

Date: February 12, 2008
Committee Meeting Date: February 21, 2008
Board Meeting Date: March 6, 2008
ACTION ITEM

BOARD MEMORANDUM

TO: Administration and Finance Committee
Santa Clara Valley Transportation Authority
Board of Directors

THROUGH: Michael T. Burns
General Manager

FROM: Joseph T. Smith
Chief Financial Officer

SUBJECT: Fiscal Year 2007 Comprehensive Annual Financial Report for the Santa Clara Valley Transportation Authority and the Amalgamated Transit Union Pension Plan Report

Policy-Related Action: No Government Code Section 84308 Applies: No

RECOMMENDATION:

Review and accept the audited Comprehensive Annual Financial Report for the Santa Clara Valley Transportation Authority and the Amalgamated Transit Union Pension Plan Report for Fiscal Year 2007.

BACKGROUND:

Pursuant to state law and the Administrative Code of the Santa Clara Valley Transportation Authority (VTA), Vavrinek, Trine, Day & Company, LLP (VTD), a Certified Public Accounting Firm, conducted an audit of VTA finances for the fiscal year ended June 30, 2007 (FY2007). The auditors are required by audit standards to obtain reasonable assurance about whether the financial statements are free of material misstatement as well as assess whether the accounting principles used and estimates made by management are reasonable. Audited financial statements are required to be submitted to the State Controller, Metropolitan Transportation Commission, Federal and State agencies, and other parties such as the bondholders and financial rating agencies.

DISCUSSION:

Audit Results

VTD rendered a “clean” or unqualified opinion on VTA’s financial statements. The audit report states that VTA’s Comprehensive Annual Financial Report (CAFR) presents fairly, in all material respects, the respective financial position of the business-type activity, the governmental activity, each major fund, the aggregate remaining fund information of VTA as of June 30, 2007, as well as the respective changes in financial position and cash flows. There were no material weaknesses noted in the internal controls over financial reporting and operations. The Independent Auditor’s opinion addressed to the Board is on pages 2-1 and 2-2 of the CAFR.

Auditor’s Management Letter

In planning and performing the audit of VTA’s financial statements, VTD considered our internal control system and procedures. Based on their consideration, they issued the attached Memorandum of Internal Controls or Management Letter addressed to the Board. This type of memo typically includes any audit findings or observations and recommendations to address the issue(s).

An audit finding denotes a serious violation of internal control procedures, such as a reportable condition or a material weakness, which must be addressed by the management. Reportable conditions are matters coming to the auditors attention, that in their judgment, represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization’s ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. A material weakness is a reportable condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. An observation reflects proposed but not required improvements to existing internal controls or procedures.

There were no audit findings as a result of the FY2007 audit. However, there was one observation brought to our attention. VTD recommended that VTA design and implement a Fraud Prevention and Training Program for its employees. VTA management concurs with this observation and plans to implement it.

Audited Financial Statements

VTA uses the fund accounting system for financial reporting to ensure and demonstrate compliance with finance-related legal requirements. 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. VTA’s funds can be divided into three categories: proprietary, governmental and fiduciary funds.

The financial statements, related footnotes, and Management Discussion and Analysis as presented in the CAFR were prepared in accordance with the reporting requirements recommended by the Government Finance Officer's Association (GFOA).

The GFOA awarded a Certificate of Achievement for Excellence in Financial Reporting to VTA for its CAFR for the fiscal year ended June 30, 2006. This was the 11th consecutive year that VTA achieved this coveted award. The award provides affirmation that VTA's Comprehensive Annual Financial Reports are prepared consistently in accordance with generally accepted accounting principles and applicable legal requirements.

The CAFR reports the results of operations for:

- Proprietary Funds
 - VTA Enterprise - Transit Operating, 1996 Measure B Transit Rail Program, and 2000 Measure A Transit Improvement Program
 - Internal Service Fund – Workers' Compensation, General Liability, Compensated Absences, and Retiree Health programs

- Governmental Funds
 - Special Revenue Fund – Congestion Management Program (CMP)
 - Capital Projects Funds – Congestion Management & Highway Program and 1996 Measure B Highway Program

- Fiduciary Funds
 - Trust Funds - VTA Amalgamated Transit Union (ATU) Pension Plan; Spousal Medical and Vision/Dental Trust
 - Agency Funds - Bay Area Air Quality Management District and 1996 Measure B Ancillary Program

Financial Highlights

Proprietary Funds

The Proprietary Funds account for business-type activities that are reported using the full accrual basis of accounting. VTA maintains two types of proprietary funds: Enterprise Funds and Internal Service Funds.

Enterprise Funds

Enterprise Funds are used to account for functions of VTA that are principally supported by user charges, sales tax and intergovernmental revenues. There are three types of activities that fall under this category: VTA Operating, 1996 Measure B Rail/Transit Program, and 2000 Measure A Transit Improvement Program.

Statement of Revenues, Expenses, and Changes in Fund Net Assets

For FY2007, operating revenues were \$37.9 million, up \$1 million or 2.6% from the prior fiscal year as a result of higher ridership in transit service. Operating expenses were \$9.5 million or 2.6% lower than FY2006 resulting mainly from lower depreciation expenses and higher non-

labor overhead costs charged to capital programs. In addition, there was a one-time transfer of \$50.0 million from Internal Service Funds due to change in estimates for provision of Workers' Compensation claims based on the actuary valuation report. Total Enterprise Fund net assets were \$2.4 billion, an increase of approximately \$367.8 million compared to FY2006. This can be seen on page 2-76 of CAFR.

Of the total net asset increase, \$357.2 million was related to the 2000 Measure A Transit Improvement Program. VTA accounts for the 2000 Measure A Transit Improvement Program as part of its Enterprise Fund. Even though the 2000 Measure A program revenues and related capital expenses are reported as part of Enterprise Fund financial statements, they are restricted for capital programs and operating activities included in the 2000 Measure A Ordinance.

Reserves

As of June 30, 2007, VTA Enterprise Fund reports a total operating reserve balance of \$96.5 million (Statistical Section, Table 7, page 3-7). VTA Board has adopted a policy to maintain a target reserve balance at 15% of its operating budget to meet emergency needs that cannot be funded from any other source. This is meant to ensure that funds are available in the event of unanticipated revenue shortfalls or if unavoidable expenditures may be required. For FY2007, VTA has exceeded the target reserve balance by \$43.5 million or at 28% of VTA's operating budget.

The Enterprise Fund also has a restricted reserve balance of \$353.2 million. These funds are restricted for specific purposes bound by legal contracted agreements or Board policies. Of this amount, \$265.2 million represents local share of approved capital funding that VTA must provide toward Board-approved capital projects and Measure A Transit Improvement Projects. The remaining \$88 million is restricted for debt service payments and other legally contractual obligations. Details of the restricted reserve calculation are shown in the Financial Section of CAFR, page 2-18.

Budgetary Comparison

As shown on the Budgetary Comparison Schedule for the Enterprise Funds (page 2-79 & 80), the FY2007 actual results for Enterprise Fund revenues and expenses were favorable compared to both the Adopted and Final Budget. VTA was originally projecting a net budgetary surplus of \$8.2 million. Subsequently, during the mid-year review approved by the Board, the surplus was revised to \$30.7 million. Based on the FY2007 actual results, VTA Enterprise Fund reported a positive net income of \$54.3 million, a \$23.6 million favorable variance when compared to the Final Budget.

Internal Service Funds

Internal Service Funds are set up to account for services to other funds, departments or to other governments on a cost-reimbursement basis. General Liability, Workers' Compensation, Retiree Health, and Compensated Absences are accounted for in the Internal Service Funds.

The Statement of Revenues, Expenses and Changes in Fund Net Assets (page 2-19) reports an increase in net assets of \$9.3 million primarily due to a \$19.5 million operating income and \$16

million investment income. In addition, there was a special one-time positive accounting adjustment of \$23.8 million related to the change in estimate for Workers' Compensation program's provision for claims liability. The actuarial valuation report as of June 30, 2007, reported that the VTA's Self-Insurance Workers' Compensation Program is over-funded assuming a 90% confidence level and present value of estimated outstanding losses using a 4% interest rate. As a result, a one-time transfer of \$50 million was made from the Internal Service Funds to Enterprise Fund during FY2007.

Total assets are reflected in the Statement of Fund Net Assets, page 2-17, Internal Service Fund column. As of June 30, 2007, total assets amounted to \$162.9 million.

Governmental Funds

Governmental funds are reported using the modified accrual basis of accounting. This means that revenues are recognized in the accounting period in which they become "measurable and available." VTA's Governmental Funds are divided in two categories: Special Revenue Funds and Capital Projects Funds.

Special Revenue Funds are set up to account for revenues from specific taxes or other earmarked revenue sources which, by law, are designated to finance particular activities of government. The Congestion Management Program falls under the Special Revenue Fund category.

Capital Projects Funds are set up to account for resources used for acquisition or construction of major capital assets by a governmental unit. VTA reports the Congestion Management and Highway Program, and 1996 Measure B Highway Program under the Capital Projects Funds category.

Congestion Management Program (CMP)

The CMP Special Revenue Fund is used to account for the congestion management, planning, and programming and development services for Santa Clara County. The Statement of Revenues, Expenses and Changes in Fund Net Assets (page 2-23) reports a decrease in net assets of \$464 thousand due to expenditures exceeding revenues in the current year, as a result of projects that were deferred in previous years now being implemented. Total fund revenues, which mainly include member assessment and grants, were \$3.6 million in FY2007; \$350 thousand higher than the prior year due primarily to an increase in member-agency assessments, Federal Technical Studies Operating Assistance Grants, and fund investment earnings. Total expenses were \$4 million, an increase of \$393 thousand due to increase in project activities. The CMP fund balance was \$1.5 million at the end of FY2007.

Congestion Management & Highway Program (CM&HP)

CM&HP Capital Projects Fund is used to account for the acquisition of capital assets and construction of highway projects administered on behalf of state and other local governments (other than those accounted for in the Measure B Highway Capital Projects Fund). The CM&HP administers highway projects on behalf of other agencies.

As reflected on page 2-23, the CM&HP expended approximately \$27.9 million on project costs during FY2007. The primary expenditures were for Coleman/I-880 improvement and Highway 87 North HOV lanes projects. The bulk of the funding for these two projects came from the City of San Jose and State grants. In total CM&HP received approximately \$27.9 million in FY2007; \$24.2 million as reimbursement from the State Grant Anticipation Revenue Vehicle (GARVEE) grants, \$2 million from the Surface Transportation Improvement Program (STIP) grant, and \$1.7 million from other local agencies.

Measure B Highway Program

Measure B Highway Program Capital Projects Fund is used to account for acquisition of capital assets or construction of Measure B Highway projects. The 1996 Measure B Highway projects consist primarily of widening highways and improvements that become the property of the State.

As shown on page 2-23, VTA expended approximately \$20.4 million during FY2007 for Measure B Highway projects. Of this amount, Santa Clara County's (County) contribution was approximately \$17.5 million and the remaining balance was received from various state and local fund sources.

Fiduciary Funds

The Fiduciary Funds are used to account for assets held by VTA as a trustee (in a trust fund) and as an agent for others (in an agency fund). These assets cannot be used to support VTA's own programs. VTA's Fiduciary Funds consist of trust and agency funds. The trust funds include the ATU Pension Plan and ATU Medical Trust. Bay Area Air Quality Management District and the Measure B Ancillary Program are reported as agency funds.

ATU Pension Plan

The ATU Pension Plan Fund reports on the activities of the benefit pension plan covering VTA employees who are members of the Santa Clara Valley Transportation Authority Amalgamated Transit Union (ATU). The report is included as part of the CAFR in addition to being published as a separate report. The ATU Pension Plan Report is discussed further on page 8 of 8.

ATU Medical Trust

The ATU Medical Trust Fund accounts for the ATU Spousal Medical Trust, which is a medical insurance benefit for eligible pensioners' spouses, and the Vision/Dental Trust, which is a vision and dental benefit for eligible pensioners. This Plan is funded through employee contribution at a rate of 25 cents per hour paid to the Medical Trust Fund and 10 cents per hour to the Retiree's Vision/Dental Trust Fund.

As shown on the Combining Statement of Changes in Fiduciary Net Assets for Pension Trust Funds (page 2-83), total employee contributions to Spousal Medical and Vision/Dental were approximately \$853 thousand and \$341 thousand, respectively. In addition, Spousal Medical

Vision/Dental earned \$1.3 million and \$264 thousand, respectively in investment income for the year. Total benefit payments made on behalf of Spousal Medical Trust Fund totaled approximately \$1.2 million for FY2007. Total changes in net assets were \$1.5 million for the Total Medical Trust funds. Total net assets for Spousal Medical were \$9.6 million and \$3.2 million for Vision/Dental.

Bay Area Air Quality Management District (BAAQMD)

The BAAQMD Agency Fund accounts for the activities that relate to the Transportation Fund for Clean Air (TFCA) Program. The TFCA is generated by a \$4.00 surcharge on vehicle registrations. The BAAQMD administers these funds in the nine-county Bay Area. Funds are available for allocation to alternative fuels, arterial management, bicycle, and trip-reduction projects that reduce vehicle emissions. Assets in the BAAQMD fund are held by VTA in a custodial capacity; therefore, they are reported in the Agency Fund. As of June 30, 2007, BAAQMD's total assets were approximately \$2.5 million, as reflected on page 2-84.

Measure B Ancillary Program

The Measure B Ancillary Program was established to administer the 1996 Measure B funds. During FY2007, VTA received and expended County contributions for Ancillary Program projects such as highway and intersection improvements, signal synchronization, and bikeway paths. The County contribution represents funding received and passed on to other governments, commonly referred to as "pass-through" grants. As of June 30, 2007, the total assets of this program were \$15.8 million (page 2-84).

Subsequent Events

The following finance-related transactions occurred after the end of FY2007 and prior to the issuance of VTA's FY2007 CAFR:

- In July 2007, VTA received \$51.2 million payment from the County per Amendment 20 of the Master Agreement for Measure B Transportation Improvement Program (MBTIP). In return, VTA would assume full responsibility for completion of the remaining MBTIP Projects for which VTA is currently responsible, and to closeout the MBTIP. The projected cost of remaining MBTIP is estimated at \$60.7 million and is expected to run through 2010. The difference between the projected costs and lump sum payment by the County under Amendment 20 would be covered by cash on hand held by VTA at June 30, 2007, projected interest earnings, and the residual sales tax to be received by VTA on the Measure B program.
- In August 2007, VTA redeemed 2006 Measure A Sales Tax Revenues Bonds, Series E, which totaled \$54.7 million using surplus funds.
- In July 2007, VTA received \$20.1million for the sale of approximately three miles of former Western Pacific Railroad Road (WPPR) right-of-way to BART. With the acquisition of this property BART would be in a position to construct the Warm Springs Extension, which is precursor to the construction of the potential BART extension to the Silicon Valley.

- In September 2007, VTA issued \$120.1 million traditional fixed rate bonds, 2000 Measure A Sales Tax Revenue Refunding Bonds, 2007 Series A (Measure A 2007 Bonds), at a true interest cost of 4.60%. The proceeds along with \$17.7 million debt service reserve funds were used to refund \$137.8 million Series F and Series G of VTA's 2006 Measure A Sales Tax Revenue Bonds (Defeased Bonds), which were originally issued as 90-day auction rate securities. Proceeds of the Measure A 2007 Bonds plus debt service reserve funds were deposited into an escrow account held by a Trustee, and were used to pay the principal and accrued interest on the Defeased Bonds on their next interest payment date in November 2007. Maturities for the Measure A 2007 Bonds extend to April 1, 2036.

Amalgamated Transit Union (ATU) Pension Plan Report

The ATU Pension Plan Fund reports on the activities of the benefit pension plan covering VTA employees who are members of the Santa Clara Valley Transportation Authority Amalgamated Transit Union (ATU). The ATU Pension Plan is 100% funded by VTA's contribution of payroll.

Audit Results

VTD rendered a "clean" or unqualified opinion on the ATU Pension Plan Report, a component unit report of VTA's CAFR. The audit report states that it presents fairly, in all material respects, the activities of the ATU Pension Plan for the year ended June 30, 2007, in conformity the accounting principles generally accepted in the United States of America. The Independent Auditor's opinion addressed to the Board is on page 1 of the component unit report.

Financial Highlights

As shown on the Statement of Changes in the Plan Net Assets of ATU Pension Plan Report (page 6), net assets increased \$45 million for the year ended June 30, 2007. The increase was due to earnings on investments of \$48.2 million, and VTA contributions of \$14.9 million less benefit payments and administration expenses of \$18.1 million. As of June 30, 2007, net assets amounted to \$349.9 million. Report details are shown on pages 5 & 6 of the ATU Pension Plan component unit report.

These financial statements can be viewed online at <http://www.vta.org/inside/investor/index.html>. A hard copy may be requested by writing to Santa Clara Valley Transportation Authority, Fiscal Resources Division, 3331 North First Street, San Jose, CA 95134-1927. For more information and questions contact VTA Public Affairs and Community Outreach at (408) 321-7575, TDD only (408) 321-2330, or email community.outreach@vta.org.

Attachments

Prepared by: Tony Sandhu, Accounting Manager

Reviewed and verified by: _____
Carol Lawson, Fiscal Resources Manager

**Santa Clara Valley Transportation Authority
Comprehensive Annual Financial Report**

(Smith)

**ATTACHMENT TO THIS BOARD MEMORANDUM
WILL BE FORWARDED UNDER SEPARATE COVER**

**Independent Auditor's Report and the Amalgamated
Transit Union Pension Plan Report**

(Smith)

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