenses
Program Revenues

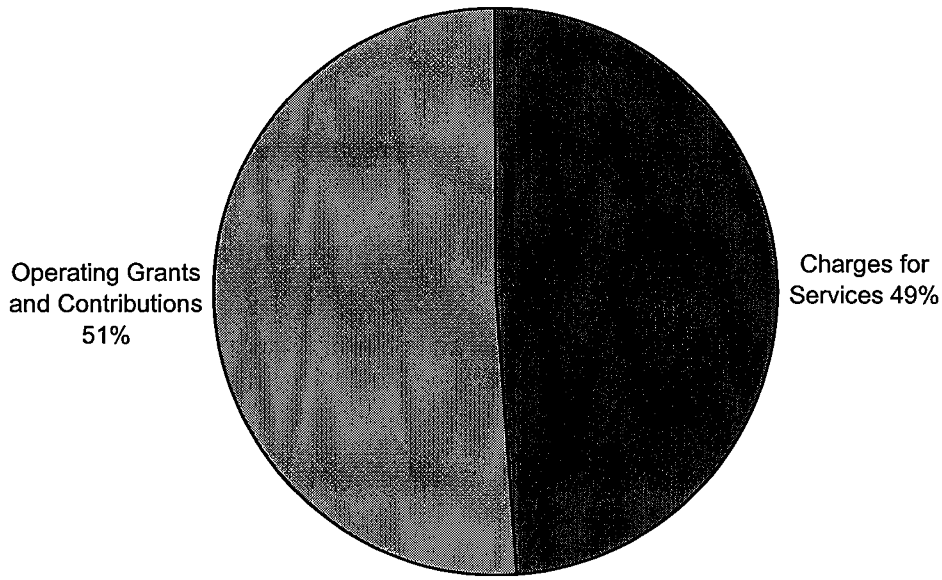

Revenues by Source - Governmental Activities FY 2006
Other
5%
Capital Grants and
Contributions
19%
Operating Grants and
Contributions
76%


Revenues by Source - Governmental Activities FY 2005
Other
8%
Operating Grants and
Contributions
47%
Capital Grants and
Contributions
45%

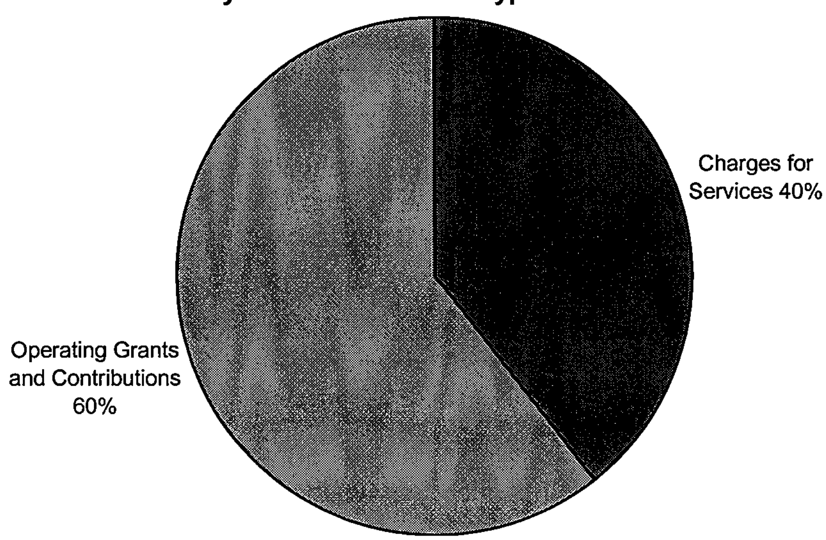

Expenses and Program Revenues
Business-type Activities FY 2006
Millions
260
240
220
200
180
160
140
120
100
80
60
40
20
0
Expenses
Program Revenues


Expenses and Program Revenues
Business-type Activities FY 2005
Millions
240
220
200
180
160
140
120
100
80
60
40
20
0
Expenses
Program Revenues

Revenues by Source - Business-type Activities FY 2006



Revenues by Source - Business-type Activities FY 2005



Financial Analysis of the Government's Funds

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

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 $182.5 million, a decrease of 2.8% in comparison with the prior year, due largely to the timing of capital project expenses and funding.

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. Revenues were $1.9 million favorable to budget due to unbudgeted indirect cost recovery. Expenditures were $1.0 million unfavorable to budget largely due to higher than planned pension costs.

The fund balance of MTS' General Fund increased by $670,000.

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 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 $21.1 million of which $10,000 is considered reserved because of third-party legal restrictions. The remainder $21.1 million is unreserved, of which $4.3 million is designated by the MTS Board for specific uses. The net increase in the fund balance during the current year was $3.9 million, which has increased the contingency reserve. 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 $19.7 million, all of which is considered unreserved, designated. The net increase in the fund balance during the current year was $22.7 million.

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 $37.7 million. The net decrease in the fund balance during the current year was $27.9 million, attributable to refunding of TransNet funds advanced from SANDAG in prior years and the timing of expenditures and grant receipts.

The Debt Service Fund is used to account for all the debt service incurred by MTS. The ending fund balance was $178.4 million, all of which is restricted for debt service purposes and is therefore considered reserved. The net decrease in the fund balance during the current year was $4.6 million as a result of scheduled debt service payments partially offset by interest income earned on invested funds.

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

The net assets balance of the Other Contracted Services Fund is $34.6 million, most of which is invested in capital assets. The remainder $182,000 is unrestricted. The total decrease in net assets for Other Contracted Services is approximately $2.8 million attributable to $6.2 million depreciation expense for the current year partially offset by receipt of $3.7 million in contributed capital assets.

The net assets balance in SDTI is $1,024 million, $1,031 million of which is invested in capital assets and the remaining $(6.4) million deficit is unrestricted. The total increase in net assets for 2006 is approximately $450.7 million, attributable to receipt of $501 million in contributed capital assets partially offset by depreciation expense totaling $50 million in the current year.

The net assets balance in SDTC is $40.7 million, $68.6 million of which is invested in capital assets and the remaining $(27.9) million deficit is unrestricted. The total reduction in net assets for 2006 is approximately $7.3 million due to current year depreciation expense totaling $8.4 million partially offset by receipt of $704,000 in contributed capital assets and a $704,000 prior period adjustment.

The net assets balance in non-major funds is $904,000, $487,000 of which is invested in capital assets and the remaining $417,000 is unrestricted. The total increase in net assets for 2006 is $3,000.

General Fund Budgetary Highlights

Differences between the General Fund original budget and the final amended budget were $646,000 increase in appropriations, summarized as follows:

- $568,000 decrease in the credit for allocated overhead
- $169,000 increase in outside services
- $65,000 increase in other general administrative expense, partially offset by:
- $156,000 decrease in personnel expense

In addition, the final amended budget included a $65,000 increase in other income.

Capital Asset and Debt Administration

Capital assets. MTS' investment in capital assets for its governmental and business-type activities as of June 30, 2006 amounts to $1,289 million (net of accumulated depreciation). This investment in capital assets includes land, buildings, vehicles, equipment, and construction-in-progress. MTS' investment in capital assets for governmental activities decreased by 76% in the current year, attributable to contribution of completed Mission Valley East project to San Diego Trolley.

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

- The Mission Valley East project was substantially completed and $481 million was contributed to San Diego Trolley.
- Construction continued on the 12th Avenue improvements with $400,000 expended in the current fiscal year, bringing the total construction-in-progress for these projects to $10.2 million.
- Construction continued on the San Ysidro Intermodal Transportation Center with $1.2 million expended in the current fiscal year, bringing the total construction-in-progress for this project to $26 million.

- Completed capital projects totaling $20.3 million were transferred from SANDAG to MTS and its component units during FY 2006.

CAPITAL ASSETS
(Net of depreciation)

	2006		
	Governmental Activities	Business-Type Activities	Total
Land	$ 21,957,196	$ 167,054,480	$ 189,011,676
Buildings	10,137,914	788,134,138	798,272,052
Vehicles	16,938	175,157,913	175,174,851
Equip & other	2,703,323	3,896,108	6,599,431
Construction-in-progress	119,475,158	-	119,475,158
Total	$ 154,290,529	$ 1,134,242,639	$ 1,288,533,168

	2005		
	Governmental Activities	Business-Type Activities	Total
Land	$ 21,957,196	$ 167,054,480	$ 189,011,676
Buildings	7,023,910	332,264,054	339,287,964
Vehicles	44,028	190,952,732	190,996,760
Equipment	3,247,684	5,214,756	8,462,440
Construction-in-progress	583,345,851	-	583,345,851
Total	$ 615,618,669	$ 695,486,022	$ 1,311,104,691

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 has two capital lease obligations outstanding in the amounts of $8.5 million and $320,000. In addition, MTS has five finance obligations outstanding relating to one sale/leaseback transaction entered into in 1990, one lease/leaseback transaction entered into in 1995, certificates of participation issued in fiscal years 2003 and 2004, and Pension Obligation Bonds issued in fiscal year 2005, for a total obligation of $247.5 million. In connection 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. The certificates of participation were issued in fiscal 2003 for $17.8 million to finance a regional transit management system to provide intelligent transportation system and radio communication services; and in fiscal 2004 for $32.9 million to finance the regional automated fare collection system project. The pension obligation bonds were issued in fiscal 2005 for $77.5 million to make a contribution to the SDTC retirement plan and reduce its unfunded liability.

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

Pension Obligation Bonds at Aaa in 2004. Additional information on MTS' long-term debt can be found in Note 8 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.

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BASIC FINANCIAL STATEMENTS

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GOVERNMENT-WIDE FINANCIAL STATEMENTS

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Statement of Net Assets
June 30, 2006

	Primary Government		
Assets	**Governmental Activities**	**Business - Type Activities**	**Total**
Current assets:			
Cash and cash equivalents	$ 782,337	$ 6,924,826	$ 7,707,163
Investments	475,798	-	475,798
Accounts and other receivables	733,408	5,682,153	6,415,561
Accounts receivable from other governments	38,785,089	2,494,352	41,279,441
Internal balances	3,517,807	(3,517,807)	-
Materials and supplies inventory	-	6,830,241	6,830,241
Prepaid items and other assets	2,486,873	111,358	2,598,231
Total current assets	46,781,312	18,525,123	65,306,435
Restricted assets:			
Cash and certificates of deposit restricted for capital support	6,187,781	-	6,187,781
Investments restricted for debt service	144,519,137	-	144,519,137
Total restricted assets	150,706,918	-	150,706,918
Noncurrent assets:			
Bond issuance costs, net of accumulated amortization	565,932	1,120,006	1,685,938
Capital assets, net of accumulated depreciation	154,290,529	1,134,242,639	1,288,533,168
Net pension asset	-	67,635,638	67,635,638
Total noncurrent assets	154,856,461	1,202,998,283	1,357,854,744
Total assets	352,344,691	1,221,523,406	1,573,868,097

See accompanying notes to basic financial statements.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Statement of Net Assets (Continued)
June 30, 2006

	Primary Government		
Liabilities	**Governmental Activities**	**Business-Type Activities**	**Total**
Current liabilities:			
Accounts payable	2,986,801	8,427,452	11,414,253
Accrued expenses	303,008	5,188,676	5,491,684
Compensated absences payable, due within one year	299,484	6,486,995	6,786,479
Retentions payable	117,673	10,000	127,673
Long-term debt, due within one year	21,502,476	1,455,000	22,957,476
Accrued damage, injury, and employee claims, due within one year	202,000	2,736,197	2,938,197
Unearned revenue	5,293,114	1,107,162	6,400,276
Total current liabilities	30,704,556	25,411,482	56,116,038
Liabilities payable from restricted assets:			
Retentions payable	6,187,781	-	6,187,781
Long-term debt	144,519,137	-	144,519,137
Total liabilities payable from restricted assets	150,706,918	-	150,706,918
Noncurrent liabilities:			
Compensated absences payable, due in more than one year	337,716	4,882,626	5,220,342
Accrued damage, injury, and employee claims, due in more than one year	8,074,503	16,127,803	- 24,202,306
Long-term debt, due in more than one year	14,693,044	74,620,000	89,313,044
Total noncurrent liabilities	23,105,263	95,630,429	118,735,692
Total liabilities	204,516,737	121,041,911	325,558,648
Net Assets			
Invested in capital assets, net of related debt	111,959,506	1,134,242,639	1,246,202,145
Unrestricted (deficit)	35,868,448	(33,761,144)	2,107,304
Total net assets	$ 147,827,954	$1,100,481,495	$1,248,309,449

See accompanying notes to basic financial statements.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Statement of Activities
Year Ended June 30, 2006

		Program Revenues			Net (Expense) Revenue and Changes in Net Assets — Primary Government		
Functions/Programs	**Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**	**Governmental Activities**	**Business-Type Activities**	**Total**
Primary government:							
Governmental activities:							
General government	$ 10,144,463	$ -	$ 1,182,150	$ -	$ (8,962,313)	$ -	$ (8,962,313)
Transit operations funding	85,352,004	-	122,835,961	-	37,483,957	-	37,483,957
Transit capital funding	-	-	-	31,727,904	31,727,904	-	31,727,904
Misc office/other expense	34,502	-	-	-	(34,502)	-	(34,502)
Interest on long-term debt	8,136,111	-	-	-	(8,136,111)	-	(8,136,111)
Total governmental activities	103,667,080	-	124,018,111	31,727,904	52,078,935	-	52,078,935
Business-type activities:							
Other Contracted Services	60,542,066	17,382,224	248,150	-	-	(42,911,692)	(42,911,692)
San Diego Transit	78,085,401	23,146,993	46,945,114	-	-	(7,993,294)	(7,993,294)
San Diego Trolley	105,069,741	28,675,661	26,156,252	-	-	(50,237,828)	(50,237,828)
Other proprietary funds	976,307	979,036	-	-	-	2,729	2,729
Total business-type activities	244,673,515	70,183,914	73,349,516	-	-	(101,140,085)	(101,140,085)
Total primary government	$ 348,340,595	$ 70,183,914	$ 197,367,627	$ 31,727,904	52,078,935	(101,140,085)	(49,061,150)
General revenues:							
Interest income					6,966,330	-	6,966,330
Indirect cost recovery					1,685,026	-	1,685,026
Capital contributions - other					895,826	22,117,191	23,013,017
Transfers of capital assets - MTS					(483,169,381)	483,169,381	-
Transfers					(36,412,020)	36,412,020	-
Total general revenues, capital contributions, and transfers					(510,034,219)	541,698,592	31,664,373
Change in net assets					(457,955,284)	440,558,507	(17,396,777)
Net assets, beginning of year as restated (see Note 15)					605,783,238	659,922,988	1,265,706,226
Net assets, end of year					$ 147,827,954	$1,100,481,495	$1,248,309,449

See accompanying notes to basic financial statements.

FUND FINANCIAL STATEMENTS

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GOVERNMENTAL FUND FINANCIAL STATEMENTS

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Balance Sheet and Reconciliation of the Governmental Funds Balance Sheet to the Government-Wide Statement of Net Assets

Governmental Funds

June 30, 2006

	Major Funds					
Assets	**General Fund**	**Subsidy Pass-Through Fund**	**TransNet Fund**	**Capital Projects Fund**	**Debt Service Fund**	**Total Governmental Funds**
Cash and cash equivalents	$ 382,932	$ 399,405	$ -	$ -	$ -	$ 782,337
Investments	35	-	475,763	-	-	475,798
Cash and certificates of deposit restricted for capital support	-	-	-	6,187,781	-	6,187,781
Accounts and other receivables	646,494	41,104	901	1,345	43,563	733,407
Accounts receivable from other governments	59,916	29,313,673	-	9,411,500	-	38,785,089
Due from other funds	12,182,831	2,300,138	21,252,143	-	34,066,335	69,801,447
Prepaid items and other assets	2,387,183	-	-	-	-	2,387,183
Investments restricted for debt service	-	-	-	-	144,519,137	144,519,137
Total assets	$ 15,659,391	$ 32,054,320	$ 21,728,807	$ 15,600,626	$ 178,629,035	$ 263,672,179

See accompanying notes to basic financial statements.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Balance Sheet and Reconciliation of the Governmental Funds Balance Sheet to the Government-Wide Statement of Net Assets
Governmental Funds
June 30, 2006

	Major Funds					
Liabilities and fund balances	**General Fund**	**Subsidy Pass-Through Fund**	**TransNet Fund**	**Capital Projects Fund**	**Debt Service Fund**	**Total Governmental Funds**
Liabilities						
Accounts payable	$ 1,674,471	$ 34	$ -	$ 1,312,296	$ -	$ 2,986,801
Accrued liabilities	303,007	-	-	-	-	303,007
Retentions payable	-	-	-	6,305,454	-	6,305,454
Due to other funds	12,500,014	10,969,702	-	42,813,924	-	66,283,640
Deferred revenue	191,352	-	2,041,952	2,836,725	223,085	5,293,114
Total liabilities	14,668,844	10,969,736	2,041,952	53,268,399	223,085	81,172,016
Fund balances:						
Reserved for:						
Debt service	-		-	-	178,405,950	178,405,950
Taxicab Administration	-	10,899	-	-	-	10,899
Unreserved:						
Designated in General Fund	990,547	-	-	-	-	990,547
Designated in Special Revenue Funds	-	4,257,689	19,686,855	-	-	23,944,544
Undesignated in Special Revenue Funds	-	16,815,996	-	-	-	16,815,996
Undesignated in Capital Projects Fund	-	-	-	(37,667,773)	-	(37,667,773)
Total fund balances	990,547	21,084,584	19,686,855	(37,667,773)	178,405,950	182,500,163
Total liabilities and fund balances	$ 15,659,391	$ 32,054,320	$ 21,728,807	$ 15,600,626	$ 178,629,035	$ 263,672,179

Reconciliation of the Governmental Funds Balance Sheet to the Government-Wide Statement of Net Assets

Fund balances - total governmental funds	$ 182,500,163
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.	154,290,529
Other long-term assets are not available to pay for current period expenditures and therefore are deferred in the funds.	665,622
Long-term liabilities, including debt payable, are not due and payable in the current period and therefore are not reported in the funds	(189,628,360)
Net assets of governmental activities	$ 147,827,954

See accompanying notes to basic financial statements.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
Year Ended June 30, 2006

	General Fund	Subsidy Pass-Through Fund	TransNet Fund	Capital Projects Fund	Debt Service Fund	Total Governmental Funds
Revenues:						
Federal funds	$ -	$ 37,803,640	$ -	$ 11,466,427	$ -	$ 49,270,067
Local TDA funds	-	76,086,231	-	-	-	76,086,231
STA funds	-	6,572,986	-	-	-	6,572,986
State funds	-	287,447	-	562,122	-	849,569
TransNet Funds	-	-	19,674,588	-	-	19,674,588
Other local subsidies	-	2,085,657	-	10,652	-	2,096,309
Other funds	1,182,150	-	-	14,115	-	1,196,265
Interest income	4,613	744,422	17,351	-	6,199,944	6,966,330
Indirect cost recovery	1,685,026	-	-	-	-	1,685,026
Total revenues	2,871,789	123,580,383	19,691,939	12,053,316	6,199,944	164,397,371
Expenditures:						
Current:						
General government:						
Personnel	10,827,530	-	-	-	-	10,827,530
Outside services	2,533,966	-	-	-	-	2,533,966
Allocated overhead	(6,946,173)	-	-	-	-	(6,946,173)
Materials and supplies	11,056	-	-	-	-	11,056
Energy	62,347					62,347
Insurance	523,828	-	-	-	-	523,828
General and administrative	493,433		9,703	2,752	66,805	572,693
Vehicle/facility lease	180,424	-	-	-	-	180,424
Interest	221,813	-	-	-	-	221,813
Transit operations funding	-	85,352,004	-	-	-	85,352,004
Debt service:						
Principal	-	-	-	-	14,493,119	14,493,119
Interest	-	-	-	-	8,113,899	8,113,899
Capital outlay:						
LRT extensions	-	-	-	10,462,914	-	10,462,914
Major LRT capital improvements	-	-	-	1,647,386	-	1,647,386
Major Bus capital improvements	-	-	-	4,515,558	-	4,515,558
Operations capital	-	-	-	703,831	-	703,831
Total expenditures	7,908,224	85,352,004	9,703	17,332,441	22,673,823	133,276,195
Excess (deficiency) of revenues over (under) expenditures	(5,036,435)	38,228,379	19,682,236	(5,279,125)	(16,473,879)	31,121,176
Other financing sources (uses):						
Transfers in	6,552,291	19,674,588	22,665,277	-	11,908,908	60,801,064
Transfers out	(846,165)	(54,027,054)	(19,674,588)	(22,665,277)	-	(97,213,084)
Total other financing sources (uses)	5,706,126	(34,352,466)	2,990,689	(22,665,277)	11,908,908	(36,412,020)
Net change in fund balances	669,691	3,875,913	22,672,925	(27,944,402)	(4,564,971)	(5,290,844)
Fund balances, beginning of year as restated (see Note 15)	320,856	17,208,671	(2,986,070)	(9,723,371)	182,970,921	187,791,007
Fund balances, end of year	$ 990,547	$ 21,084,584	$ 19,686,855	$ (37,667,773)	$ 178,405,950	$ 182,500,163

See accompanying notes to basic financial statements.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Governmental Funds Fund Balances
to the Government-Wide Statement of Activities
Year Ended June 30, 2006

Amounts reported for governmental activities in the statement of activities are different because:

Net change in fund balances-total governmental funds	$ (5,290,844)
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. This is the amount by which capital outlays exceeded depreciation in the current period.	16,095,036
Transfer of capital projects including Mission Valley East and other miscellaneous projects	(483,169,381)
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.	14,470,907
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.	(61,002)
Change in net assets of governmental activities	$ (457,955,284)

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PROPRIETARY FUND FINANCIAL STATEMENTS

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SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Statement of Net Assets
Proprietary Funds
June 30, 2006

	Business-Type Activities				
	Major funds				
Assets	**Other Contracted Services**	**San Diego Transit Corporation**	**San Diego Trolley Incorporated**	**Non-major funds**	**Totals**
Current assets:					
Cash and cash equivalents	$ -	$ 4,425,883	$ 2,474,083	$ 24,860	$ 6,924,826
Accounts and other receivables	65,736	4,544,622	1,071,795	-	5,682,153
Accounts receivable from other governments	2,494,352	-	-	-	2,494,352
Due from other funds	3,482,332	3,063,413	4,065,135	515,163	11,126,043
Materials and supplies inventory	-	2,152,630	4,677,611	-	6,830,241
Prepaid expenses and other current assets	-	49,614	2,657	59,087	111,358
Total current assets	6,042,420	14,236,162	12,291,281	599,110	33,168,973
Noncurrent assets:					
Capital assets (net of accumulated depreciation)	34,433,350	68,587,437	1,030,734,888	486,964	1,134,242,639
Unamortized bond issuance cost	-	1,120,006	-	-	1,120,006
Net pension asset	-	67,635,638	-	-	67,635,638
Total noncurrent assets	34,433,350	137,343,081	1,030,734,888	486,964	1,202,998,283
Total assets	40,475,770	151,579,243	1,043,026,169	1,086,074	1,236,167,256
Liabilities					
Current liabilities:					
Accounts payable	4,730,062	2,729,900	927,496	39,994	8,427,452
Accrued expenses	-	2,600,483	2,588,193	-	5,188,676
Retentions payable	10,000	-	-	-	10,000
Due to other funds	12,862	5,608,145	8,880,824	142,019	14,643,850
Compensated absences payable, due within one year	-	4,125,197	2,361,798	-	6,486,995
Accrued damage, injury, and employee claims due within one year	-	2,083,262	652,935	-	2,736,197
Long-term debt, due within one year	-	1,455,000	-	-	1,455,000
Unearned revenue	1,107,162	-	-	-	1,107,162
Total current liabilities	5,860,086	18,601,987	15,411,246	182,013	40,055,332
Noncurrent liabilities:					
Compensated absences payable, due in more than one year	-	4,882,626	-	-	4,882,626
Accrued damage, injury, and employee claims, due within one year	-	12,823,738	3,304,065	-	16,127,803
Long-term debt, due in more than one year	-	74,620,000	-	-	74,620,000
Total noncurrent liabilities	-	92,326,364	3,304,065	-	95,630,429
Total liabilities	5,860,086	110,928,351	18,715,311	182,013	135,685,761
Net Assets					
Invested in capital assets, net of related debt	34,433,350	68,587,437	1,030,734,888	486,964	1,134,242,639
Unrestricted	182,334	(27,936,545)	(6,424,030)	417,097	(33,761,144)
Total net assets	$ 34,615,684	$ 40,650,892	$1,024,310,858	$ 904,061	$1,100,481,495

See accompanying notes to basic financial statements.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Statement of Revenues, Expenses, and Changes in Fund Net Assets
Proprietary Funds
Year Ended June 30, 2006

	Business-Type Activities				
	Major funds				
	Other Contracted Services	San Diego Transit Corporation	San Diego Trolley Incorporated	Non-major funds	Totals
Operating revenues:					
Passenger revenue	$ 17,382,224	$ 22,263,739	$ 27,933,766	$ -	$ 67,579,729
Advertising	-	764,224	-	74,439	838,663
Charter	-	30,940	-	-	30,940
Misc operating revenue	-	88,090	741,895	904,597	1,734,582
Total operating revenues	17,382,224	23,146,993	28,675,661	979,036	70,183,914
Operating expenses:					
Personnel costs	591,160	48,594,596	29,055,215	-	78,240,971
Outside services	44,780,498	1,605,510	8,789,239	-	55,175,247
Allocated overhead	803,464	3,182,101	2,704,860	-	6,690,425
Materials and supplies	621,367	4,060,923	3,464,448	-	8,146,738
Energy	7,349,170	8,397,223	8,496,047	-	24,242,440
Risk management	67,487	2,214,674	2,272,079	-	4,554,240
General & administrative	125,596	192,380	232,711	934,440	1,485,127
Vehicle/facility leases	48,353	49,393	-	-	97,746
Amortization of net pension asset	-	1,415,000	-	-	1,415,000
Depreciation	6,154,971	8,373,601	50,055,142	41,867	64,625,581
Total operating expenses	60,542,066	78,085,401	105,069,741	976,307	244,673,515
Operating income (loss)	(43,159,842)	(54,938,408)	(76,394,080)	2,729	(174,489,601)
Public support and nonoperating revenues:					
Federal revenue	-	15,000,000	12,787,588	-	27,787,588
Transportation Development Act (TDA) funds	-	18,131,664	6,592,144	-	24,723,808
State Transit Assistance (STA) funds	-	5,283,210	823,132	-	6,106,342
State revenue - other	137,375	-	-	-	137,375
TransNet funds	-	13,104,889	6,000,000	-	19,104,889
Other local subsidies	455,476	278,001	-	-	733,477
Investment income	-	129,054	-	-	129,054
Interest expense	-	(3,385,151)	-	-	(3,385,151)
Debt service costs	-	(135,087)	-	-	(135,087)
Amortization of bond issuance costs	-	(52,365)	-	-	(52,365)
Gain/(loss) on disposal of assets	(344,701)	(1,409,101)	(46,612)	-	(1,800,414)
Total public support and nonoperating revenues	248,150	46,945,114	26,156,252	-	73,349,516
Income (loss) before transfers and capital contributions	(42,911,692)	(7,993,294)	(50,237,828)	2,729	(101,140,085)
Transfer of capital assets	3,693,951	704,024	500,888,597	-	505,286,572
Transfers in	36,412,020	-	-	-	36,412,020
Change in net assets	(2,805,721)	(7,289,270)	450,650,769	2,729	440,558,507
Net assets, beginning of year as restated (see Note 15)	37,421,405	47,940,162	573,660,089	901,332	659,922,988
Net assets, end of year	$ 34,615,684	$ 40,650,892	$ 1,024,310,858	$ 904,061	$ 1,100,481,495

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Statement of Cash Flows
Proprietary Funds
Year Ended June 30, 2006

	Business-Type Activities				
	Major funds				
	Other Contracted Services	San Diego Transit Corporation	San Diego Trolley Incorporated	Non-major funds	Totals
Cash flows from operating activities:					
Receipts from customers and users	$ 18,494,721	$ 25,952,463	$ 28,633,352	$ 788,110	$ 73,868,646
Payments to suppliers	(54,908,432)	(20,485,825)	(23,570,853)	(788,225)	(99,753,335)
Payments to employees	(591,160)	(49,845,277)	(27,911,264)	-	(78,347,701)
Payments for damage, injury, and employee claims	-	(2,657,691)	(2,509,687)	-	(5,167,378)
Net cash (used) by operating activities	(37,004,871)	(47,036,330)	(25,358,452)	(115)	(109,399,768)
Cash flows from noncapital financing activities:					
Transfers in	36,412,020	-	-	-	36,412,020
Public support funds received	592,851	48,418,803	26,915,959	-	75,927,613
Net cash provided by noncapital financing activities	37,004,871	48,418,803	26,915,959	-	112,339,633
Cash flows from capital and related financing activities:					
Proceeds from sale of capital assets	-	40,404	-	-	40,404
Net cash provided by capital and related financing activities	-	40,404	-	-	40,404
Cash flows from investing activities:					
Interest received on investments	-	129,054	-	-	129,054
Net increase (decrease) in cash and cash equivalents	-	1,551,931	1,557,507	(115)	3,109,323
Cash and cash equivalents, beginning of year	-	2,873,952	916,576	24,975	3,815,503
Cash and cash equivalents, end of year	$ -	$ 4,425,883	$ 2,474,083	$ 24,860	$ 6,924,826
Operating income (loss)	$ (43,159,842)	$ (54,938,408)	$ (76,394,080)	$ 2,729	$ (174,489,601)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:					
Depreciation	6,154,971	8,373,601	50,055,142	41,867	64,625,581
Prior period adjustment	-	704,362	-	-	704,362
(Increase) decrease in:					
Accounts and other receivables	1,549,332	2,805,470	(42,309)	(190,926)	4,121,567
Due from other funds	1,443,551	-	-	-	1,443,551
Materials and supplies inventory	-	22,066	324,009	-	346,075
Prepaid expenses	-	(8,394)	(2,657)	-	(11,051)
Increase (decrease) in:					
Accounts payable	(1,112,497)	(1,340,030)	936,704	(664)	(1,516,487)
Accrued expenses	-	(97,866)	(371,335)	-	(469,201)
Compensated absences payable	-	(967,131)	(818,433)	146,879	(1,638,685)
Accrued damage, injury, and employee claims	-	(1,590,000)	306,773	-	(1,283,227)
Deferred revenue	(1,880,386)	-	647,734	-	(1,232,652)
Total adjustments	6,154,971	7,902,078	51,035,628	(2,844)	65,089,833
Net cash provided (used) by operating activities	$ (37,004,871)	$ (47,036,330)	$ (25,358,452)	$ (115)	$ (109,399,768)

Supplemental noncash disclosures:
During the year $500,888,597, $704,024, and $3,693,951 in capital assets were contributed by MTS and SANDAG to SDTI, SDTC and Other Contracted Services, respectively.

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NOTES TO BASIC FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies

The accompanying basic financial statements of the San Diego Metropolitan Transit System (MTS) have been prepared in conformity with generally accepted accounting principles in the United States (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 (formerly San Diego Metropolitan Transit Development Board) 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, and 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. Beginning in FY 2004, SDTC and SDTI are presented as blended component units.

As required by GAAP, these basic financial statements present MTS and its legally separate component units, entities for which MTS is considered to be financially accountable. GASB Statement No. 14, *The Financial Reporting Entity,* discusses the criteria used to determine the reporting status of the primary government's component units. Because MTS appoints a majority of the component units' boards of directors, the boards are substantively the same, and MTS is able to impose its will on the component units, MTS presents blended component units. Blended component units, although legally separate entities, are, in substance, part of MTS' operations.

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 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. MTS' approval of the agreement extension is scheduled for December, 2006. 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 1255 Imperial Avenue, Suite 1000, San Diego, CA 92101.

San Diego Trolley, Inc.: San Diego Trolley, Inc. (SDTI) was 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. MTS' approval of the agreement extension is scheduled for December, 2006. 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 1000, 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) Government-Wide and Fund Financial Statements

The Government-Wide 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 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 Government-Wide 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, as listed below, 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 of 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:

Fare Revenue

Passenger fares make up approximately 30 percent of the system's $240 million operating budget.

Other Operating Revenues

MTS receives a variety of operating revenues that are not received directly from passenger fares. The sources of these revenues are advertising, interest income, rental and land management income, income related to Taxicab administration, income from the SD&AE, and other miscellaneous income.

Non Operating Revenues

MTS receives subsidies that are derived from federal, state and local tax revenues. MTS does not levy or collect any tax funds, but receives allocated portions of tax funds through federal, state and local granting agencies.

Federal Transit Administration (FTA)

FTA revenues are funded by a federal gas tax and revenues of the federal general fund. MTS receives Section 5307 grants which are earmarked for capital assistance and preventive maintenance, and Congestion Management and Air Quality (CMAQ) funds intended to subsidize the first three years' operations of trolley line extensions.

Transportation Development Act (TDA)

TDA provides funding for public transit operators. This state fund is one quarter of a percent of the 7 ¾ percent sales tax assessed in the region. SANDAG is responsible for apportionment of these funds within the San Diego region.

State Transit Assistance (STA)

STA funding comes from the Public Transportation Act (PTA) which derives its revenue from the state sales tax on gasoline. These funds are designated as discretionary or formula. The former is appropriated by the legislature. The latter is a formula based upon population and fares generated.

Other State Revenue

Caltrans provides mitigation related funding for the Sorrento Valley and Poway areas.

MediCal provides further funding support specifically tied to several ADA Paratransit routes to aid patients in their transportation to medical appointments.

TransNet

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 ordinance, which was scheduled to expire in 2008, has been extended an additional forty years. The ordinance allocated one-third of the sales tax proceeds for transit purposes, which are further divided between MTS and North County Transit District (NCTD) based on the proportion of the population with the area of each jurisdiction. TransNet funds are also apportioned by SANDAG.

Other Local Subsidies

The City of San Diego provides Maintenance of Effort funds to aid ADA efforts.

SANDAG provides funding from Fasttrack tolls to operate the I-15 Inland Breeze services.

The Air Pollution Control District (APCD) provides support for the Sorrento Valley Coaster Connection.

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 monies 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.

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.

MTS reports the Taxicab Administration fund and SD&AE combined as nonmajor proprietary funds.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed in both the government-wide 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.

In the current year MTS has changed the manner of reporting subsidy revenue and transfers among funds. All subsidies for operations, excluding TransNet receipts, are now recorded as revenues only in the Subsidy Pass-through Fund, and are then transferred to other funds as appropriate. This has increased revenue in the Subsidy Pass-through Fund and increased transfer activity in other funds. TransNet funds are recorded as revenue in the TransNet Fund, and are then transferred to other funds as appropriate. Comparisons with prior year activity show offsetting variances in revenue and transfer line items. There has been no change in the manner of recording subsidies related to capital projects.

As a general rule, the effect of interfund activity has been eliminated from the government-wide 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 Contracted Services Enterprise Fund are charges to customers for public transportation services. The principal operating revenues of the Taxicab Administration Enterprise Fund, a non-major enterprise fund, are charges for the issuance of taxi and jitney service permits. The principal operating revenues for SD&AE, also reported as a non-major enterprise fund, 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.

(d) Use of Restricted/Unrestricted Net Assets

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.

(e) 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.

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 re-appropriated in the following year.

(f) Cash, Cash Equivalents, 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. 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.

In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools,* investments were stated at fair value.

MTS participates in an investment pool managed by the State of California titled Local Agency Investment Fund (LAIF), which has invested a portion of the pool funds in structured notes and asset-backed securities. LAIF's investments are subject to credit risk with the full faith and credit of the State of California collateralizing these investments. In addition, these structured notes and assets-backed securities are subject to market risk and to change in interest rates. The reported value of the pool is the same as the fair value of the pool shares.

In accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3*), certain disclosure requirements, if applicable for deposit and investment risk, are specified for the following areas:

- Interest Rate Risk
- Credit Risk
    - Overall
    - Custodial Credit Risk
    - Concentration of Credit Risk
- Foreign Currency Risk

(g) Interfund Transactions

Activities between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the Government-Wide Financial Statements as "internal balances." Transfers between funds relate to allocations of subsidy revenue from special revenue funds to other funds.

(h) Materials and Supplies Inventory

Business-Type inventories are valued at the weighted average unit cost. The costs of governmental fund type inventories are recorded as expenditures when purchased.

(i) Prepaid Items and Other Assets

Payments made to vendors for services that will benefit periods beyond June 30, 2006 are recorded as prepaid items in both government-wide and fund financial statements.

(j) 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 government-wide 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 recorded as expenditures of the governmental funds and as assets in the government-wide 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' 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 capital 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 basic 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:

Assets	Years
Buildings and improvements	20 to 40
Vehicles	5 to 30
Equipment	3 to 20

(k) Construction-in-Progress

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

(l) Net Pension Assets

A pension asset is created when an employer pays into a retirement plan amounts in excess of its annual required contribution (ARC). The ARC is an actuarially calculated amount that is sufficient to fund future costs and extinguish any existing unfunded actuarial accrued liability (UAAL). In October 2004, MTS made a payment of $76,282,336 to SDTC Retirement Plan from the proceeds of the issuance of pension obligation bonds, of which $69,050,638 was to reduce SDTC's UAAL as calculated at that time. The prepaid Net Pension Asset will be amortized over the life of the bonds on a straight line basis.

(m) Compensated Absences

It is MTS' policy to permit employees to accumulate earned but unused personal leave time, which includes both vacation and sick pay benefits. All personal leave time is accrued when incurred in the government-wide and proprietary fund type financial statements. A liability for these amounts is reported in governmental funds only if they have matured.

(n) *Long-Term Obligations*

In the Government-Wide Financial Statements and in the Proprietary Fund Financial Statements, 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. Long-term debt is reported net of the applicable 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.

(o) *Fund Balances*

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.

(p) *Refunding of Debt*

Gains or losses occurring from advance refunding 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.

(q) *Use of Estimates*

The preparation of the basic financial statements in conformity with generally accepted accounting principles in the United States 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 reported period. Actual results could differ from these estimates.

(r) *Implementation of New GASB Pronouncements*

In fiscal year 2006 MTS adopted new accounting standards in order to conform to the following Governmental Accounting Standards Board Statements:

- GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section* – an amendment of NCGA Statement 1 (issued 5/04)
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation*
- GASB Statement No. 47, *Accounting for Termination Benefits*

GASB Statement No. 44 amends the portions of NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, which guide the preparation of the statistical section. The Statement improves the understandability and usefulness of statistical section information by addressing the comparability problems that have developed in practice and by adding information from the new financial reporting model for state and local governments required by Statement 34. MTS has elected to adopt GASB Statement No. 44 prospectively, and will present information for fiscal years 2006 and 2005.

GASB Statement No. 46 addresses selected issues and amends GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*. The Statement enhances the usefulness and comparability of net asset information and clarifies the meaning of legal enforceability. The Statement also specified accounting and financial reporting requirements for restricted net assets.

GASB Statement No. 47 provides accounting guidance for state and local governmental employers regarding benefits (such as early-retirement incentives and severance benefits) provided to employees that are terminated. The Statement requires recognition of the cost of involuntary termination benefits in the period in which a government becomes obligated to provide benefits to terminated employees.

(2) Reconciliation of Government-Wide and Fund Financial Statements

(a) Explanation of Certain Differences Between the Governmental Fund Balance Sheet and the Government-Wide 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 government-wide 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 $665,622 difference are as follows:

Prepaid interest	$ 99,690
Deferred issuance costs	565,932
Net adjustment to increase fund balance – total governmental funds to arrive at net assets – governmental activities	$ 665,622

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 $(189,628,360) difference are as follows:

Compensated absences payable	$ (637,200)
Accrued damage, injury, and employee claims	(8,276,503)
Long-term debt	(180,281,339)
Premium of debt payable	(433,318)
Net adjustment to reduce fund balance – total governmental funds to arrive at net assets - governmental activities	$ (189,628,360)

(b) Explanation of Certain Differences Between the Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances and the Government-Wide 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 government-wide statement of activities. One 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." The details of this $16,095,036 difference are as follows:

Contributed capital - SANDAG	$	895,826
Transit capital funding expense		17,374,447
Depreciation expense		(2,175,237)
Net adjustment to decrease net changes in fund balances – total governmental funds to arrive at changes in net assets – governmental activities	$	16,095,036

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 $14,470,907 difference are as follows:

Interest expense	$	147,496
Principal repayment		14,493,119
Amortization expense – bond issuance costs		(169,708)
Net adjustment to increase net changes in fund balances – total governmental funds to arrive at changes in net assets – governmental activities	$	14,470,907

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 $(61,002) difference are as follows:

Compensated absences	$	(98,002)
Damage, injury, and employee claims		37,000
Net adjustment to decrease net changes in fund balances – total governmental funds to arrive at changes in net assets – governmental activities	$	(61,002)

(3) Cash, Cash Equivalents, and Investments

A summary of cash and investments at June 30, 2006, was as follows:

	Governmental Activities	Business-Type Activities	Total
Cash and cash equivalents	$ 782,337	$ 6,924,826	$ 7,707,163
Investments	475,798	-	475,798
Cash and certificates of deposit restricted for capital support	6,187,781	-	6,187,781
Investments restricted for debt service	144,519,137	-	144,519,137
Total cash and investments	$ 151,965,053	$ 6,924,826	$ 158,889,879

Cash, cash equivalents, and investments consisted as follows on June 30, 2006:

Investment type	Fair value
Cash and equivalents:	
Demand deposits	$ 7,303,626
Retention Trust Account	6,187,781
State of California - Local Agency Investment Fund	403,536
Total cash and cash equivalents	$ 13,894,943
Investments:	
Money Market	13,911,852
U.S. Treasuries	24,911,858
U.S. Agencies	17,603,636
Bank Investment Contract	88,567,590
Total investments	$ 144,994,936
Total cash, cash equivalents, and investments	$ 158,889,879

At year end the carrying amount of demand deposits was $13,491,407 and the bank balance was $17,400,318, of which the total amount was collateralized or insured with securities held by the pledging financial institutions in MTS' name as discussed below.

MTS follows the practice of pooling cash and investments of all funds, except for funds required to be held by fiscal agents under the provisions of bond indentures.

Investments

Under the provisions of MTS' investment policy and in accordance with California Government Code, MTS is authorized to invest or deposit in the following:

- Securities of the U.S. Government, its agencies and instrumentalities
- Obligations of the State of California or any local agency within the state rated A or higher by Standard and Poor's Corporation or Moody's Investor Services, Inc.
- Repurchase agreements
- Bankers' acceptances
- Commercial paper rated A or higher by Standard and Poor's Corporation or Moody's Investor Services, Inc.
- Medium-term corporate notes rated A or higher by Standard and Poor's Corporation or Moody's Investor Services, Inc.
- Negotiable certificates of deposit
- Local Agency Investment Fund (LAIF) established by the State Treasurer
- San Diego County Pooled Money Fund
- Passbook savings or money market demand deposits with an FDIC, SIPC, or SAIF insured financial institution

Local Agency Investment Funds

MTS' investments with Local Agency Investment Fund (LAIF) at June 30, 2006, include a portion of the pool funds invested in Structured Notes and Asset-Backed Securities. These investments include the following:

- Structured Notes - debt securities (other than asset-backed securities) whose cash flow characteristics (coupon rate, redemption amount, or stated maturity) depend upon one or more indices and/or that have embedded forwards or options.
- Asset-Backed Securities - the bulk of which are mortgage-backed securities, entitle their purchasers to receive a share of the cash flows from a pool of assets such as principal and interest repayments from a pool of mortgages (such as CMO's) or credit card receivables.

LAIF is overseen by the Local Agency Investment Advisory Board, which consists of five members, in accordance with State statute.

As of June 30, 2006, MTS had $403,536 invested in LAIF which had invested 2.567% of the pool investment funds in Structured Notes and Asset-Backed Securities.

Interest Rate Risk

As a means of limiting its exposure to fair value losses arising from rising interest rates, MTS' investment policy limits investments to a maximum of five years unless otherwise approved by the Board. The investment instruments with maturities beyond five years are held for scheduled repayment of long-term debt. Maturities are scheduled to permit MTS to meet all projected obligations.

Credit Risk

MTS' investment policy limits investments in commercial paper and negotiable certificates of deposit to instruments rated A or better by Standard and Poor's or Moody's Investor Services, Inc. MTS' investments are rated by the nationally recognized statistical rating organizations as follows:

	Moody's	Standard and Poor's
Investment Pool		
State of California Local Agency Investment Fund	Not rated	Not rated
Money Market Account		
Highmark Money Market Account	AAA	AAA
Bank of New York	Not rated	Not rated
Government Obligations		
FHLMC	AAA	AAA
FNMA	AAA	AAA
US Government Securities		
U.S. Treasury Notes	AAA	AAA
U.S. Treasury Bonds	AAA	AAA
Resolution Funding Corporation Bonds	Not Rated	Not Rated
Investment Contract		
Rabobank Investment Contract	Not Rated	Not Rated

Concentration of Credit Risk

The investment policy limits the amount of the percentage of the portfolio that can be invested by the type of investment for certain types of investments. MTS is in compliance with investment type percentages of the total portfolio of the investment policy.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the broker or dealer to a transaction, a government will not be able to recover the value of its investments or collateral securities that are in the possession of another party. The California Government Code requires California banks and savings and loan associations to secure the MTS' cash deposits by pledging securities as collateral. This Code states that collateral pledged in this manner shall have the effect of perfecting a security interest in such collateral superior to those of a general creditor. Thus, collateral for cash deposits is considered to be held in MTS' name.

The market value of pledged securities must equal at least 110% of the MTS' cash deposits. California law also allows institutions to secure MTS deposits by pledging first trust deed mortgage notes having a value of 150% of the MTS' total cash deposits. MTS may waive collateral requirements for cash deposits which are fully insured up to $100,000 by the Federal Deposit Insurance Corporation. MTS, however, has not waived the collateralization requirements

Summary of investments to Maturity

Investments held by MTS grouped by maturity date at June 30, 2006, are shown below:

Maturity	
Current to one year	$ 27,986,126
One to two years	3,529,362
Two to five years	-
Five to ten years	24,911,858
Ten to twenty years	88,567,590
Total	$ 144,994,936

(4) Interfund Transactions

Due to and from other funds

MTS receives operating and capital assistance from federal, state, and local sources for the benefit of SDTC and SDTI. These funds are recorded as revenue in a special revenue fund and reported as expenditures when transferred to SDTC and SDTI. Expenses incurred for the benefit of other funds are recorded as interfund receivables and payables. Interfund receivable and payable balances, including amounts due from and to component units, at June 30, 2006 were as follows:

		Due from						
Due to/from primary government and component units	**General Fund**	**Subsidy Pass-Through Fund**	**Capital Projects Fund**	**Other Contracted Services**	**SDTC**	**SDTI**	**SD&AE**	**Total**
Due to								
General Fund	$ -	$ -	$ -	$ -	$3,302,007	$ 8,880,824	$ -	$ 12,182,831
Subsidy Pass-Through Fund	-	-	-	-	2,300,138	-	-	2,300,138
TransNet	12,236,969	4,128,945	4,886,229	-	-	-	-	21,252,143
Contract Services	-	-	3,476,332	-	6,000	-	-	3,482,332
Taxicab Administration	-	-	515,163	-	-	-	-	515,163
Debt Service	-	-	33,924,316	-	-	-	142,019	34,066,335
SDTC	253,062	2,805,511	-	4,840	-	-	-	3,063,413
SDTI	9,983	4,035,246	11,884	8,022	-	-	-	4,065,135
Total	$ 12,500,014	$ 10,969,702	$ 42,813,924	$ 12,862	$ 5,608,145	$ 8,880,824	$ 142,019	$ 80,927,490

Transfers In and Out

MTS receives operating and capital assistance from federal, state, and local sources for the benefit of other governmental funds. In FY 2006 MTS recorded all subsidy revenue in the Subsidy Pass-Through Fund and then transferred to other funds, including transfers totaling $36,412,020 recorded in the Contracted Services fund.

		Transfers out			
Transfer description	**General Fund**	**Subsidy Pass-Through Fund**	**TransNet Fund**	**Capital Projects Fund**	**Total**
Transfer in					
General Fund	$ -	$ 6,552,291	$ -	$ -	$ 6,552,291
Subsidy Pass-Through Fund	-	-	19,674,588	-	19,674,588
TransNet Fund				22,665,277	22,665,277
Debt Service Fund	846,165	11,062,743	-		11,908,908
Total primary government	846,165	17,615,034	19,674,588	22,665,277	60,801,064
Contracted Services Fund	-	36,412,020	-	-	36,412,020
Total business-type activities	-	36,412,020	-	-	36,412,020
Net transfers	$ 846,165	$ 54,027,054	$ 19,674,588	$ 22,665,277	$ 97,213,084

(5) Capital Assets

MTS adopted GASB Statement No. 42, *Accounting and Financial Reporting of Impairment of Capital Assets and Insurance Recoveries*, in FY 2005, which has no impact on current year reporting.

A. Governmental Activities

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

	Balance, July 1, 2005	Additions	Deletions	Balance, June 30, 2006
Capital assets, not depreciated:				
Land and right-of-way	$ 21,957,196	$ -	$ -	$ 21,957,196
Construction-in-progress	583,345,851	22,774,804	(486,645,497)	119,475,158
Total capital assets, not depreciated	605,303,047	22,774,804	(486,645,497)	141,432,354
Capital assets, depreciated:				
Buildings and structures	1,440,430	4,062,269	-	5,502,699
Non revenue vehicles	246,428	-	(30,026)	216,402
Equipment and other	294,688	-	-	294,688
Office equipment and furniture	1,319,147	651,636	(1,018,726)	952,057
Capital lease building	12,091,981	-	-	12,091,981
Computer equipment	4,302,865	-	-	4,302,865
Misc operations capital	-	36,921	-	36,921
Total capital assets, depreciated	19,695,539	4,750,826	(1,048,752)	23,397,613
Less accumulated depreciation for:				
Buildings and structures	(273,574)	(570,391)	-	(843,965)
Non-revenue vehicles	(202,398)	(27,090)	30,026	(199,462)
Equipment and other	(28,248)	(98,229)	-	(126,477)
Office equipment and furniture	(1,177,221)	(139,591)	985,690	(331,122)
Capital lease building	(6,234,927)	(377,874)	-	(6,612,801)
Computer equipment	(1,463,549)	(960,011)	-	(2,423,560)
Misc operations capital	-	(2,051)	-	(2,051)
Total accumulated depreciation	(9,379,917)	(2,175,237)	1,015,716	(10,539,438)
Total capital assets, depreciated, net	10,315,622	2,575,589	(33,036)	12,858,175
Governmental activities capital assets, net	$ 615,618,669	$ 25,350,393	$ (486,678,533)	$ 154,290,529

Depreciation expense in governmental activities for capital assets for the year ended June 30, 2006 was $2,175,237. MTS allocated the entire depreciation expense to general government. Disposals of construction-in-progress assets include $480,822,600 for the Mission Valley East project, which was completed in July 2005.

B. Business-Type Activities

A summary of changes in capital assets for Business-Type Activities is as follows:

	Balance, July 1, 2005	Additions	Deletions	Balance, June 30, 2006
Capital assets, not depreciated				
Land and right-of-way	$ 167,054,480	$ -	$ -	$ 167,054,480
Capital assets, depreciated:				
Buildings and structures	653,017,715	499,373,457	(695,130)	1,151,696,042
Vehicles and buses	342,317,021	5,759,347	(13,448,400)	334,627,968
Equipment and other	21,352,164	153,820	(4,432,302)	17,073,682
Total capital assets, depreciated	1,016,686,900	505,286,624	(18,575,832)	1,503,397,692
Less accumulated depreciation for:				
Buildings and structures	(320,753,661)	(43,503,373)	695,130	(363,561,904)
Vehicles and buses	(151,364,289)	(20,206,428)	12,100,662	(159,470,055)
Equipment and other	(16,137,408)	(915,780)	3,875,613	(13,177,575)
Total accumulated depreciation	(488,255,358)	(64,625,581)	16,671,406	(536,209,533)
Total capital assets, depreciated, net	528,431,542	440,661,043	(1,904,426)	967,188,159
Business-Type Activities – capital assets, net	$ 695,486,022	$ 440,661,043	$ (1,904,426)	$ 1,134,242,639

Depreciation expense in Business-Type Activities for capital assets for the year ended June 30, 2006 is composed of the following:

Other Contracted Services	$ 6,154,971
San Diego Transit Corporation	8,373,601
San Diego Trolley Inc.	50,055,142
Taxicab Administration	22,367
SD&AE	19,500
Total	$ 64,625,581

Capital asset additions totaling $505,286,624 were contributed by MTS, SANDAG, and others. The largest portion of the contribution is $480,822,600 for the completed Mission Valley East project.

C. Construction Commitments

Construction-in-progress is comprised of the following at June 30, 2006:

	Expended through June 30, 2006	Contractually Committed
Mission Valley E.	$ 11,889,192	$ 11,391,353
SYITC	27,497,243	1,684,481
Orange Line-Blue Line Connection	850,824	54,655
12th & Market Station Retrofit	8,838,438	694,750
12th Avenue Corridor Improvements	545,622	303,009
Regional Misc Oper Capital	4,752	82,150
Replace senior/disabled lift	3,631	-
Mills Building Rehab	47,723	23,147
Organizational desktops	42,551	14,162
Network Servers	48,532	10,816
LRV Body Rehab	498,842	1,027
CCTV Surveillance Equip	36,660	6,000
LRV Tires	10,130	348,469
San Ysidro Surveillance	8,583	16,000
MCS ADA Small Vehicles	17,776	4,511,461
Total MTS managed projects	50,340,499	19,141,480
Automated Fare Collection	31,174,775	-
SDTC Radio System Replacement	12,654,361	-
I-15 Bus Rapid Transit	11,315,478	-
SBMF Expansion	3,553,037	-
IAD Land Expansion	3,465,985	-
East County Bus Maintenance Facility	3,268,019	-
Nobel Drive Coaster Station Improvements	1,076,909	-
Gaslamp Station Improvements	537,775	-
Other projects	2,088,320	-
Total SANDAG managed projects	69,134,659	-
Total construction-in-progress	$ 119,475,158	$ 19,141,480

Additional costs related to the Mission Valley East project remain in Construction in Progress. These costs relate to accrucd liabilities and other expenses that are in process, and for which the total costs are not estimable at this time.

(6) Net Pension Asset

In August 2004, MTS issued the 2004 Taxable Pension Obligation Bonds to fund 85% of the SDTC's unfunded accrued actuarial liability (UAAL) and the normal cost reimbursement for the fiscal year 2006. As a result, the Pension Obligation Bonds of $77,490,000 were sold and $76,282,336 was deposited into the pension plan in October 2004. Of this amount $7,231,698 was funded for the current year contribution and $69,050,638 was funded for prior year unfunded accrued actuarial liability.

As of June 30, 2006, the Net Pension Asset amounted to $67,635,638. Current year amortization was $1,415,000.

(7) Revenue Anticipation Notes

In January 2005, MTS issued revenue anticipation notes totaling $13,161,676 to provide for operating cash need in FY 2005. The notes were general obligations of MTS and were payable from taxes, cash receipts, and other moneys of MTS. The notes paid interest at 2.0 % and were retired in January, 2006. Short-term activity for the year ended June 30, 2006 is summarized below.

	Balance at July 1, 2005	Proceeds	Repayment	Balance at June 30, 2006
Revenue Anticipation Notes	$ 13,161,676	$ -	$ (13,161,676)	$ -

(8) Long-Term Debt

A. Governmental Activities

The following is a summary of changes in long-term obligations for governmental activities for the year ended June 30, 2006:

	Balance at July 1, 2005	Additions and net increases	Reductions and net decreases	Balance at June 30, 2006	Amounts due within one year	Amounts due in more than one year
Governmental Activities:						
Long-term Debt						
Capitalized lease obligations	$ 8,940,118	$ 345,847	$ (449,942)	$ 8,836,023	$ 504,986	$ 8,331,037
Finance obligation	185,488,489	-	(14,043,173)	171,445,316	20,997,490	150,447,826
Deferred amounts for issuance premium	522,411	-	(89,093)	433,318	-	433,318
Total Long-term debt	194,951,018	345,847	(14,582,208)	180,714,657	21,502,476	159,212,181
Compensated absences payable	539,198	98,002	-	637,200	299,484	337,716
Accrued damage, injury, and employee claims	2,913,150	5,412,769	(49,416)	8,276,503	202,000	8,074,503
Governmental Activities long-term debt	$ 198,403,366	$ 5,856,618	$ (14,631,624)	$ 189,628,360	$ 22,003,960	$ 167,624,400

For governmental activities, compensated absences and damage claims liabilities are liquidated by the General Fund.

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 February 2006, MTS entered into a lease agreement with Toshiba America Information Systems for the acquisition of telecommunications equipment. The lease is classified as a capital lease because title will transfer to MTS when the lease terminates in January 2011.

The assets acquired through capital leases are as follows:

	Governmental Activities
Building – MTS Tower	$ 12,091,981
Toshiba telecommunications equipment	345,848
Less accumulated depreciation	(6,635,858)
Total	$ 5,801,971

The following is a summary of future minimum payments under capital leases as of June 30, 2006

	Tower lease payments	Toshiba equipmnet lease payments	Total lease payments
Year ending June 30:			
2007	$ 847,778	$ 76,820	$ 924,597
2008	847,750	76,820	924,570
2009	847,005	76,820	923,824
2010	843,070	76,820	919,890
2011	864,123	44,811	908,934
2012-2016	4,209,799	0	4,209,799
2017-2020	3,379,830	0	3,379,830
Total minimum lease payments	11,839,355	352,090	12,191,445
Less amount representing interest	(3,323,050)	(32,371)	(3,355,421)
Present value of minimum lease payments	$ 8,516,304	$ 319,719	$ 8,836,023

Finance Obligations

The following is a summary of changes in finance obligations for the year ended June 30, 2006:

	Balance at July 1, 2005	Additions and net increases	Reductions and net decreases	Balance at June 30, 2006	Amounts due within one year	Amounts due in more than one year
1990 LRV Sale/Leaseback	$ 15,878,727	$ -	$ (2,703,929)	$ 13,174,798	$ 9,351,404	$ 3,823,394
1995 LRV Lease/Leaseback	125,774,762	-	(999,244)	124,775,518	1,076,086	123,699,432
2002 San Diego Regional Transit Management System Project	10,985,000	-	(3,555,000)	7,430,000	3,660,000	3,770,000
2003 Regional Fare Collection Project	32,850,000	-	(6,785,000)	26,065,000	6,910,000	19,155,000
Total Finance Obligations	$ 185,488,489	$ -	$ (14,043,173)	$ 171,445,316	$ 20,997,490	$ 150,447,826

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 covered lease payments into 2006. 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, 2006, the remaining future obligations total $13,174,798.

	Principal	Interest	Total
Year ending June 30:			
2007	$ 9,351,404	$ -	$ 9,351,404
2008	3,823,394	-	3,823,394
	$ 13,174,798	$ -	$ 13,174,798

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 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 are sufficient to cover the amounts due under the finance obligation. As of June 30, 2006, the remaining future obligations total $124,775,518.

	Principal	Interest	Total
Year ending June 30:			
2007	$ 1,076,086	$ 6,518,871	$ 7,594,957
2008	1,158,836	6,432,956	7,591,792
2009	1,247,951	6,340,434	7,588,385
2010	1,343,918	6,240,797	7,584,715
2011	1,447,266	6,133,498	7,580,764
2012-2016	47,901,208	28,920,703	76,821,911
2017-2021	28,117,251	22,278,934	50,396,185
2022-2026	42,483,002	7,153,620	49,636,622
	$ 124,775,518	$ 90,019,813	$ 214,795,331

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 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, 2006, the outstanding balance is $7,430,000.

	Principal	Interest	Total
Year ending June 30:			
2007	$3,660,000	$168,000	$3,828,000
2008	3,770,000	56,550	3,826,550
	$7,430,000	$224,550	$7,654,550

2003 Regional Fare Collection Project - In fiscal year 2004, MTS issued $32,850,000 of Certificates of Participation (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, 2006, the outstanding balance is $26,065,000.

Year ending June 30:	Principal	Interest	Total
2007	$ 6,910,000	$ 632,180	$ 7,542,180
2008	6,545,000	477,813	7,022,813
2009	6,710,000	295,350	7,005,350
2010	5,900,000	97,350	5,997,350
	$ 26,065,000	$ 1,502,693	$ 27,567,693

B. Business-Type Activities

The following is summary of long-term debt for the Business-Type Activities for the year ended June 30, 2006

	Balance at at July 1, 2005	Additions and net increases	Reductions and net decreases	Balance at June 30, 2006	Amounts due within one year	Amounts due in more than one year
San Diego Transit Corporation						
Pension Obligation Bonds	$ 77,490,000	$ -	$ (1,415,000)	$ 76,075,000	$ 1,455,000	$ 74,620,000
Compensated absences payable	9,974,954	-	(967,131)	9,007,823	4,125,197	4,882,626
Accrued damage, injury and employee claims	16,497,000	-	(1,590,000)	14,907,000	2,083,262	12,823,738
San Diego Transit Corporation long-term debt	$ 103,961,954	$ -	$ (3,972,131)	$ 99,989,823	$ 7,663,459	$ 92,326,364
San Diego Trolley, Inc.						
Compensated absences payable	$ 2,321,724	$ 40,074	$ -	$ 2,361,798	$ 2,361,798	$ -
Accrued damage, injury and employee claims	3,861,000	96,000	-	3,957,000	652,935	3,304,065
San Diego Trolley, Inc; long-term debt	$ 6,182,724	$ 136,074	$ -	$ 6,318,798	$ 3,014,733	$ 3,304,065
Total	$ 110,144,678	$ 136,074	$ (3,972,131)	$ 106,308,621	$ 10,678,192	$ 95,630,429
Reconciliation to Statement of Net Assets						
Bonds payable	$ 77,490,000	$ -	$ (1,415,000)	$ 76,075,000	$ 1,455,000	$ 74,620,000
Compensated absences	12,296,678	40,074	(967,131)	11,369,621	6,486,995	4,882,626
Accrued damage, injury, and employee claims	20,358,000	96,000	(1,590,000)	18,864,000	2,736,197	16,127,803
Business-Type Activities long-term debt	$ 110,144,678	$ 136,074	$ (3,972,131)	$ 106,308,621	$ 10,678,192	$ 95,630,429

Pension Obligation Bonds

In October 2004, MTS issued $77,490,000 of Taxable Pension Obligation Bonds (POBs) for the benefit of SDTC. The purpose of the bonds was to make contributions to the San Diego Transit Corporation Retirement Plan and reduce its unfunded liability. This is in essence a hedge versus the assumed investment rate of 8% used by the actuary to determine the Actuarial Accrued Liability. The proceeds less fees were invested into the retirement plan. The bonds are consisted of the following:

Series A Bonds of $38,690,000 are fixed rate bonds that mature in annual installments between 2006 and 2014 and bear an interest rate from 2.58% to 5.15% increasing progressively over the maturities. Interest is due and payable semi-annually on June 1 and December 1. Principal is due and payable on December 1.

Series B Bonds of $38,800,000 are variable rate bonds that mature in annual installments between 2024 to 2034. Interest is adjusted on a weekly basis indexed to London Interbank Borrowing Rate (Libor) and payable on a monthly basis. In August 2005, MTS entered into a seven year agreement with UBS investment bank to fix the interest at 4.424%. Under this agreement SDTC pays the variable Libor rate and UBS pays or bills for the difference from the fixed 4.424% rate.

At June 30, 2006, the outstanding balance of the Pension Obligation Bonds is $76,075,000.

Year ending June 30:	Principal	Interest	Total
2007	$ 1,455,000	$ 3,412,447	$ 4,867,447
2008	1,500,000	3,366,020	4,866,020
2009	1,555,000	3,313,432	4,868,432
2010	1,615,000	3,254,351	4,869,351
2011	1,685,000	3,188,891	4,873,891
2012-2016	9,605,000	14,632,537	24,237,537
2017-2021	12,195,000	12,004,384	24,199,384
2022-2026	15,665,000	8,542,122	24,207,122
2027-2031	19,900,000	4,608,933	24,508,933
2032-2034	10,900,000	584,536	11,484,536
	$ 76,075,000	$ 56,907,653	$ 132,982,653

(9) Risk Management

MTS (including SDTI, SDTC, SD&AE, Taxicab Administration and Other Contracted Services) are 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 earthquake) insurance coverage for property damage up to $600,000,000 per occurrence with deductibles ranging from $25,000 to $100,000, depending on the peril involved. In addition, MTS, SDTC, and SDTI are self-insured for costs arising from employee workers' compensation act benefit claims including employer's liability to a retained limit of $1,000,000 per occurrence. Amounts in excess of $1,000,000 are insured up to $2,000,000 per occurrence. 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 up to $2,000,000 per incident were recorded as general and administrative expenses in the statements of revenues, expenses, and changes in net assets. 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:				
2003 – 2004	$ 13,885,205	$ 11,724,554	$ (4,870,648)	$ 20,739,111
2004 – 2005	20,739,111	7,090,185	(4,558,146)	23,271,150
2005 – 2006	23,271,150	6,692,772	(2,823,419)	27,140,503

Following is summary of accrued damage injury, and employee claims for Governmental Activities and Business-Type Activities for fiscal year 2004-2006:

Accrued damage, injury, and employee claims	Governmental Activities	Business-Type Activities	Total
Current portion	$ 202,000	$ 2,736,197	$ 2,938,197
Non-current portion	8,074,503	16,127,803	24,202,306
Total	$ 8,276,503	$ 18,864,000	$ 27,140,503

MTS has established a policy to consolidate the minimum balances required in the liability claims reserve accounts of SDTC and SDTI to be held by MTS. The policy also established eligible uses for the MTS reserve account, which included the reimbursement to SDTC and SDTI of awards/settlements of individual liability claims for personal injury and/or property damage in excess of $300,000, but within the self-insurance retention at SDTC and SDTI. In connection with these self-insurance programs, liabilities for SDTC, SDTI and MTS were $27,140,503 and June 30, 2006.

At June 30, 2006, The Board designated $2,000,000 for the purposes of funding the future claims liabilities of MTS, SDTI, and SDTC. As a result, $990,547 of the General Fund balance and $1,009,453 of the Subsidy-Pass Through Fund are designated for payment of future claims liabilities.

(10) Contingencies

MTS, SDTC, and SDTI have been named in certain legal actions pending at June 30, 2006. While 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. In addition, MTS has been named in a number of claims related to various construction projects. While the outcome of these claims is not presently determinable, MTS has recorded an estimated liability to reserve for a potential loss of $8,000,000.

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.

Federal arbitrage regulations require analysis of bonds more than five years old. Pursuant to these requirements, MTS will perform arbitrage analysis of its bonds in FY 2007. Management has determined that MTS' liability related to arbitrage, if any, is not material and has not recorded a liability in the current year.

During 1990 and 1995, MTS entered into sale/leaseback and lease/leaseback arrangements related to the acquisition of 52 trolley cars. This agreement provided tax benefits for the purchaser/lessor. Certain terms of the agreements 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. Subsequent changes in Internal Revenue Code may cause an amount to be repaid to the purchaser/lessor. No repayment has been requested to date, and the amount of any future request is not estimable at this time.

(11) Reserves

The reservations of fund balances of MTS' governmental funds at June 30, 2006 consist of:

	Reserved	Designated	Undesignated	Total fund balance
Major Governmental Funds:				
General Fund				
Insurance	$ -	$ 990,547	$ -	$ 990,547
Subsidy Pass-Through Special Revenue Fund:				
Billboard – San Diego	-	249,866	-	249,866
Billboard – Chula Vista	-	672,769	-	672,769
CCDC	-	922,692	-	922,692
Contingency	-	-	16,413,218	16,413,218
Insurance	-	1,009,453	-	1,009,453
Land management	-	-	402,778	402,778
MTS Building	-	493,988	-	493,988
SD&AE	-	908,921	-	908,921
Taxicab Administration capital replacement	10,899	-	-	10,899
TransNet Fund	-	19,686,855	-	19,686,855
Capital Projects Fund	-	-	(37,667,773)	(37,667,773)
Debt Service Fund	178,405,950	-	-	178,405,950
	$ 178,416,849	$ 24,935,091	$ (20,851,777)	$ 182,500,163

Board policy requires a minimum funding level of $2,000,000 in the insurance reserve. When this reserve falls below the minimum funding level, Board policy requires replenishment in the following budget cycle.

(12) Post-Employment Health Care Benefits

In 1992, pursuant to requirements of the state retirement system in which MTS participates, MTS adopted a policy to provide post-retirement health care 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, 2006 were $18,155. There are eight retirees currently receiving post-employment health care benefits. SDTC provides post-retirement health care benefits to all retired employees through a self-insured program. Total payments for the year ended June 30, 2006 were $256,959 for 48 retirees. SDTI, through a separate agreement with California Public Employees Retirement System, provides post-retirement health care benefits to all retired employees. Total payments for the year ended June 30, 2006 were $29,224 for 15 retirees.

(13) 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 2006, 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 third anniversary, after which SDTI pays their full contribution. Prior to January 1, 1992, SDTI paid half the employee contribution for non-managerial employees. As of January 1, 1992, the non-managerial employees pay the entire contribution.

Annual Pension Cost

For fiscal year 2006, MTS' and SDTI's annual required employer contributions were $1,266,643 and $2,313,877, respectively. The required contribution for fiscal year 2006 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) 7.75% investment rate of return (net of administrative expenses); (b) projected salary increases from 3.25% to 14.45% depending on age, service, and type of employment; (c) 3.25% payroll growth adjustment; (d) 3.0% inflation adjustment; and (e) a merit scale varying by duration of employment coupled with an assumed annual inflation component of 3.0% 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 fifteen-year period depending on the size of investment gains and/or losses. MTS' and SDTI's initial unfunded actuarial accrued liability (or excess assets) is being amortized as a level percentage of projected payroll on a closed basis depending on the plan's date of entry. Subsequent gains and losses are amortized over variable periods depending on the events precipitating the gain or loss. The average remaining amortization period at June 30, 2005, the most recent valuation date, was 15 years for MTS and 27 years for SDTI.

Trend information for MTS (in 000s):

	Annual Required Contribution (ARC)	Actual Contribution	Percentage of APC Contributed
Fiscal year ended June 30:			
2004	$ -	$ -	100%
2005	653	653	100%
2006	1,267	1,267	100%

Trend information for SDTI (in 000s):

	Annual Required Contribution (ARC)	Actual Contribution	Percentage of APC Contributed
Fiscal year ended June 30:			
2004	$ 727	$ 727	100%
2005	2,015	2,015	100%
2006	2,314	2,314	100%

B. SDTC

Plan Description

The SDTC defined benefit pension plan provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. 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, 1255 Imperial Avenue, Suite 1000, San Diego, CA 92101

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) 8.00% investment rate of return, (b) projected salary increase of 3.5% to 11% depending on age, service, and type of employment; (d) 3.5% inflation adjustment; and (e) cost of living adjustments up to 2% annually for certain Non-Contract members only. The actuarial value of the assets of the plan was determined using a technique that smoothes the effect of short-term volatility in the market value of investments over a five-year period depending on the size of investment gains and/or losses. SDTC's initial unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on a open basis. Subsequent gains and losses are amortized over variable periods depending on the events precipitating the gain or loss. The average remaining amortization period at January 1, 2006, the most recent valuation date, was 30 years.

Annual Pension Cost

For fiscal year ended June 30, 2006, the annual pension cost of $3,825,590 for the pension plan was equal to SDTC's required and actual contributions. The required contribution was determined as part of the January 1, 2005 actuarial valuation using the entry age normal cost method. Following is the most recent data available.

Trend information for SDTC (in 000s):

	Annual Required Contribution (ARC)	Actual Contribution	Percentage of APC Contributed
Fiscal year ended June 30:			
2004	$ 6,018	$ 5,493	91%
2005	7,232	76,282	1055%
2006	3,826	3,826	100%

(14) Other Required Individual Fund Disclosures

SDTC and SDTI had unrestricted net deficits of $(27,936,545) and $(6,424,030) respectively, at June 30, 2006. 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 a deficit fund balance of $(37,667,773) which is results from recording bond proceeds, which were intended to provide funding for certain capital projects, in the Debt Service Fund rather than the Capital Projects Fund, and from timing differences between project expenses and receipt of subsidy funding for those projects.

(15) Prior Period Adjustment

A. In FY 2005 SDTC reported compensated absences at an amount higher than was vested and due to employees. In the current year SDTC has recorded a prior period adjustment in the amount of $704,362.

	Beginning net assets as originally reported	Prior period adjustment to compensated absences	Beginning net assets as restated
Other contracted services fund	$ 37,421,405	$ -	$ 37,421,405
San Diego Transit Corporation	47,235,800	704,362	47,940,162
San Diego Trolley, Inc.	573,660,089	-	573,660,089
Non-major proprietary funds	901,332	-	901,332
Total proprietary funds	$ 659,218,626	$ 704,362	$ 659,922,988

B. In FY 2006 MTS has recorded prior period adjustments totaling $27,461,021 in governmental funds consisting of the following:

(1) In FY 2005 MTS reported unearned revenue at an amount that was lower than the actual amount. In the current year MTS has recorded a prior period adjustment in the amount of $461,021.

(2) In FY 2004 MTS received an advance of funds from SANDAG in anticipation of receiving TransNet funds at a later date. These funds were recorded as revenue rather than as a liability. In the current year MTS has recorded a prior period adjustment in the amount of $27,000,000.

	Beginning fund balance as originally reported	Prior period adjustments		Beginning fund balance as restated
		Unearned revenue	Advance payable	
General fund	$ 320,856	$ -	$ -	$ 320,856
Subsidy pass-through fund	17,208,671	-	-	17,208,671
TransNet fund	24,013,930	-	(27,000,000)	(2,986,070)
Capital projects fund	(9,544,162)	(179,209)	-	(9,723,371)
Debt service fund	183,252,733	(281,812)	-	182,970,921
Total changes to governmental funds	$ 215,252,028	$ (461,021)	$ (27,000,000)	$ 187,791,007

C. The combined effect of prior period adjustments as presented in the government-wide financial statements is summarized below:

	Beginning net assets as originally reported	Prior period adjustments	Beginning net assets as restated
Governmental activities	$ 633,244,259	$ (27,461,021)	$ 605,783,238
Business-type activities	659,218,626	704,362	659,922,988
Total primary government	$ 1,292,462,885	$ (26,756,659)	$ 1,265,706,226

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REQUIRED SUPPLEMENTARY INFORMATION

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Required Supplementary Information

For the year ended June 30, 2006

1. BUDGETARY INFORMATION

Legal Compliance – Budgets

MTS' budgets are prepared on the modified accrual basis of accounting consistent with GAAP. 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.

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	$	646,667
Subsidy Pass-Through Special Revenue Fund	$	(994,351)

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
General Fund
Schedule of Revenues, Expenditures and Changes in Fund Balances – Budget and Actual
Year Ended June 30, 2006

	Budgeted Amounts			
	Original	**Final**	**Actual Amounts**	**Variance with Final Budget – Positive (Negative)**
Revenues:				
Other income	$ 865,110	$ 930,110	$ 1,182,150	$ 252,040
Interest income	-	-	4,613	4,613
Indirect cost recovery	-	-	1,685,026	1,685,026
Total revenues	865,110	930,110	2,871,789	1,941,679
Expenditures:				
Current:				
General government:				
Personnel	8,172,959	8,017,373	10,827,530	(2,810,157)
Outside services	3,128,763	3,298,225	2,533,966	764,259
Allocated overhead	(7,513,863)	(6,946,172)	(6,946,173)	1
Materials and supplies	46,500	43,500	11,056	32,444
Energy	153,124	172,224	62,347	109,877
Insurance	729,739	729,739	523,828	205,911
General and administrative	1,515,058	1,564,058	493,433	1,070,625
Vehicle/facility lease	830	830	180,424	(179,594)
Interest			221,813	(221,813)
Total expenditures	6,233,110	6,879,777	7,908,224	(1,028,447)
Excess (deficiency) of revenues over (under) expenditures	(5,368,000)	(5,949,667)	(5,036,435)	913,232
Other financing sources (uses):				
Transfers in	5,368,000	5,949,667	6,552,291	602,624
Transfers out			(846,165)	(846,165)
Total other financing sources and uses	5,368,000	5,949,667	5,706,126	(243,541)
Net change in fund balances	$ -	$ -	669,691	$ 669,691
Fund balance, beginning of year			320,856	
Fund balance, end of year			$ 990,547	

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Subsidy Pass-Through Special Revenue Fund
Schedule of Revenues, Expenditures and Changes in Fund Balances – Budget and Actual
Year Ended June 30, 2006

	Budgeted Amounts			
	Original	**Final**	**Actual Amounts**	**Variance with Final Budget – Positive (Negative)**
Revenues:				
Federal funds	$ 38,067,548	$ 37,833,186	$ 37,803,640	$ (29,546)
Local TDA funds	73,839,362	74,403,478	76,086,231	1,682,753
STA funds	6,572,986	6,572,986	6,572,986	-
State funds	544,543	544,543	287,447	(257,096)
Other local subsidies	2,049,512	2,030,947	2,085,657	54,710
Interest income	-	-	744,422	744,422
Total revenues	121,073,951	121,385,140	123,580,383	2,195,243
Expenditures:				
Current:				
Transit operations funding	86,215,271	85,220,920	85,352,004	(131,084)
Total expenditures	86,215,271	85,220,920	85,352,004	(131,084)
Excess (deficiency) of revenues over (under) expenditures	34,858,680	36,164,220	38,228,379	2,064,159
Other financing sources (uses):				
Transfers in	19,663,889	19,663,852	19,674,588	10,736
Transfers out	(54,522,569)	(55,828,072)	(54,027,054)	1,801,018
Total other financing sources and uses	(34,858,680)	(36,164,220)	(34,352,466)	1,811,754
Net change in fund balances	$ -	$ -	3,875,913	$ 3,875,913
Fund balance, beginning of year			17,208,671	
Fund balance, end of year			$ 21,084,584	

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

TransNet Special Revenue Fund

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

Year Ended June 30, 2006

	Budgeted Amounts: Original	Budgeted Amounts: Final	Actual Amounts	Variance with Final Budget – Positive (Negative)
Revenues:				
TransNet funds	$ 19,663,889	$ 19,663,852	$ 19,674,588	$ 10,736
Interest income	-	-	17,351	17,351
Total revenues	19,663,889	19,663,852	19,691,939	28,087
Expenditures:				
Current:				
General and administrative	-	-	9,703	-
Total expenditures	-	-	9,703	-
Excess (deficiency) of revenues over (under) expenditures	19,663,889	19,663,852	19,682,236	28,087
Other financing sources (uses):				
Transfers in	-	-	22,665,277	-
Transfers out	(19,663,889)	(19,663,852)	(19,674,588)	(10,736)
Total other financing sources and uses	(19,663,889)	(19,663,852)	2,990,689	(10,736)
Net change in fund balances	$ -	$ -	22,672,925	$ 17,351
Fund balance, beginning of year, as restated (see Note 15)			(2,986,070)	
Fund balance, end of year			$ 19,686,855	

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SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Required Supplementary Information

For the year ended June 30, 2006

DEFINED PENSION PLAN

Schedule of Funding Progress

The following Schedule of Funding Progress shows the recent history of the actuarial value of assets, actuarial accrued liability, their relationship, and the relationship of the unfunded actuarial accrued liability to payroll. (Amounts in thousands of dollars).

MTS

Valuation date	Actuarial value of assets	Entry age normal accrued liability	Unfunded liability	Funded status	Annual covered payroll	UAAL as a % of payroll
6/30/03	456,062	515,421	59,359	88.5%	120,692	49.2%
6/30/04	580,961	681,517	100,556	85.2%	160,107	62.8%
6/30/05	729,557	872,347	142,790	83.6%	203,995	70.0%

Beginning with the 6/30/2003 valuation, CalPERS established a risk pool for cities and other government entities that have less than 100 active members. Actuarial valuation was performed with other participants within the same risk pool. Therefore, standalone information of the Schedule of the Funding Progress for MTS is not available.

SDTI

Valuation date	Actuarial value of assets	Entry age normal accrued liability	Unfunded liability	Funded status	Annual covered payroll	UAAL as a % of payroll
6/30/03	32,694	37,235	4,541	87.8%	16,827	27.0%
6/30/04	35,905	41,695	5,790	86.1%	17,749	32.6%
6/30/05	41,415	48,698	7,283	85.0%	19,917	36.6%

SDTC

Valuation date	Actuarial value of assets	Entry age normal accrued liability	Unfunded liability	Funded status	Annual covered payroll	UAAL as a % of payroll
1/1/2004	78,667	132,307	53,640	59.5%	36,237	148.0%
1/1/2005	152,877	162,879	10,002	93.9%	34,859	28.7%
1/1/2006	153,083	168,877	15,794	90.6%	34,959	45.2%

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SUPPLEMENTARY INFORMATION

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Non-major Proprietary Funds
Combining Statement of Cash Flows
Year Ended June 30, 2006

	Enterprise Funds		
	Taxicab Administration	**San Diego & Arizona Eastern Railway**	**Totals**
Cash flows from operating activities:			
Receipts from customers and users	$ 705,349	$ 82,761	$ 788,110
Payments to suppliers	(705,349)	(82,876)	(788,225)
Net cash provided (used) by operating activities	-	(115)	(115)
Net increase in cash and cash equivalents	-	(115)	(115)
Cash and cash equivalents, beginning of year	-	24,975	24,975
Cash and cash equivalents, end of year	$ -	24,860	24,860
Operating income (loss)	$ 166,170	(163,441)	2,729
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:			
Depreciation	22,367	19,500	41,867
(Increase) decrease in:			
Accounts and other receivables	(190,926)	-	(190,926)
Prepaid expenses	-	(664)	(664)
Increase (decrease) in:			
Accounts payable	2,389	144,490	146,879
Total adjustments	(166,170)	163,326	(2,844)
Net cash provided (used) by operating activities	$ -	$ (115)	$ (115)

STATISTICAL

SECTION

STATISTICAL SECTION

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SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Net Assets by Component
Last Two Fiscal Years
(accrual basis of accounting)

	Fiscal Year 2006	Fiscal Year 2005, as restated
Governmental activities		
Invested in capital assets, net of related debt	$ 111,959,506	$ 420,667,651
Unrestricted	35,868,448	185,115,587
Total governmental activities net assets	$ 147,827,954	$ 605,783,238
Business-type activities		
Invested in capital assets, net of related debt	$ 1,134,242,639	$ 695,486,022
Unrestricted	(33,761,144)	(35,563,034)
Total business-type activites net assets	$ 1,100,481,495	$ 659,922,988
Primary government		
Invested in capital assets, net of related debt	$ 1,246,202,145	$ 1,116,153,673
Unrestricted	2,107,304	149,552,553
Total primary government net assets	$ 1,248,309,449	$ 1,265,706,226

Offsetting changes in governmental activities and business-type activities net assets between 2005 and 2006 reflect the transfer of $483 million in capital assets, including the Mission Valley East project valued at $481 million, from MTS to SDTC and SDTI.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Changes in Net Assets
Last Two Fiscal Years
(accrual basis of accounting)

	Fiscal Year 2006	Fiscal Year 2005
Expenses:		
Governmental activities:		
General government	$ 10,144,463	$ 10,429,104
Transit operations funding	85,352,004	73,905,584
Transit capital funding	-	261,775
Misc office/other expense	34,502	-
Interest on long-term debt	8,136,111	8,669,729
Total governmental activities expenses	103,667,080	93,266,192
Business-type activities:		
Other Contracted Services	60,542,066	56,444,048
San Diego Transit	78,085,401	86,301,787
San Diego Trolley	105,069,741	81,963,639
Other proprietary funds	976,307	964,603
Total business-type activities expenses	244,673,515	225,674,077
Total primary government expenses	348,340,595	318,940,269
Program revenues:		
Governmental activities:		
Operating grants and contributions	124,018,111	86,270,079
Capital grants and contributions	31,727,904	83,084,460
Total governmental activities program revenues	155,746,015	169,354,539
Business-type activities:		
Charges for services	70,183,914	66,055,549
Operating grants and contributions	73,349,516	101,128,154
Total business-type activities program revenues	143,533,430	167,183,703
Total primary government program revenues	299,279,445	336,538,242
Net revenues (expenses):		
Governmental activities	52,078,935	76,088,347
Business-type activities	(101,140,085)	(58,490,374)
Total net revenues (expenses)	(49,061,150)	17,597,973
General revenues and other changes in net assets:		
Governmental activities:		
Interest income	6,966,330	11,638,987
Indirect cost recovery	1,685,026	2,827,481
Capital contributions - other	895,826	946,278
Transfers of capital assets - MTS	(483,169,381)	(21,679,153)
Transfers	(36,412,020)	(626,720)
Total governmental activities	(510,034,219)	(6,893,127)
Business-type activities:		
Capital contributions - other	22,117,191	29,061,061
Transfers of capital assets - MTS	483,169,381	21,679,153
Transfers	36,412,020	626,720
Total business-type activities	541,698,592	51,366,934
Total primary government	31,664,373	44,473,807
Changes in net assets:		
Governmental activities	(457,955,284)	69,195,220
Business-type activities	440,558,507	(7,123,440)
Total primary government	$ (17,396,777)	$ 62,071,780

Offsetting variances in operating grants and transfers are the result of a change in the manner of recording grant receipts in 2006.
The reduction in capital grants and contributions is related to the completion of the Mission Valley East project.
Business-type activities contributed capital assets includes the $483 million contributed by MTS and $22 million contributed by SANDAG and others. The $483 contribution from MTS includes $481 million for the completed Mission Valley East project.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Fund Balances of Governmental Funds
Last Two Fiscal Years
(modified accrual basis of accounting)

	2006	As restated 2005
General fund:		
Unreserved	$ 990,547	$ 320,856
Total general fund	$ 990,547	$ 320,856
All other governmental funds		
Reserved	$ 178,416,849	$ 182,981,419
Unreserved, reported in:		
Special revenue funds	40,760,540	14,212,103
Capital projects fund	(37,667,773)	(9,723,371)
Total all other governmental funds	$ 181,509,616	$ 187,470,151

Offsetting changes in Special Revenue and Capital Projects funds are related to interfund transfers recorded in 2006.

SAN DIEGO METROPOLITAN TRANSIT SYSTEM
Changes in Fund Balances of Governmental Funds
Last Two Fiscal Years
(modified accrual basis of accounting)

	2006	2005
Revenues:		
Federal funds	$ 49,270,067	$ 109,231,192
Local TDA funds	76,086,231	36,790,082
STA funds	6,572,986	4,542,952
State funds	849,569	974,738
TransNet Funds	19,674,588	16,043,175
Other local subsidies	2,096,309	278,000
Other funds	1,196,265	1,494,400
Interest income	6,966,330	11,638,987
Indirect cost recovery	1,685,026	2,827,481
Total revenues	164,397,371	183,821,007
Expenditures:		
General government:	7,987,484	7,959,010
Transit support activities	85,352,004	73,905,584
Debt service:		
Principal	14,493,119	5,819,127
Interest	8,113,899	8,447,080
Capital outlay:	17,329,689	77,497,055
Total expenditures	133,276,195	173,627,856
Excess (deficiency) of revenues over (under) expenditures	31,121,176	10,193,151
Other financing sources (uses):		
Transfers in	60,801,064	22,172,167
Transfers out	(97,213,084)	(22,798,887)
Total other financing sources (uses)	(36,412,020)	(626,720)
Net change in fund balances	(5,290,844)	9,566,431
Fund balances, beginning of year	187,791,007	205,685,597
Prior period adjustments	-	(27,461,021)
Fund balances, as restated	187,791,007	178,224,576
Fund balances, end of year	$ 182,500,163	$ 187,791,007
Debt service as a percentage of noncapital expenditures	24.22%	17.43%

Reduction in Federal Funds reflects reduced capital funding associated with completion of the Mission Valley East project
Increase in TDA funds reflects a change in the method of recording revenue and transfers between funds

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Fare Structure

For the Fiscal Year Ended June 30, 2006

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		58.00
Express Bus (multi-zones)		64.00 - 84.00
Senior/Disabled Bus and Trolley		14.50
Youth Bus and Trolley		29.00

SOURCE:

Codified Ordinance No. 4, an ordinance establishing a Metropolitan Transit System fare pricing schedule, last amended January 15, 2004

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Component Units and Major Proprietary Fund

Farebox Recovery Percentage

Last Two Fiscal Years (in Percentages)

Fiscal Year Ended	San Diego Transit Corporation	San Diego Trolley Inc.	MTDB Contract Services
2005	27.34	54.25	31.97
2006	30.40	50.78	31.96

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

SAN DIEGO METROPOLITAN TRANSIT SYSTEM

Ratios of Outstanding Debt by Type
Last two Fiscal Years

	Governmental Activities							Business-type Activities				
Year ended une 30	Capital Lease - Tower	Capital Lease- Equipment	1990 LRV Sale/ Leaseback	1995 LRV Lease/ Leaseback	Certificates of Participation 2002	Certificates of Participation 2003	Total Governmental Activities	Pension Obligation Bonds	Total Business-type Activities	Total Primary Government	Percentage of Personal Income	Debt per Capit
2005	8,940,118	-	15,878,727	125,774,762	10,985,000	32,850,000	194,428,607	77,490,000	77,490,000	271,918,607	0.54%	126
2006	8,516,304	319,719	13,174,798	124,775,518	7,430,000	26,065,000	180,281,339	76,075,000	76,075,000	256,356,339	0.52%	117

'etails regarding MTS' outstanding debt can be found in the notes to the financial statements.
ITS issued pension obligation bonds in FY 2005 to fund 85% of SDTC's unfunded pension liability