AUDIT REPORT

CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
BUREAU OF FINANCIAL AUDIT
WILLIAM C. THOMPSON, JR., COMPTROLLER

Audit Report on the Financial Practices of the New York City Transit Authority

FN03-141A

April 23, 2003

To the Citizens of the City of New York

Ladies and Gentlemen:

This audit, initiated on January 15, 2003, analyzed the New York City Transit Authority's procedures for recording and reporting financial and statistical data presented to the public. The audit was prompted by the fiscal difficulties reported by the Metropolitan Transportation Authority (MTA) and the New York City Transit Authority (Transit Authority) and the concerns raised by the public about whether a proposed fare increase was justified.

The audit was conducted in accordance with the audit responsibilities of my office, as set forth in Chapter 5, § 93, of the New York City Charter, and pursuant to Chapter 43-A, Article 5, Title 9, § 1208 of the New York State Public Authorities Law. The audit reviewed the Transit Authority's procedures for recording revenue and expenses on its financial statements and determined whether the Transit Authority provided the public with complete, clear, and accurate information about its current and future financial position prior to the MTA Board's approval of the proposed fare increase.

Audits such as this provide a means of ensuring that the public can trust the integrity of information that is used as a basis to make decisions affecting them.

I trust that this report contains information that is of interest to you. If you have any questions concerning this report, please contact my audit bureau at 212-669-3747 or e-mail us at audit@Comptroller.nyc.gov.

Very truly yours,

William C. Thompson, Jr.

William C. Thompson, Jr.

WCT/GR

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Office of the Comptroller
Bureau of Financial Audit

Audit Report on the Financial Practices of the New York City Transit Authority

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AUDIT REPORT IN BRIEF

The New York City Transit Authority (Transit Authority) was created in June 1953 to operate the City subway and bus systems previously operated by the New York City Board of Transportation. The Transit Authority is a public benefit corporation established under the State of New York Public Authorities Law. In 1968, New York State created the Metropolitan Transportation Authority (MTA) to oversee, maintain, and administer the mass transportation systems in the City as well as commuter transportation and related services within the Metropolitan Transportation Commuter District—New York City, Dutchess, Nassau, Orange, Putnam, Rockland, Suffolk, and Westchester Counties. The MTA accomplishes these objectives through its subsidiaries: the Long Island Rail Road; the Metro-North Railroad; the Staten Island Rapid Transit Operating Authority; and the Metropolitan Surburban Bus Authority (Long Island Bus); and through its affiliates: the Triborough Bridge and Tunnel Authority (TBTA) and the Transit Authority.[1]

Transit Authority operations are funded by passenger fares and operating subsidies. Passenger fares represent approximately 50 percent of the Transit Authority's revenues. State and City subsidies as well as a portion of the surplus net income of the TBTA flow through the MTA to the Transit Authority to fund its operations. To fund capital projects, State legislation authorizes the MTA and TBTA to issue bonds on behalf of the Transit Authority. The proceeds of these bonds are used to fund the construction and rehabilitation of infrastructure and to purchase subway cars and buses. Funds dedicated to capital expenditures are also provided by grants from the City, State, and federal governments.

Given the fiscal difficulties reported by the MTA and the Transit Authority, and the concerns raised by the public about whether a proposed fare increase was justified, the Comptroller's Office reviewed a preliminary budget proposal that was released on December 9, 2002, and a revised proposal on December 16, 2002. Unfortunately, the December 16 proposal contained a number of deficiencies that rendered it far from complete. (On December 18, 2002, New York City Comptroller William C. Thompson, Jr. sent a letter to the Chairman of the MTA

[1] Detailed Transit Authority financial data are included in the MTA consolidated financial statements. The Transit Authority also issues separate audited financial statements, since it is legally and operationally independent.

advising him of the deficiencies in the December 16th proposal. See Attachment for a copy of the letter.) As a result, on January 15, 2003, the Comptroller's Office began this audit of the Transit Authority's procedures for recording and reporting financial and statistical data presented to the public.

Audit Findings and Conclusions

The Transit Authority had adequate procedures for recording revenue and expenses. Based on our evaluation of Transit Authority internal controls and our review of its financial records for calendar years 2001 and 2002, we are reasonably assured that revenue derived from MetroCards, tokens, subsidies, and Other Revenue (from advertising, concessions, etc.) were properly deposited in the bank and accurately recorded on Transit Authority books and records. We are also generally assured that expenses incurred by the Transit Authority were appropriate, reasonable, and properly recorded.

However, the Transit Authority did not provide the public with complete, clear, and accurate information about its current and future financial position. The Transit Authority overstated its operating expenses on its financial statements for 2001 and on its draft financial statements for 2002, and its Fiscal Year 2003 Operating Budget Proposal lacked essential information. Specifically, the Transit Authority improperly included capital costs and interest expense on long-term debt as operating expenses on its financial statements; and its Operating Budget Proposal did not provide adequate details of its debt service, debt restructuring, and projected revenue and expenses. Overall, the errors in the Transit Authority's financial statements combined with the shortcomings of the Operating Budget make it impossible for all concerned parties to assess the financial position of the Transit Authority and make an informed judgment about the necessity for a fare increase.

Indeed, after spending three months reviewing the initial and revised operating budgets and various other documents and having discussions with officials of the MTA and the Transit Authority, we were finally provided enough information to analyze and determine whether a fare increase is justified. Our analysis revealed two significant problems with the operating budgets that cause us to question the need for the fare increase. Specifically, the draft financial statements indicated that the Transit Authority ended calender year 2002 with approximately $300 million in the "MTA Investment Pool."[2] However, we could not determine whether these resources were included in the budget plans and were considered on March 6, 2003, when the MTA Board voted to increase the basic Transit authority fare from $1.50 to $2.00. In addition, the Transit Authority's "Fare Revenue Model," which the MTA used to project Transit Authority revenue from the fare increase in the revised budget, made assumptions regarding ridership that are questionable based on our review of historic ridership data.

Furthermore, based on our evaluation of available records, we determined that the ridership of the Transit Authority pays a significantly higher percentage of Transit Authority operating expenses when compared to the percentage of operating expenses paid for by the ridership of the

[2] According to the notes to the financial statements, "the MTA, on behalf of the [Transit] Authority, invests funds which are not immediately required for the Authority's operations in securities permitted by the State Public Authorities Law. . . . Funds held therein, including interest earned, shall be expended per MTA Board approval to stabilize the Authority's cash flow requirements as needed."

commuter railroads and Long Island Bus. Moreover, after taking the fare increases into consideration, Transit Authority riders will pay more towards reducing the Transit Authority's operating deficit than riders of the commuter railroads and Long Island Bus pay towards reducing the operating deficits of those systems.

Overall, we conclude that the Transit Authority's financial documents issued prior to and after the March 6, 2003, meeting of the MTA Board were not adequate to provide the basis for sound policy-making. Our analysis revealed that financial statements and budget documents were incomplete, misleading, and obfuscating. The Transit Authority made important financial revisions only ***after*** the MTA Board voted to increase the transit fare. We cannot determine whether those revisions, and possibly others yet to be revealed, will prove the necessity of a fare hike that affects more than seven million passengers a day. To ensure that the public can trust the integrity of decisions that so affect them, we recommend that the Transit Authority, in conjunction with MTA:

- Reevaluate the need for a fare increase based on the issues discussed in this report.
- Ensure that capital costs are properly reported on its financial statements in accordance with GAAP (Generally Accepted Accounting Principles).
- Ensure that future budget proposals contain complete, clear, and accurate information pertaining to the Transit Authority's financial position. In that regard, the Transit Authority and MTA should appoint an independent task force to review Transit Authority budget proposals before they are presented to the MTA Board for approval. Also, the Transit Authority and the MTA should consider including members of the public as well as elected officials on the task force.

The MTA should:

- When considering future fare increases for the Transit Authority, the commuter railroads, and Long Island Bus, take into account the amount of operating expense already paid for by their riders.

INTRODUCTION

Background

The New York City Transit Authority (Transit Authority) was created in June 1953 to operate the City subway and bus systems previously operated by the New York City Board of Transportation. The Transit Authority is a public benefit corporation established under the State of New York Public Authorities Law. The Transit Authority employs more than 48,000 individuals and is responsible for one of the most complex and extensive public transportation systems in the world. The subway and bus systems operate 24 hours a day, seven days a week, and transport an average of seven million passengers a day.

In 1968, New York State created the Metropolitan Transportation Authority (MTA) to oversee, maintain, and administer the mass transportation systems in the City as well as commuter transportation and related services within the Metropolitan Transportation Commuter District. The District encompasses New York City, and Dutchess, Nassau, Orange, Putnam, Rockland, Suffolk and Westchester Counties. The MTA accomplishes these objectives through its subsidiaries: the Long Island Rail Road; the Metro-North Railroad; the Staten Island Rapid Transit Operating Authority; and the Metropolitan Surburban Bus Authority (Long Island Bus); and through its affiliates: the Triborough Bridge and Tunnel Authority (TBTA) and the Transit Authority.[3]

Transit Authority operations are funded by passenger fares and operating subsidies. Passenger fares represent approximately 50 percent of the Transit Authority's revenues. State and City subsidies as well as a portion of the surplus net income of the TBTA flow through the MTA to the Transit Authority to fund its operations.

To fund capital projects, State legislation authorizes the MTA to issue bonds on behalf of the Transit Authority. The proceeds of these bonds are used to fund the construction and rehabilitation of infrastructure and to purchase subway cars and buses. Funds dedicated to capital expenditures are also provided by grants from the City, State and federal governments.

Table I below summarizes Transit Authority finances for its calendar year 2001 and 2002 operations.[4]

[3] Detailed Transit Authority financial data are included in the MTA consolidated financial statements. The Transit Authority also issues separate audited financial statements, since it is legally and operationally independent.

[4] The data presented for 2002 and 2001 were abstracted from a draft of the Transit Authority's financial statements that was provided to us by Transit Authority officials.

TABLE I

Comparison of Consolidated Statements of Revenues,
Expenses, and Changes in Net Assets for
Calendar Years Ending December 31, 2001, and December 31, 2002
(In thousands)

	2002	2001	Variance
Revenues:			
Passenger Revenue	$2,134,374	$2,136,648	
School, Elderly Reimbursement and Other	199,599	198,983	
Total Operating Revenue	2,333,973	2,335,631	(0.1)%
Tax Supported Subsidy	$1,031,452	$ 946,954	
Operating Assistance Subsidy	317,344	317,344	
Triborough Bridge and Tunnel Authority	100,101	133,134,	
Expense Reimbursement Subsidy	4,393	3,928	
Total Subsidy Revenue	1,453,290	1,401,360	3.7%
Total Revenues	**$3,787,263**	**$3,736,991**	**1.3%**
Expenses:			
Payroll	$2,394,074	$2,338,373	2.4%
Pension and Other Benefits	692,695	623,456	11.1%
Material, Fuel and Power	420,049	460,934	(8.9)%
Consultants	210,588	205,316	2.6%
Depreciation	760,868	727,167	4.6%
Public Liability, Rental, and Other	165,719	131,732	25.8%
Total Expenses	**$4,643,993**	**$4,486,978**	**3.5%**
Interest	$ (86,548)	$ (153,074)	(43.5)%
Loss on Impairment Due to 9/11/01		(172,576)	
Loss on the Disposal of Subway Cars	(58,287)	(57,973)	
Capital Contributions	7,067,738	1,934,992	265.3%
Change in Net Assets	**$6,066,173**	**$ 801,382**	**657.0%**

Note: Wages and benefits make up the largest portion of Transit Authority operating expenses. This is common in the transportation industry, as the provision of service is labor intensive. Also, because of large investments in capital assets, depreciation continues to represent a significant portion of its operating expenses. Unlike other operating expenses, depreciation is not a cash expense and therefore has no effect on Transit Authority cash flow.

Given the fiscal difficulties reported by the MTA and the Transit Authority, and the concerns raised by the public about whether a proposed fare increase was justified, the Comptroller's Office reviewed a preliminary budget proposal that was released on December 9, 2002, and a revised proposal on December 16, 2002. Unfortunately, the December 16 proposal contained a number of deficiencies that rendered it far from complete. (On December 18, 2002, New York City Comptroller William C. Thompson, Jr. sent a letter to the Chairman of the MTA advising him of the deficiencies in the December 16th proposal. See Attachment for a copy of the letter.) As a result, on January 15, 2003, the Comptroller's Office began this audit of the Transit Authority's procedures for recording and reporting financial and statistical data presented to the public.

Objectives

The audit's objectives were to evaluate Transit Authority procedures for recording and reporting revenue, expenses, and other financial data, and to determine the accuracy of certain financial and statistical data presented to the public.

Scope and Methodology

This audit covered the period January 1, 2001, to March 27, 2003.

Transit Authority's Consolidated Financial Statements

We reviewed the Transit Authority's consolidated financial statements, general ledger, trial balance, and year-end adjustments for calendar years 2001 and 2002. To determine the accuracy of the consolidated financial statements, we traced account balances recorded on Transit Authority books to the amounts reported on the financial statements. We reviewed the year-end adjusting entries for accuracy. We also performed an analytical review of the financial data for calendar years 2001 and 2002 and analyzed those accounts that had significant differences in balances from one year to the other.

We evaluated Transit Authority controls over the recording and reporting of revenue, expenses, assets, and liabilities. To gain an understanding of each function, we interviewed management personnel, conducted a walk-through of the operations, and familiarized ourselves with Transit Authority accounting and record-keeping procedures. We documented our understanding of the internal controls through flowcharts and written narratives. We evaluated the effectiveness of Transit Authority internal controls to determine the type and extent of testing needed to determine whether Transit Authority operations were fairly stated on its consolidated financial statements.

For Passenger Revenue, we examined the months of May 2001 and May 2002. To determine whether the amounts collected from passenger MetroCards and token sales were accurate and deposited promptly into the bank, we traced the amounts recorded on Transit Authority revenue reports to the bank statements. To determine whether the deposits were properly accounted for, we reviewed the bank reconciliations, recalculated the differences between the bank and book balances, and determined whether any outstanding items were researched and adjusted. To determine whether passenger revenue was accurately recorded and reported, we traced the amounts on revenue reports to the general ledger, trial balance, and consolidated financial statements. We also reviewed discount, commission, and credit card fee accounts to determine whether offsets to Passenger Revenue were valid and reasonable.

For Subsidy Revenue, we identified all subsidy accounts reported on the Transit Authority books and records. Since Subsidy Revenue reported on the Transit Authority financial statements were amounts provided by the MTA, we met with MTA officials to gain an understanding of the methods used to allocate and distribute subsidies to the Transit Authority. We reviewed subsidies for the period October 1, 2001, through December 31, 2001, and determined whether the MTA distributed the appropriate amounts to the Transit Authority. We traced subsidy amounts recorded on the Transit Authority books and records to State Revenue Reports. We analyzed all subsidy accounts to determine whether there were any significant fluctuations in the amounts reported in calendar years 1999, 2000, and 2001.

To determine whether Other Revenue (Advertisement, Concession, Investment, and Lease Sales) was accurately reported, we traced the amounts recorded on the original journal entries in Transit Authority books and records (for the months May 2001 and May 2002) to supporting documentation, including rental revenue reports, advertising income reports, investment reports, and concession reports.

For Personnel Services, we sampled 50 employees and traced the work hours recorded on the payroll records to each employee's timekeeping documents. We also reviewed payroll records to determine whether pay rates and transfers were properly authorized and recorded on the Transit Authority payroll system.

For Other than Personnel Services, we examined:

- Materials, Supplies, and Public Liability accounts: we reviewed all purchases exceeding $20 million.
- Consultants and Outside Services: we reviewed all contracts exceeding $15 million.
- Rental expenses: we reviewed all expenses exceeding $9 million.

For each transaction tested, we traced the general ledger amounts to supporting documentation that included requisitions, purchase orders, invoices, and receiving reports. In addition, we determined whether all adjusting entries for calendar year 2001 were reasonable and appropriate.

For the other Transit Authority expenses, we judgmentally sampled expenses (based on expense type and dollar amount) in May 2001. To determine whether these expenses were properly authorized, appropriate, and accurately recorded, we traced the general ledger amounts to supporting documentation that included requisitions, purchase orders, invoices, and receiving reports. In addition, we determined whether all adjusting entries for calendar years 2001 and 2002 were reasonable and appropriate. In that regard, we evaluated estimates used by management when calculating certain expenses (e.g., liability claims).

For our tests of Capital Expenses, we judgmentally sampled 15 (based on the type of work performed) of 168 payments to contractors in May 2001. We reviewed the vouchers and other supporting documentation to determine whether payments were properly authorized and whether the work performed was inspected by Transit Authority personnel prior to payment.

Financial and Budget Plans for Fiscal Year 2003

To determine the accuracy, completeness, reliability, and validity of the financial and statistical data presented to the public, we reviewed and analyzed the finances of the Transit Authority contained in the MTA Fiscal Year 2003 Operating Proposal submitted to the MTA Board at its monthly public meeting on December 18, 2002. We also reviewed and analyzed the "Revised MTA-Wide Financial Plan For 2003-2004 and Revised Year 2003 Agency Budgets" submitted to the MTA Board at its March 27, 2003, public meeting. Based on the information in these documents, we requested that Transit Authority and MTA officials provide additional documentation and explanations pertaining to: actual and projected debt service expense; projected cost savings from and allocations formulas pertaining to debt restructuring; detailed lists of projected expenses; and additional revenue projected from fare increases.

This audit was conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS) and included test of records and other auditing procedures considered necessary. This audit was performed in accordance with the audit responsibilities of the New York City Comptroller as set forth in Chapter 5, § 93, of the New York City Charter, and pursuant to Chapter 43-A, Article 5, § 1208 of the New York State Public Authorities Law.

Discussion of Audit Results

The matters covered in this report were discussed with MTA and Transit Authority officials during and at the conclusion of this audit. A preliminary draft report was sent to MTA and Transit Authority officials and was discussed at an exit conference on April 16, 2003. Also, on April 16, 2003, we submitted a draft report to MTA and Transit Authority officials with a request for comments. We received a response from MTA and Transit Authority officials on April 21, 2003. In its response, the MTA and Transit Authority agreed only with the audit finding concerning adequate procedures for recording of revenue and expenses. The response took exception to the audit's negative findings and to its recommendations. The full text of the MTA and Transit Authority comments is included as an addendum to this report.

FINDINGS AND RECOMMENDATIONS

The Transit Authority had adequate procedures for recording revenue and expenses. Based on our evaluation of Transit Authority internal controls and our review of its financial records for calendar years 2001 and 2002, we are reasonably assured that revenue derived from MetroCards, tokens, subsidies, and Other Revenue were properly deposited in the bank and accurately recorded on Transit Authority books and records. We are also generally assured that expenses incurred by the Transit Authority were appropriate, reasonable, and properly recorded.

However, the Transit Authority did not provide the public with complete, clear, and accurate information about its current and future financial position. The Transit Authority overstated its operating expenses on its financial statements for 2001 and on its draft financial statements for 2002, and its Fiscal Year 2003 Operating Budget Proposal lacked essential information. Specifically, the Transit Authority improperly included capital costs and interest expense on long-term debt as operating expenses on its financial statements; and its Operating Budget Proposal did not provide adequate details of its debt service, debt restructuring, and projected revenue and expenses. Overall, the errors in the Transit Authority's financial statements combined with the shortcomings of the Operating Budget make it impossible for all concerned parties to assess the financial position of the Transit Authority and make an informed judgment about the necessity for a fare increase.

Indeed, after spending three months reviewing the initial and revised operating budgets and various other documents and having discussions with officials of the MTA and the Transit Authority, we were finally provided enough information to analyze and determine whether a fare increase is justified. Our analysis revealed two significant problems with the operating budgets that cause us to question the need for the fare increase.

Based on our evaluation of available records, we determined that the ridership of the Transit Authority pays a significantly higher percentage of Transit Authority operating expenses when compared to the percentage of operating expenses paid for by the ridership of the commuter railroads and Long Island Bus. Moreover, after taking the fare increases into consideration, Transit Authority riders will pay more towards reducing the Transit Authority's operating deficit than riders of the commuter railroads and Long Island Bus pay towards reducing the operating deficits of those systems.

These issues are discussed in detail in the following sections of this report.

Operating Expenses Overstated

We found that the amount reported as operating expenses on the Transit Authority 2001 financial statements was overstated because it included as operating expenses capital project costs and interest on long term debt. Generally Accepted Accounting Principles (GAAP) require that a capital cost be expensed over the life of an asset (known as depreciation) rather than charging it to the period in which the item was purchased.

Specifically, the Transit Authority's 2001 financial statements reported operating expenses of approximately $5,346,127,000. This amount included approximately $706,075,000 in capital costs and approximately $153,074,000 in related interest. Thus, 2001 operating expenses were overstated by approximately $859,149,000, or 16.1 percent of reported expenses.

We found the same type of overstatement on the Transit Authority's draft 2002 financial statements. According to the draft financial statements, operating expenses totaled approximately $5,496,898,000. However, this amount included approximately $766,357,000 in capital costs and approximately $86,548,000 in related interest. Thus, total operating expenses were overstated by approximately $852,905,000 or 15.5 percent of reported operating expenses. Although misclassifying capital costs has no effect on Transit Authority net income, such errors convey the impression that the Transit Authority's operating deficit is larger than it actually is and that revenue enhancement measures, such as a fare increase, are necessary.

After we brought this matter to the attention of Transit Authority officials, they consulted their independent auditors and revised the 2002 draft financial statements accordingly. We should note that according to senior Transit Authority fiscal personnel, capital costs were reported as operating expenses for a number of years.

At the exit conference, MTA and Transit Authority officials stated that the 2002 financial statements that we reviewed were not final and would have been changed to accurately reflect capital costs and interest expense whether or not we brought this matter to their attention.

MTA and Transit Authority Response: "We strongly disagree with the claim that the operating expenses of the Authority were overstated in our 2001 financial statements. Use of the caption 'operating expense' is associated with the new GASB 34 reporting model that was adopted in Fiscal Year 2002. In prior years, the Authority's financial statements focused on total expense and total revenues, not operating expense or operating loss. Presenting certain expenditures as both expenses and expense reimbursements in 2001, and prior years, reflected the actual flow of activity with the MTA. This presentation has no effect on net income, as pointed out in the audit, and is in full compliance with GAAP, as the Authority's audited statements evidence. Furthermore, these costs and reimbursements are inter-agency transactions that have been eliminated (netted out) upon combination in the MTA financial statements. Note also that some persons believe the inclusion of such 'force account' transactions is necessary to give a full presentation of the dollar magnitude of Transit's operations.

"The finding suggests that the Authority is not capitalizing and depreciating these costs. We conducted a detailed review, with the NYC Comptroller's audit team, of the Authority's capital expense accounting flow—to the individual entry level—which clearly evidenced the fact that we are correctly recording and depreciating our capital assets. The suggestion that we are not is simply not correct. Since capital assets account for $19.1 billion, or 90%, of the Authority's assets, this is an area of intense concern and focus for the Authority.

"In attempting to evaluate a future cash flow projection, we question the sole focus on the statement of operations and surplus. While this statement is on the accrual basis and in accordance with GAAP, it recognizes both revenues and expenses when they are generated rather than when they are paid or received. More relevant to this effort would have been the Consolidated Statement of Cash Flows, which is also one of our basic financial statements. Since these statements are not mentioned in the Comptroller's report we do not know whether they were reviewed by the audit staff. Review of this statement may have led to a better understanding of the Authority's cash flows and allowed the Comptroller to reach an opinion on our financial condition."

Auditor Comment: The changes in reporting requirements under GASB 34 are irrelevant to the finding. As stated in the audit, Generally Accepted Accounting Principles (GAAP) require that a capital cost be expensed over the life of an asset rather than charging it to the period in which the item was purchased. The Transit Authority clearly did not adhere to this requirement when it mischaracterized capital project costs and related interest as current period expenses on its Consolidated Statements of Revenues, Expenses, and Changes in Net Assets.

Contrary to the response, we did not suggest in this finding that the Transit Authority is not capitalizing and depreciating capital project costs, nor did we attempt "to evaluate a future cash flow projection." Rather, we criticized the Transit Authority for presenting its capital costs in a way that gives the impression that operating deficits are larger than they actually are and that revenue enhancement measures, such as a fare increase, are necessary. We would further note that while disagreeing with this finding in its response, the Transit Authority and its independent auditor immediately corrected its 2002 financial statement in order to comply with GAAP.

Operating Budget Proposal Lacks Critical Information

The Transit Authority Fiscal Year 2003 Operating Budget Proposal—a critical document used by the MTA Board in determining whether a fare increase was necessary—lacked essential information. Specifically, the Proposal did not indicate whether it included: savings from debt restructuring; costs associated with the recent collective bargaining agreement or reserves set aside to cover these costs; surpluses associated with toll increases for bridges and tunnels; and additional revenues from the proposed increase in the transit fare.

In addition, the Proposal reported different operating deficits in two sections of the document. In one section, the deficit was reported as $1.632 billion, while in another section, the deficit was reported as $2.009 billion. The Proposal provided no explanation or reconciliation of the two numbers.

On March 27, 2003, the MTA released a revised budget entitled "Revised MTA-Wide Financial Plan for 2003-2004 and Revised Year 2003 Agency Budgets" (Revised Budget). This document, which was released more than three weeks ***after*** the fare increase was approved by the MTA Board, contained more comprehensive information than the prior proposal—namely, the costs associated with the recent collective bargaining agreement, surpluses associated with toll increases for bridges and tunnels; and additional revenues from the increase in the transit fare. We question why the MTA did not provide such information prior to the public hearings on the proposed fare increase, which would have enabled the public and elected officials to make an informed judgment about whether a fare increase was necessary.

> ***MTA and Transit Authority Response:*** "The Draft Audit Report states that New York City Transit's Operating Budget Proposal 'did not indicate whether it included: savings from debt restructuring; costs associated with the recent collective bargaining agreement or reserves set aside to cover these costs; surplus associated with toll increases for bridges and tunnels; and additional revenues from the proposed increase to the transit fare.'. . .
>
> "The case for the fare increase was presented in several documents that need to be taken as a whole, not just one document. The finances of the MTA are complicated, which is why the case was set forth in what we believed were 'digestible' pieces that would make it easier for the public to understand MTA's finances. These documents included the November 22, 2002 financial plan presentation to the Board, the December 9, 2002 Transit Operating Budget, the December 16, 2002 MTA-wide Financial Plan, the January 17, 2003 presentation by Executive Director Lapp to the City Council, the January 27, 2003 fare policy presentation, the January 30, 2003 presentation on the debt restructuring and the March 6, 2003 financial plan review. . . .
>
> "Finally, the draft Audit Report claims that certain information was not given to the Board until after the fare increase was approved. The collective bargaining information was provided to the Board when it approved the labor contract with TWU Local 100 in January, two months before the vote on fare and toll increases, and the other information was provided in the various presentations and documents listed above."
>
> ***Auditor Comment:*** We agree that the finances of the MTA are complex, but we do not agree that the MTA and the Transit Authority needed to present their financial data in separate "digestible" pieces in order for the public to understand the MTA's finances. In fact, we believe that presenting bits and pieces of information at various times in various documents with changing numbers and assumptions makes it even more difficult to digest and evaluate the MTA's financial situation. In any case, we maintain that the Operating Budget Proposal did not provide clear, accurate, and comprehensive information to enable the public, MTA Board members, and elected officials to make an informed judgment about whether a fare increase was necessary.

Questions Regarding the Necessity for A Fare Increase

After spending three months reviewing the initial and revised operating budgets and various other documents, and having discussions with officials of the MTA and the Transit Authority, on April 10, 2003, we were finally provided enough information to analyze and determine whether a fare increase is justified. Our analysis revealed two items that cause us to question the necessity for the fare increase that was approved.

Specifically, the draft financial statements indicated that the Transit Authority ended calender year 2002 with approximately $300 million in the "MTA Investment Pool."[5] However, we could not determine whether these resources were included on the budget plans and were considered on March 6, 2003, when the MTA Board voted to increase the basic Transit Authority fare from $1.50 to $2.00.

At the exit conference, MTA and Transit Authority officials claimed that most of the funds in the MTA Investment Pool were spent by March 2003 and were therefore not available to cover the projected deficit. However, these officials did not provide any documentation to substantiate this assertion.

In addition, the Transit Authority's "Fare Revenue Model," which the MTA used to project Transit Authority revenue from the fare increase in the revised budget, made assumptions regarding ridership that are questionable based on our review of historic ridership data. According to the Model, a 33 percent fare increase would result in decreased bus and subway ridership ranging from 3.3 to 10 percent, depending on whether the riders use tokens, cash, regular MetroCard, 1-day pass, bonus MetroCard, 7-day pass, or 30-day pass.

However, based on ridership data provided by the MTA, the last fare increase imposed in November 1995 did not negatively affect the level of ridership for more than a few months. (The basic fare was increased from $1.25 to $1.50.) In fact, total 1996 ridership was slightly higher than total 1995 ridership. Furthermore, since the last fare increase, ridership has steadily grown from approximately 1.594 billion in 1996 to 2.175 billion in 2002—a 36 percent increase, as shown in Chart I.

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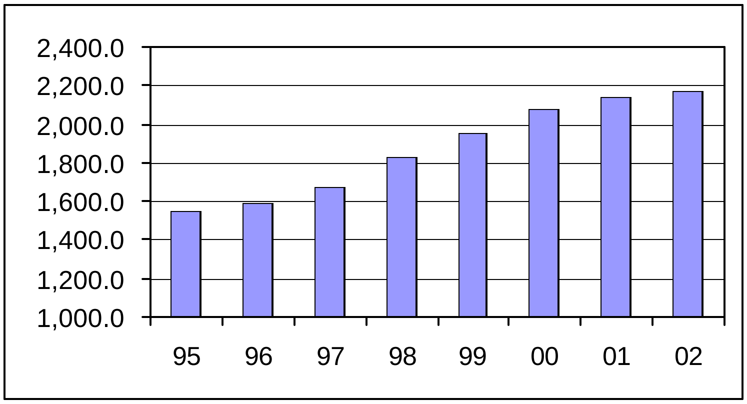
[5] According to the notes to the financial statements, "the MTA, on behalf of the [Transit] Authority, invests funds which are not immediately required for the Authority's operations in securities permitted by the State Public Authorities Law. . . . Funds held therein, including interest earned, shall be expended per MTA Board approval to stabilize the Authority's cash flow requirements as needed."

Chart I
Actual Transit Authority Ridership
Fiscal Years 1995-2002
(Ridership figures presented in millions)



Based on the above data, we question the projected budget shortfalls presented in the Transit Authority's budget plans, and we question whether the fare increase is justified.

MTA and Transit Authority Response: "The topic of the Investment Pool monies was discussed at the exit conference, and none of that discussion is reflected here. As you were told at that exit conference, the largest portion of the Pool monies, the $240 million in Stabilization Fund, has already been programmed for budget balance, a fact that has been disclosed publicly. See, for example, page 17 of the 'Review of 2002 Actual Results,' prepared for the MTA Finance Committee. . . .Most of the remaining $60 million represents (a) withheld taxes that will shortly be paid over to the appropriate governments and (b) monies needed to cover checks that have already been issued. Use of either of these resources for budget balance is illegal. . . .

"The Audit Report points out that the model employed by New York City Transit to determine the impacts of a fare increase on ridership and revenue projects a loss of ridership resulting from the proposed increase. The Report goes on to question this assumption since ridership has grown by 36 percent since 1996. The fact is that ridership has declined in the year following transit fare increases in every instance but one covering at least the last 9 fare changes going back to 1972, including 1995. The relationship of the ridership decline to the percentage fare increase over the last 9 increases is approximately equal to that used in the Transit model.

"Basically, the Draft Audit Report does not seek to distinguish the effects of those factors that decrease ridership (like fare increases) from that of the factors that increase ridership (like increased employment and the introduction of MetroCard).

"The statement about ridership increases since 1996 is true, but fails to mention that these increases resulted in large part from decreases in the average fare made possible by the revolutionary introduction of MetroCard fare incentives such as free subway-to-bus transfers, the $15 bonus and the implementation of unlimited ride passes. . . ."

Auditor Comment: The MTA and Transit Authority's response did not address whether MTA Investment Pool funds were included in the budget plans considered by the MTA Board when it voted to increase the fare. The fact that the MTA and Transit Authority disclosed these funds to the public in the 'Review of 2002 Actual Results' in mid-April after receiving the draft of this report is irrelevant to the finding.

With regard to ridership, MTA and Transit Authority officials state that various factors such as MetroCard fare incentives and employment affect ridership. However, they do not indicate what part these factors played, if any, when projected ridership and related revenue was calculated. In addition, the MTA and the Transit Authority fail to acknowledge that despite the 1995 fare increase and the lack of MetroCard incentives at that time, 1996 ridership was higher than 1995 ridership. Thus, the effect of the last fare increase on ridership does not support the MTA and Transit Authority's contention that ridership will fall between 3.3 and 10 percent as a result of the approved fare increase. This is an important factor that served to suppress revenue projections in the Operating Budget Proposal.

Inequities in Fares of Transit Riders As Compared to Fares of Riders of Commuter Railroads and Long Island Bus Lines

The ridership of the Transit Authority pays a significantly higher percentage of Transit Authority operating expenses when compared to the percentage of operating expenses paid for by the ridership of the commuter railroads and Long Island Bus. Specifically, according to the revised budget, Transit Authority riders are expected to pay 53.87 percent of operating expenses for 2003 through funds derived from the fare box, while riders of Long Island Rail Road are expected to cover 38.83 percent, riders of Metro-North Railroad are expected to cover 45.26 percent, and riders of Long Island Bus are expected to cover 35.03 percent of the operating expenses for those systems.

In addition, after taking the fare increases into consideration, Transit Authority riders will pay more towards reducing the purported Transit Authority operating deficit than riders of the commuter railroads and Long Island Bus pay for the purported operating deficits of those systems. For 2003, the fare increase will provide the Transit Authority with $285.5 million towards reducing the currently projected operating deficit of $1.631 billion. This represents 17.50 percent of the projected Transit Authority deficit. By contrast, the riders of the Long Island Rail Road will contribute 10.70 percent, riders of Metro-North Railroad will contribute 8.45 percent, and riders of Long Island Bus will contribute 6.56 percent towards reducing those entities' currently projected operating deficits.

We question why Transit Authority riders are expected to pay for a greater percentage of its operating expenses and projected deficit than riders of the commuter railroads and Long Island Bus pay for their systems. One can only conclude that riders of the commuter railroads and Long Island Bus are more heavily subsidized than riders of the Transit Authority.

Conclusion and Recommendations

Transit Authority financial documents issued prior to and after the March 6, 2003, meeting of the MTA Board were not adequate to provide the basis for sound policy-making. Our analysis revealed that financial statements and budget documents were incomplete, misleading, and obfuscating. The Transit Authority made important financial revisions only ***after*** the MTA Board voted to increase the transit fare. We cannot determine whether those revisions, and possibly others yet to be revealed, will prove the necessity of a fare hike that affects more than seven million passengers a day. To ensure that the public can trust the integrity of decisions that so affect them, we recommend that the Transit Authority, in conjunction with MTA:

1. Reevaluate the need for a fare increase based on the issues discussed in this report.

   MTA and Transit Authority Response: "The report presents no information or facts to indicate the fare increase approved by the MTA Board on March 6, 2003 was not justified and ignores the overwhelming evidence that it was. The report does not mention the November 22, 2002 presentation to the Board and public, which detailed the MTA financial condition and presented alternative gap-closing scenarios including alternative fare and toll increase proposals. Nor does the report describe the January 27, 2003 presentation to the Board on fare increase options and impacts, the January 30, 2003 presentation to the Board on the debt restructuring, or the March 6, 2003 Board Presentation describing how proposed actions, including the fare and toll changes approved by the Board that day, would result in a balanced cash position as required by law."

   Auditor Comment: As mentioned earlier, the MTA and Transit Authority's practice of presenting bits and pieces of information at various times in various documents with changing numbers and assumptions makes it difficult if not impossible to evaluate the MTA's financial situation. In addition, MTA Board members, elected officials, and the public were unable to make an informed judgment about whether a fare increase was necessary since the Operating Budget Proposal did not provide clear, accurate, and comprehensive information. Therefore, we urge the MTA and the Transit Authority to reconsider this recommendation.

2. Ensure that capital costs are properly reported on its financial statements, in accordance with GAAP.

   MTA and Transit Authority Response*:* "The capital costs and all elements of the Financial Statements of the MTA NewYork City Transit Authority have always been in compliance with Generally Accepted Accounting Principles (GAAP). The treatment of capital expenses on our balance sheets and income statements has been consistently applied since 1985 and our independent auditors have all rendered opinions stating that our financial statements are in compliance with GAAP for every year during that timeframe.

"Additionally, our financial statements have been reviewed each year with the New York City Audit Committee, on which the NYC Comptroller has representation, without criticism or comment. As you are aware, since November 1989, the Authority has applied all applicable pronouncements of the Government Accounting Standards Board (GASB) as the basis of its accounting policies."

Auditor Comment*:* As stated in the audit, Generally Accepted Accounting Principles (GAAP) require that a capital cost be expensed over the life of an asset rather than charging it to the period in which the item was purchased. The Transit Authority clearly did not adhere to this requirement when it mischaracterized capital project costs and related interest as current period expenses on its Consolidated Statements of Revenues, Expenses, and Changes in Net Assets.

It is unfair of the MTA and the Transit Authority to fault the Audit Committee for not criticizing the assertions of management regarding these issues. The Committee does not audit the Transit Authority's financial statements. Rather, the Committee relies on representations made to it by the Transit Authority and its certified public accountants regarding financial statement presentation. We should note that our preliminary review of the financial statements did not disclose this issue. It was identified only as a result of our full audit of the financial statements and the accompanying books and records.

3. Ensure that future budget proposals contain complete, clear, and accurate information pertaining to the Transit Authority's financial position. In that regard, the Transit Authority and MTA should appoint an independent task force to review Transit Authority budget proposals before they are presented to the MTA Board for approval. Also, the Transit Authority and the MTA should consider including members of the public as well as elected officials on the task force.

MTA and Transit Authority Response*:* "We submit that the MTA budget process is one of the most open of all governmental budget processes. It provides opportunities for public participation at Committee and Board meetings where agency budgets and financial plans are introduced and discussed, again at subsequent meetings where they are voted upon, and further at the monthly meetings where actual budget results are reviewed. The MTA Committees and Board include members representing local elected officials, unions, and passenger constituency groups who articulate the views of our customers.

"This year special care was taken to make the budget process even more accessible to the public. Public hearings on the budgets and fare and toll proposals were held in ten of the 12 counties in the MTA District. MTA and TA officials testified before City and State legislative committees on budgetary matters. And, for the first time, a wealth of financial information was posted on our website to allow the public to better understand our financial position."

Auditor Comment: We do not dispute that the MTA and the Transit Authority provided opportunities for public participation at Committee and Board meetings and that the MTA Committees and Board include members representing local elected officials, unions, and passenger constituency groups who represent the general ridership. However, we question the value of such meetings when participants lack adequate information upon which to offer informed comments and to make informed decisions.

The MTA should:

4. When considering future fare increases for the Transit Authority, the commuter railroads and Long Island Bus, take into account the amount of operating expense already paid for by their riders.

   MTA and Transit Authority Response: "This is primarily an issue for our City and State funding partners who provide subsidy support to the MTA and its agencies in accordance with formulae mandated by law. The imposition of fare changes occurs when those sources, combined with operating revenues, are not sufficient to provide safe and reliable service to our customers. Fares are then adjusted by the Board consistent with the statutory requirement to operate with balanced cash positions at each agency."

   Auditor Comment: We agree that allocations of certain City and State funding are governed by law. However, certain tax-supported subsidies, such as the mortgage recording tax, are distributed at the discretion of the MTA. Therefore, the MTA could use such funds to begin rectifying the inequities noted in this report.

347 Madison Avenue
New York, NY 10017-3739
212 878-7200 Tel
212 878-7030 Fax

Peter S. Kalikow
Chairman

Metropolitan Transportation Authority
State of New York

April 21, 2003

Mr. Greg Brooks
Deputy Comptroller
The City of New York
Office of the Comptroller
Executive Offices
1 Centre Street
New York, NY 10007-2341

Re: Audit Report on the Financial Practices of the New York City Transit Authority FN03-141A

Dear Mr. Brooks:

This is in reply to your letter requesting a response to the above-captioned audit report.

I have attached for your information the comments of Mr. Lawrence G. Reuter, President, MTA New York City Transit and Mr. Gary G. Caplan, MTA Director of Budgets and Financial Management, which address this report.

Sincerely,

Attachment

347 Madison Avenue
New York, NY 10017-3739
212 878-7000 Tel

Metropolitan Transportation Authority
State of New York

April 21, 2003

Honorable Peter S. Kalikow
Chairman
Metropolitan Transportation Authority
347 Madison Avenue
New York, NY 10017

Re: New York City Audit Report

Dear Mr. Kalikow:

On Friday, April 11, 2003 we received a preliminary draft of the New York City Comptroller's Office Report on Financial Practices of the New York City Transit Authority (FN03-141A). Staff members of both the MTA and MTA NYCT met with representatives of the Comptroller on Wednesday, April 16, 2003 and a revised draft of the aforementioned report was submitted later that day. We have reviewed the report with our staffs and find it to contain numerous inaccuracies and many misstatements of fact. We offer the following responses to the recommendations:

Recommendation #1: Reevaluate the need for a fare increase based on the issues discussed in this report.

The report presents no information or facts to indicate the fare increase approved by the MTA Board on March 6, 2003 was not justified and ignores the overwhelming evidence that it was. The report does not mention the November 22, 2002 presentation to the Board and public, which detailed the MTA financial condition and presented alternative gap-closing scenarios including alternative fare and toll increase proposals. Nor does the report describe the January 27, 2003 presentation to the Board on fare increase options and impacts, the January 30, 2003 presentation to the Board on the debt restructuring, or the March 6, 2003 Board Presentation describing how proposed actions, including the fare and toll changes approved by the Board that day, would result in a balanced cash position as required by law.

Recommendation #2: Ensure that capital costs are properly reported on its financial statements in accordance with GAAP.

The capital costs and all elements of the Financial Statements of the MTA New York City Transit Authority have always been in compliance with Generally Accepted Accounting Principles (GAAP). The treatment of capital expenses on our balance sheets and income statements has been consistently applied since 1985 and our independent auditors have all rendered opinions stating that our financial statements are in compliance with GAAP for every year during that timeframe.

Additionally, our financial statements have been reviewed each year with the New York City Audit Committee, on which the NYC Comptroller has representation, without criticism or comment. As you are aware, since November 1989, the Authority has applied all applicable pronouncements of the Government Accounting Standards Board (GASB) as the basis of its accounting policies. In 2002, the Authority adopted GASB Statement 34 titled, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments,* and the related GASB Statements 37 and 38. These GASB Statements represent the biggest change in the history of public-sector accounting. The 2002 NYCTA financial statements are in full compliance with these new standards and will be so certified by our independent auditors.

Recommendation #3: Ensure that future budget proposals contain complete, clear, and accurate information pertaining to the Transit Authority's financial position. In that regard, the Transit Authority and MTA should appoint an independent task force to review Transit Authority budget proposals before they are presented to the MTA Board for approval. Also, the Transit Authority and the MTA should consider including members of the public as well as elected officials on the task force.

The first part of this recommendation implies the 2003 Budget Proposal did not include complete, clear and accurate information yet the report presents no supporting evidence for this allegation. In fact, the Authority's Operating Budget Proposal and Multi-year Financial Plan for New York City Transit, presented to the Board on December 18, 2002 were complete, clear and accurate presentations of the Authority's financial position and supplemented detailed information included in the November 22, 2002 Financial Plan presentation. In addition, as noted above in our comments on Recommendation #1, various supplementary presentations on matters related to the budget and financial plan were presented in public to our Board Members on several occasions.

We submit that the MTA budget process is one of the most open of all governmental budget processes. It provides opportunities for public participation at Committee and Board meetings where agency budgets and financial plans are introduced and discussed, again at subsequent meetings where they are voted upon, and further at the monthly meetings where actual budget results are reviewed. The MTA Committees and Board include members representing local elected officials, unions, and passenger constituency groups who articulate the views of our customers.

This year special care was taken to make the budget process even more accessible to the public. Public hearings on the budgets and fare and toll proposals were held in ten of the 12 counties in the MTA District. MTA and TA officials testified before City and State legislative committees on budgetary matters. And, for the first time, a wealth of financial information was posted on our website to allow the public to better understand our financial position.

Recommendation #4: The MTA should, when considering future fare increases for the Transit Authority, the commuter railroads and Long Island Bus, take into account the amount of operating expense already paid for by their riders.

This is primarily an issue for our City and State funding partners who provide subsidy support to the MTA and its agencies in accordance with formulae mandated by law. The imposition of fare changes occurs when those sources, combined with operating revenues, are not sufficient to provide safe and reliable service to our customers. Fares are then adjusted by the Board consistent with the statutory requirement to operate with balanced cash positions at each agency.

Attached you will find responses on specific findings and comments raised in the audit report.

Sincerely,

Lawrence G. Reuter
President,
MTA New York City Transit

Gary G. Caplan
MTA Director of
Budgets and Financial Management

Attachment

Responses to Specific New York City Audit Report Comments

Audit Finding: Operating Budget Proposal Lacks Critical Information

Audit Response: The Draft Audit Report states that New York City Transit's Operating Budget Proposal "did not indicate whether it included: savings from debt restructuring; costs associated with the recent collective bargaining agreement or reserves set aside to cover these costs; surplus associated with toll increases for bridges and tunnels; and additional revenues from the proposed increase to the transit fare."

In fact, the financial tables included in the Budget Proposal contained the following note. "Excludes subsidies and debt service; continues fares at current levels." Financial Plan information presented in a separate section of the December 16 financial plan document provided agency and MTA-wide projections with subsidies and debt service. The Transit Operating Budget is meant to focus on Transit operations, while those activities that are the responsibility of MTA are shown in the MTA-wide financial plan. As for collective bargaining, the Budget Proposal was issued before there was a contract agreement in place. The Board was told that the proposal included New York City Transit's offer on the table at that time.

The case for the fare increase was presented in several documents that need to be taken as a whole, not just one document. The finances of the MTA are complicated, which is why the case was set forth in what we believed were "digestible" pieces that would make it easier for the public to understand MTA's finances. These documents included the November 22, 2002 financial plan presentation to the Board, the December 9, 2002 Transit Operating Budget, the December 16, 2002 MTA-wide Financial Plan, the January 17, 2003 presentation by Executive Director Lapp to the City Council, the January 27, 2003 fare policy presentation, the January 30, 2003 presentation on the debt restructuring and the March 6, 2003 financial plan review.

The Draft Audit Report also states that the proposal reported "different operating deficits in two sections of the document. In one section, the deficit was reported as $1.632 billion, while in another, the deficit was reported as $2.009 billion." The $1.632 billion total is from New York City Transit's Operating Budget Proposal and is clearly labeled net Operating Cash Deficit and marked with an asterisk referring to the note described above. The $2.009 billion amount is from the MTA section of the Board Presentation and represents the Operating Deficit (not cash) including debt service. These differences are clearly noted.

Finally, the Draft Audit Report claims that certain information was not given to the Board until after the fare increase was approved. The collective bargaining information was provided to the Board when it approved the labor contract with TWU Local 100 in January, two months before the vote on fare and toll increases, and the other information was provided in the various presentations and documents listed above.

Audit Finding: Questions Regarding the Necessity for a Fare Increase

Audit Response: The Draft Audit Report cities "two items that cause us to question the necessity for the fare increase that was approved."

The first of these is the $300 million MTA Investment Pool. The topic of the Investment Pool monies was discussed at the exit conference, and none of that discussion is reflected here. As you were told at that exit conference, the largest portion of the Pool monies, the $240 million in the Stabilization Fund, has already been programmed for budget balance, a fact that has been disclosed publicly. See, for example, page 17 of the "Review of 2002 Actual Results," prepared for the MTA Finance Committee and contained in the current Finance Committee agenda. Most of the remaining $60 million represents (a) withheld taxes that will shortly be paid over to the appropriate governments and (b) monies needed to cover checks that have already been issued. Use of either of these resources for budget balance is illegal.

The second item appears to be a belief that fare increases do not depress ridership. This opinion is not shared by most observers of public transportation, including the passenger advocacy groups that follow MTA affairs.

The Audit Report points out that the model employed by New York City Transit to determine the impacts of a fare increase on ridership and revenue projects a loss of ridership resulting from the proposed increase. The Report goes on to question this assumption since ridership has grown by 36 percent since 1996. The fact is that ridership has declined in the year following transit fare increases in every instance but one covering at least the last 9 fare changes going back to 1972, including 1995. The relationship of the ridership decline to the percentage fare increase over the last 9 increases is approximately equal to that used in the Transit model.

Basically, the Draft Audit Report does not seek to distinguish the effects of those factors that decrease ridership (like fare increases) from that of the factors that increase ridership (like increased employment and the introduction of MetroCard).

The statement about ridership increases since 1996 is true, but fails to mention that these increases resulted in large part from decreases in the average fare made possible by the revolutionary introduction of MetroCard fare incentives such as free subway-to-bus transfers, the $15 bonus and the implementation of unlimited ride passes. These incentives resulted in the average fare paid by transit customers dropping from $1.38 in 1996 to $1.04 in 2002. The fare declined and ridership increased. The current increase is being implemented in a more stable fare media environment without the significant changes that occurred with the introduction of the MetroCard incentives. It is therefore reasonable and prudent to assume, with the support of historical performance, that the fare increase will result in ridership declines.

Audit Finding: Inequities in Fares of Transit Riders

Audit Response: No one disputes the fact that fare revenues cover a higher proportion of Transit's costs than those of the other MTA properties. Whether this constitutes an "inequity," as you term this condition, and whether a finding of "inequity" is an audit finding or an expression of a policy view, are entirely different questions. A more complete discussion of this issue would take account of the following:

- Consistent application of this position would seem to require that bus riders be charged more than subway riders, since the current ratio for them is much lower than for the subway riders, and that the existing Staten Island Railway fare be tripled, so that SIR's ratio could be close to Transit's.

- This report elevates one fact into a "fairness" proposition. Many factors should be considered when discussing the equity of a particular condition. One useful discussion of these factors is contained in an opinion of the US Court of Appeals at the time of the last fare increase, when it denied a request for a TRO to stop that increase (the Court determined that the Legislature was making a reasonable judgment when it established the subsidy allocations that are a cause of the different ratios).

- The different ratios are not only the result of a legislative determination, but also different usage patterns. The Transit system is not primarily a journey-to-work system, while the Commuter Railroads are. The average Transit User uses the transit system much more frequently than the Commuter Rail rider uses the commuter system, especially for non-journey-work purposes. That is why fewer than 50% of NYC households have cars. Since mass transit systems have significant fixed costs, this means that each individual person using Transit contributes proportionately more to covering those costs than the comparable Commuter Railroad individual, but this is a consequence of individuals' trip frequencies, not of "unfair" subsidiziation policies.

- As a result of the fare increases, each Transit rider will pay $.26 more toward covering the deficit, while each Long Island Rail Road rider will pay $.98 and each Metro-North rider $1.10. Each Commuter rider pays more towards reducing his/her related operating deficit than does each Transit rider. (This illustrates another point about "equity." The average Commuter fare is four times the average Transit fare. Some people have argued for "One MTA, one fare.")

Audit Finding: Comments on internal controls

Audit Response: The Preliminary Audit Report concluded that "The Transit Authority had adequate procedures for recording revenue and expenses." It further stated "We are reasonably assured that revenues...were properly deposited...and accurately recorded." It indicated that "We are generally assured that expenses...were appropriate, reasonable and properly recorded." The Transit Authority concurs with the aforementioned audit findings.

Audit Finding: In 2001, operating expenses overstated.

Audit Response: We strongly disagree with the claim that the operating expenses of the Authority were overstated in our 2001 financial statements. Use of the caption "operating expense" is associated with the new GASB 34 reporting model that was adopted in Fiscal Year 2002. In prior years, the Authority's financial statements focused on total expense and total revenues, not operating expense or operating loss. Presenting certain expenditures as both expenses and expense reimbursements in 2001, and prior years, reflected the actual flow of activity with the MTA. This presentation has no effect on net income, as pointed out in the audit, and is in full compliance with GAAP, as the Authority's audited statements evidence. Furthermore, these costs and reimbursements are inter-agency transactions that have been eliminated (netted out) upon combination in the MTA financial statements. Note also that some persons believe the inclusion of such "force account" transactions is necessary to give a full presentation of the dollar magnitude of Transit's operations.

Audit Finding: Suggestion that capital costs are not capitalized and depreciated.

Audit Response: The finding suggests that the Authority is not capitalizing and depreciating these costs. We conducted a detailed review, with the NYC Comptroller's audit team, of the Authority's capital expense accounting flow - to the individual entry level - which clearly evidenced the fact that we are correctly recording and depreciating our capital assets. The suggestion that we are not is simply not correct. Since capital assets account for $19.1 billion, or 90%, of the Authority's assets, this is an area of intense concern and focus for the Authority.

Audit Finding: Unable to make an informed judgement on Authority financial condition

Audit Response: In attempting to evaluate a future cash flow projection, we question the sole focus on the statement of operations and surplus. While this statement is on the accrual basis and in accordance with GAAP, it recognizes both revenues and expenses when they are generated rather than when they are paid or received. More relevant to this effort would have been the Consolidated Statement of Cash Flows, which is also one of our basic financial statements. Since these statements are not mentioned in the Comptroller's report we do not know whether they were reviewed by the audit staff. Review of this statement may have led to a better understanding of the Authority's cash flows and allowed the Comptroller to reach an opinion on our financial condition.

Audit Table - Table 1, Abstract of Transit Authority Financial Data

Authority Comment: As mentioned in the closing conference, we do not think the abstract presents a clear picture to the reader. We recommend the inclusion of loss before capital contribution in your presentation. Given the significant ($7.1 billion) Capital Contributions in 2002, we reiterate our request that the transfer of $4.5 billion in debt and deferred debt expenses, as a result of the MTA Debt Restructuring Plan, which are included in the Capital Contributions, be explained with a footnote.

Other Comments:

Page 1. first paragraph, line 4

The MTA was created to accomplish the purposes specified in 1968, not 1965.

Page 1, second paragraph, line 2

Later on, the report criticizes the Transit Authority for showing "revenues" and "expenses" because these terms include non-operating revenues and non-operating expenses. Yet the report in this place goes on to make a point using "revenues" -- which include both operating and non-operating revenues.

Page 1, second paragraph, line 5

TBTA may also issue bonds for this purpose.

Page 1, third paragraph, line four

No revision of the Transit budget proposal was released on December 16. The MTA-wide Financial Plan was released on that date.

Page 2, third complete paragraph, lines one to four

While the report says that you were provided with enough information to determine whether a fare increase was justified, you actually make no such determination. You nowhere state flatly, "The fare increase was justified" or "the fare increase was not justified." In fact, the report later goes on to say you can't yet make a determination (see second paragraph on page 3 of the Draft Report).

Page 3, second paragraph, lines six through nine

Average weekday ridership in 2003 is 6.882 million passengers, which rounds to seven million, not six million. In February (the latest month for which numbers are available), average weekday ridership exceeded seven million.

Page 3, third paragraph, line four

Both the 2003 budgeted headcount and the 2002 year-end actual headcount were less than 48,000 not more than 48,000.