

PORT AUTHORITY OF ALLEGHENY COUNTY

SINGLE AUDIT

JUNE 30, 2008

MaherDuessel

Certified Public Accountants || *Pursuing the Profession While Promoting the Public Good**

PORT AUTHORITY OF ALLEGHENY COUNTY

JUNE 30, 2008

DIRECTORY

Financial Statements:

Independent Auditor's Report	
Management's Discussion and Analysis	i
Financial Statements	1
Required Supplementary Information	31
Additional Information	33

Independent Auditor's Reports in Accordance with OMB Circular A-133:

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	35
Independent Auditor's Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133	37
Schedule of Findings and Questioned Costs	39
Summary Schedule of Prior Audit Findings	42

PORT AUTHORITY OF ALLEGHENY COUNTY

FINANCIAL STATEMENTS AND REQUIRED SUPPLEMENTARY INFORMATION AND ADDITIONAL INFORMATION

YEARS ENDED JUNE 30, 2008 AND 2007

WITH

INDEPENDENT AUDITOR'S REPORTS

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PORT AUTHORITY OF ALLEGHENY COUNTY

YEARS ENDED JUNE 30, 2008 AND 2007

TABLE OF CONTENTS

Independent Auditor's Report

Management's Discussion and Analysis	i
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Financial Statements:

Statements of Net Assets	1
Statements of Revenues, Expenses, and Changes in Net Assets	2
Statements of Cash Flows	3
Notes to the Financial Statements	4

Required Supplementary Information:

Schedule of Funding Progress – Pension Plans	31
Schedule of Funding Progress – Other Post Employment Benefit Plans	32

Additional Information:

Schedule of Expenditures of Federal Awards	33
Notes to Schedule of Expenditures of Federal Awards	34

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Independent Auditor's Report

Board of Directors
Port Authority of Allegheny County

We have audited the accompanying financial statements of the Port Authority of Allegheny County (Authority), a component unit of Allegheny County, as of and for the years ended June 30, 2008 and 2007 as listed in the directory. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the Authority's financial position as of June 30, 2008 and 2007, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 16, 2009 on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and is important in assessing the results of our audit.

The Management's Discussion and Analysis on pages i through xv and the required supplementary information presented on pages 31 and 32 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was made primarily for the purpose of expressing an opinion on the financial statements taken as a whole. The accompanying schedule of expenditures of federal awards on page 33 is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the financial statements. Additionally, the schedules on pages 31 and 32 are required by the Commonwealth of Pennsylvania Department of Transportation. Such information and the schedule of expenditures of

Board of Directors
Port Authority of Allegheny County
Independent Auditor's Report
Page 2

federal awards have been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole.

Maher Duessel

Pittsburgh, Pennsylvania
January 16, 2009

Port Authority of Allegheny County Management's Discussion and Analysis (MD&A)

The following Management's Discussion and Analysis of the financial performance of the Port Authority of Allegheny County provides both an introduction and explanation of the basic financial statements of Port Authority for the fiscal year ended June 30, 2008 with comparative financial information for the fiscal year ended June 30, 2007. This section is designed to highlight significant financial issues and activities of Port Authority. The following analysis should be used in conjunction with the attached financial statements.

Highlights

- ◆ FY2008 Net Expenses exceeded Revenues Before Capital Related Items by (\$29,558,882). This shortfall is primarily due to the adoption of GASB 45 and the recognition of the OPEB (Other Post Employment Benefits) expense in the amount of \$42,154,853. Excluding this OPEB entry, which is currently unfunded and not a budgeted item, Port Authority's Revenues exceeded Net Expenses Before Capital Related Items by \$12,595,971.
- ◆ Port Authority recently reached agreement with its largest union, the Amalgamated Transit Union Local #85 (ATU-#85). While this agreement provides limited, concrete savings in its daily operating budget expenses, it does significantly reduce Port Authority's annual Other Post Employment Benefit (OPEB) liability by over \$20 million annually.
- ◆ In FY2008, Port Authority operated the entire fiscal year at a service level that was 15% less than FY2007. As a result of this service reduction, in late FY2007 Port Authority eliminated 370 budgeted positions and instituted 203 layoffs, a painful but necessary step to reduce expenses. These reductions were needed to improve service efficiency and were, in part, the result of recommendations of the Transit Funding and Reform Commission and help build support for the legislative efforts that solidified State funding in the form of Act 44.
- ◆ FY2008 was the first year Port Authority operated under Act 44. Act 44 had a two-fold financial impact on Port Authority in FY2008. The legislation gave Port Authority a dedicated and predictable source of funding. This source of funding resulted in Port Authority receiving over \$50 million in dedicated revenues. Act 44

also had the positive impact of consolidating various state funding programs into one, single operating assistance program. This resulted in reduced administrative burden associated with accessing the State operating assistance dollars.

- ◆ Ridership decreased by 2,500,000 overall with the bulk of the ridership loss attributable to the 15% service cuts in June 2007 and an increase in base fares from \$1.75 to \$2.00 in January 2008.
- ◆ The North Shore connector project is currently underway with the continuation of the boring of the twin tunnels under the Allegheny River. The boring is scheduled to be completed early in 2009.

Basic Financial Statements

The Port Authority's consolidated financial statements are prepared in conformity with generally accepted accounting principles (GAAP) that apply to U.S. governmental units. The Port Authority uses the accrual basis of accounting whereby revenues are recorded when earned and expenses are recorded when incurred. Since the Port Authority is comprised of a single enterprise fund, no individual fund level financial statements are presented.

The following financial statements, along with the "Notes to Financial Statements," serve as the basis for the analysis and understanding of the Port Authority's financial position:

- ◆ **Statements of Net Assets** - These financial statements summarize the Port Authority's capital structure as to whether company assets were financed with equity or by incurring a liability. Net assets increase when revenues exceed expenses. Increases in assets without a corresponding increase in liabilities generally indicate an improved financial condition.
- ◆ **Statements of Revenues, Expenses, and Changes in Net Assets** - These financial statements provide information on the net income generated from Port Authority's continuing operations. Operating Expenses are subtracted from Operating Revenues in order to determine an Operating Gain or Loss. Non-Operating Revenues that are defined as significant recurring federal and state grants are added to the Operating Gain or Loss in order to calculate Net Revenue over Expenses Before Capital Related Items. The net revenue over expenses before capital related items is added to the change in net assets which is derived

by combining capital grant contribution revenue, interest income, interest expense, unrealized gain on investments, and depreciation expense.

- ◆ **Statements of Cash Flows** - The statements of cash flows detail the cash flows generated by Port Authority's operations, non-capital financing, and capital and related financing activities. These statements incorporate a direct approach by adding FY2008 changes in cash flows from operating activities, non-capital financing activities, capital and related financing activities, and investing activities to fiscal year-end 2007 cash balance.

The Port Authority's Financial Condition

The Statements of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets report information about the Port Authority as a whole and details changes in the Port Authority's financial position. These statements include all assets and liabilities using the accrual basis of accounting. Increases or decreases in the Port Authority's net assets are one indicator of whether its financial health has improved or deteriorated over a period of time. Other less tangible factors, such as the age of the revenue vehicle fleet, new service initiatives, health of the local economy, labor union contractual issues, and the level of inter-governmental financial support all combine to influence the current and future financial health of the organization.

It is with the assistance of Federal, State, and County operating subsidies and grants that the Port Authority is able to provide ongoing transit service. These operating subsidies and grants are categorized as Non-Operating Revenues on the Statements of Revenues, Expenses, and Changes in Net Assets. Operating Expenses are subtracted from the combination of Operating Revenue and Non-Operating Revenue in order to determine the Port Authority's operating surplus or deficit. In compliance with GASB 45 regulations, Port Authority determined and expensed an annual required contribution (ARC) on the operating statement. The ARC represents the amount of funds needed to cover the pay as you go costs and the unfunded future years' obligation spread over 30 years. The \$42,154,853 OPEB expense is net of the current year contributions. In FY2008, the Port Authority completed the fiscal year with Net Operating Expenses over Revenue Before Capital Related Items of (\$29,558,882.)

The Port Authority as Trustee

Port Authority is a trustee of the Port Authority of Allegheny County Retirement and Disability Allowance Plan for Employees Represented by Local 29 of the International Brotherhood of Electrical Workers and the Port Authority of Allegheny County Retirement and Disability Allowance Plan for Employees Not Represented by a Union. In addition, the Port Authority serves as a joint trustee, along with the Amalgamated Transit Union (ATU) Local #85, on the Port Authority of Allegheny County Retirement and Disability Plan for Employees Represented by Local 85 of the Amalgamated Transit Union. Although not subject to the Employee Retirement Income Security Act (ERISA), Port Authority follows its guidelines and has separate, external audits of these plans conducted.

Statement of Net Assets

Total Current Assets increased by \$21.9 million from \$100.4 million in FY2007 to \$122.3 million in FY2008. Below are explanations of significant changes in various current asset classifications:

CURRENT ASSETS

Cash

At year-end, the Port Authority's ending cash and cash equivalents balance was \$56.5 million, a decrease of \$12.3 million in comparison to the prior year. This change is partially attributable to Port Authority using previously programmed Basic Supplemental Grant (BSG) funds to supplement the absence of local operating assistance from Allegheny County.

Capital Grant Receivables

Capital Grants Receivable increased by \$5.3 million from \$20.7 million in FY2007 to \$26.0 million in FY2008. Approximately \$17.6 million of the outstanding balance at fiscal year-end is associated with Federal grants and \$3.6 million is due from State grants and \$3.9 million from Allegheny County.

Other Receivables

Other Receivables, including Due from Allegheny County, increased by \$27.0 million from \$1.5 million in FY2007 to \$28.5 million in FY2008. This increase was due to an establishment of an Account Receivable of \$27.5 million that represents the Operating Assistance due from Allegheny County.

Prepaid Expenses

The Port Authority's prepaid expense experienced a net increase of \$2.0 million when compared to the prior fiscal year. This was due to \$2.0 million in Prepaid Healthcare Premiums.

NON-CURRENT ASSETS

The Port Authority's major facilities include five, bus garages, a rail center, a complex housing the Power and Ways Departments, the Manchester Administrative Center and General Shops building, South Hills Village Parking Garage, fixed guideways such as the 9.1 mile Martin Luther King, Jr. East Busway, 4.3-mile South Busway, 5.0-mile West Busway, 48.9 miles of Light Rail Transit (LRT) infrastructure, the Monongahela Incline, and other various structures that are situated throughout Allegheny County.

The net change to accumulated depreciation during FY2008 was (\$67.4) million. When combined to the FY2008 net asset additions of \$85.6 million including \$60.1 million in Projects in Progress, it results in an increase to non-current assets of \$21.4 million due to Capital Assets, net of depreciation.

Restricted Assets for Capital Lease Obligations fell by (\$2.0) million from FY2007 levels. These assets are restricted for payment of principal and interest on a sale-lease back transaction of light rail vehicles that the Port Authority entered into June 1997. This decrease was due to a reduction in Accrued Interest Receivable US Lease.

Major capital project activities during the reporting year included the following:

- Incurred costs of approximately \$17.7 million for the final design, project administration, and management on the North Shore Connector project.
- Incurred costs of approximately \$74.6 million on construction of the North Shore Connector project.

- Progress and support payments of \$13.5 towards the rehabilitation of the 55 existing LRV's.
- Incurred costs amounting to \$4.7 million toward the South Hills Junction Busway Rehabilitation project.

LIABILITIES AND NET ASSETS

In FY1999, the Port Authority borrowed \$225 million of 30-year, long-term debt to finance the aforementioned projects in addition to other capital projects. Subsequently, in FY2001, the Port Authority refinanced the 1999 borrowing with a refunding amount of \$250.6 million.

The Port Authority used its dedicated funding as a source of security for the debt issuance. The issuance received a credit rating of "Aaa" and "AAA" from Moody's Investors Service, Inc. and Standard & Poor's Rating Services, respectively.

In FY2003, the Port Authority entered into a 10-year lease agreement with Koch Financial to finance the purchase of new buses manufactured by the Gillig Corporation.

In FY2004, the Port Authority was able to take advantage of a low-interest rate environment to sell an option on refunding outstanding Series 2001 bonds with variable rate bonds. This transaction, also referred to as a Swaption, allowed the Port Authority to receive an upfront net benefit of \$9,500,000 after expenses.

At the year-end, the Port Authority had a total of \$313.6 million in bonds outstanding versus \$339.1 million for FY2007, a decrease of \$25.5 as shown below. Most of this decrease is attributable to a reduction in the Koch Bus Financing due to payments of principal and interest towards this financing arrangement.

Port Authority of Allegheny County Outstanding Long-term Debt Year-End		
	2008	2007
Series of 1999	\$0.00	\$11.94
Series of 2001	\$244.49	\$245.48
Koch Bus Financing	\$79.16	\$91.42
(Discounts) and Premiums	\$1.61	\$2.49
Deferred Amount of Refunding	<u>\$(11.64)</u>	<u>\$(12.20)</u>
Totals	\$ 313.62	\$ 339.13

Other Liabilities

In addition to long-term debt obligations, the Port Authority has other short-term, current liabilities. These other obligations include accounts payable, accrued compensation, benefits, and withholdings, deferred credits, reserves for claims and settlements, current portions of capital leases, and bonds payable and other current liabilities. The Port Authority's total current liabilities increased by \$16.6 million from FY2007 levels. The increase in current liabilities was partially due to an \$8.1 million increase in Accounts Payable. The net increase in Accounts Payable was primarily due to an increase of unvouchered expenses of \$9.1 million while vouchered accounts payable decreased by (\$1.7) million. The net decrease was also contributed to by an increase of \$1.0 million in Accounts Payable Retainage.

A \$4.0 million increase in Deferred Credits also contributed to the increase in current liabilities. The increase in the Deferred Credits was attributable to a \$1.8 million deferred revenue related to Service Center Annual Pass Sales that will be recognized in FY2009 and a \$1.2 million Deferred Grant Credit for the Public Transportation Assistance Fund (PTAF).

The increase in Total Current Liabilities also occurred due to a \$2.7 million increase in Reserves for Claims and Settlements. This account is set-up to reflect potential liabilities for both public liability and workers compensation claims.

Total Current Liabilities also increased during FY2008 due to a \$1.3 million increase in the Current portion of bonds payable.

The Port Authority's non-current liabilities increased by \$13.4 million in FY 2008 due primarily to an increase in unfunded accrued liability for Other Post-Employment Benefits (OPEB) of \$42.2 million that was required to be recorded due to GASB 45. In addition, a \$1.3 million increase in the category of Deferred Interest Payable- Capital Lease contributed to the increase in non-current liabilities. A \$3.6 million reduction in Capital lease obligations and the aforementioned \$25.5 million reduction in Bonds Payable, net partially offset the increases to OPEB and Deferred Interest Payable-Capital Lease.

Net Assets (Deficits)

The Port Authority's investment in capital assets, net of related debt, increased, from \$1.17 billion to \$1.22 billion, or 4.0%. Total Net Assets increased to \$1.10 billion from \$1.08 billion.

Financial Comparison (FY2008 versus FY2007)

The following discussion measures the financial performance of the Port Authority by comparing the actual revenue, expenditure, and total asset changes between FY2008 and FY2007. This section comments on revenue and expense categories that exhibited significant dollar variances between FY2008 and FY2007.

Revenues

Operating Revenues comprised 28.6% of total revenues required to support the operating budget, which was unchanged from FY2007. The amount of operating revenue decreased by \$3.3 million from FY2007 to FY2008. Non-Operating Revenues increased by \$19.8 million between FY2007 and FY2008. The change in Non-Operating Revenues was predominantly attributable to a \$11.6 million increase in the County Operating Assistance. In FY2007, Passenger revenues were derived from four primary sources: directly operated services for bus, light rail, and incline plane; senior citizen reimbursements for non-peak ridership; contract services with local universities for student-ride programs; and Non-Fixed Route revenues from ACCESS Program Services. Beginning in FY2008, Senior Citizen Free Transit Revenues were no longer provided as a stand-alone program, but rather were combined with State-Act 44 Non-Operating Revenue. This accounts for the \$10.1 million reduction in Senior Citizen Free Transit Program Revenue.

Bus, trolley, and light rail revenues, including contract service revenue from the local universities, increased by \$5.7 million. All passenger revenue categories experienced an increase from FY2007 levels as a result of a January 2008 base-fare increase. The largest revenue category increase was in Annual Pass Sales which increased by \$2.3 million due to a new agreement with the Pittsburgh Public Schools. Secondly, Contract Service revenue increased by \$593,000 due to contractual increases with the University of Pittsburgh and Carnegie Mellon University.

As indicated in the Port Authority Ridership Summary below, total ridership fell by -3.7% from FY2007 levels. This decrease can be attributed to a 15 percent service reduction Port Authority implemented June 2007. This reduction negatively impacted ridership totals in all categories except for a 3.6% increase in Senior Citizens totals.

Port Authority Ridership Summary			
	2008	2007	%Increase/ (Decrease)
Bus, Light Rail and Incline	50,685,856	53,187,653	-4.7%
Contract Services	7,085,301	7,286,866	-2.8%
Senior Citizens	5,970,729	5,765,328	3.6%
ACCESS	1,693,648	1,708,450	-87%
Free Ridership	1,842,570	1,890,752	-2.5%
Total	67,278,104	69,839,049	-3.7%

The Port Authority contracts with Veolia Transportation Services Inc. for professional services to coordinate door-to-door, demand-response transportation service for elderly and handicapped citizens. The Commonwealth of Pennsylvania also reimburses the Port Authority for a portion of the costs incurred in providing this program. In FY2008, ACCESS revenues increased by \$1.0 million or 8.6%. A ridership reduction of (14,802) was offset by a fare increase ACCESS implemented in July 2008.

Expenses

The Port Authority's total operating expenses, net of capitalizations, increased by \$12.1 million or 3.5% from FY2007 to FY2008. Total Operating Expenses, net of capitalizations would have increased more dramatically except for the June 2007 re-organization plan that eliminated 370 budgeted positions. This re-organization plan led to the \$6.7 million reduction in Employee Wages & salaries between FY2007 and FY2008. The category of Employee benefits increased by \$5.8 million from FY2007. This increase is predominantly attributable to a \$5.3 million increase in Pension expense. The Employee benefits expense increase is also attributable to a \$2.8 million increase in Other Post Employment Benefits (OPEB).

ACCESS Program Service expense for FY2008 was higher than FY2007 by \$820,446 or 3.3%. The provider of this service has been subject to many of the same expenses as drivers for the Port Authority. Most notably, fuel prices continue to impact ACCESS Program Service expense.

The Provision for Injuries and Damages category of expenses increased from FY2007 levels by \$4,078,488. This was mostly due to an increase in Workers Compensation

Indemnity Payments of \$4,078,484 and Litigated Settlements of \$1,209,047 resulting in increased total expenses within this category.

Utilities increased by \$450,911 over FY2007 expense totals. Port Authority uses high amounts of electricity to power its Light Rail System and facilities. It also relies on natural gas to keep its garage facilities comfortable during winter months. Port Authority incurred a (\$243,545) reduction in natural gas expense, but this was offset by a \$334,838 increase in Propulsion Power and a \$435,322 increase in electricity due to higher rates.

The capitalization category represents reimbursement from capital funds of personnel and non-personnel operating expenses incurred that are associated with capital projects. In addition, the capitalization category includes reimbursement of expenses associated with Access-to-Jobs, the Federal Flex program for New Service Initiatives, and non-fixed asset capital expenses. The amount of capitalizations subtracted from gross operating expenses decreased in FY2008 by \$5.2 million over FY2007. This reduction is due to a \$1.7 million decrease in capitalizations associated with the Access-to-Jobs program. In addition, Port Authority made a policy shift during the fiscal year that curtailed the amount of administrative expenses charged to capital projects. This change resulted in a \$1.9 reduction in the amount of salaries and fringe benefits charged to capital projects.

Non-Operating Revenues

Total FY2007 Non-Operating Revenues increased by \$19.8 million, or 8.0%, from FY2007. Non-operating revenues originate from a number of sources. The Commonwealth of Pennsylvania provided operating subsidies in FY2008 in the amount of \$183 million under Act 44. While this \$183 million in State-Act 44 Operating subsidy represents an increase from the \$99 million in FY2007, it also must be mentioned that the total subsidy amount is a consolidation of revenues that were accounted for separately in the FY2007 totals. The operating subsidies from Allegheny County for FY2008 increased by \$11.6 million due to Port Authority supplementing Allegheny County's FY2007 Operating Assistance with proceeds from a Swaption financing arrangement.

In FY2007, Asset Maintenance funds were provided by the Commonwealth of Pennsylvania via Act 26 of 1991 to offset operating expenses associated with the general maintenance of machinery, equipment and infrastructure. Asset Maintenance funding originated from two distinct sources. The State's Public Transportation Assistance Fund enacted in 1991 (PTAF), and its associated local match from Allegheny County. The portion from the

state provided \$25.1 million of the total \$30 million in Asset Maintenance funding. Annually, the Port Authority also received the Additional Supplemental Grant (ASG), as a result of Act 3 of 1997, which provided \$4.9 million of additional asset maintenance funds including local match. These funds are now included within State-Act 44 totals for FY2008.

In FY2007, Preventative Maintenance program was a combination of \$12.6 million of Section 5307 funding towards the Preventative Maintenance program and an additional payment of flex funding for federal Preventative Maintenance totaling \$32.0 million. These funds are used predominantly to offset the cost of salaries and wages associated with operating expenses incurred in the inspection, maintenance, and servicing of revenue vehicles. In FY2008, Port Authority only utilized \$494,000 in Preventative Maintenance funding.

The Infrastructure Safety Renewal Program utilizes state capital funds to offset operating expenses related to the renovation and/or rehabilitation of transit and railroad bridges, track stations, signals, power, and miscellaneous components of the Port Authority's transit and rail systems. The Vehicle Improvement Program uses state capital funds to cover labor and material costs incurred in performing overhaul activities on motorbus and light rail vehicles. The Port Authority has available a total of approximately \$18.5 million from the Commonwealth of Pennsylvania each fiscal year to be divided between these two programs. The variance between FY2008 and FY2007 for Vehicle Improvement and Infrastructure Safety Renewal is a function of the eligible reimbursable costs the Port Authority had for each of these programs.

The Capital Cost of Contracting component of non-operating revenues remained flat from FY2007. These federal funds (Section 5307) are used to offset up to 50% of total program costs incurred for the ACCESS program and other contracted services, including bus leases for the Small Transit Vehicle (STV) program and building leases.

Interest income for FY2008 and FY2007 was \$1,651,250 and \$2,653,363, and interest expense was \$886,756 and \$1,675,697, respectively. Generally, FY2008 can be characterized as Port Authority having lower cash reserves and borrowing less in the form of a Grant Anticipation Note (GAN). As a consequence, the Port Authority realized a decrease in investment income on its short-term investment of cash holdings of \$1,002,113. Likewise, due to decreased Grant Anticipation Note (GAN) borrowing, Port Authority realized a -\$788,941 decrease in interest expense on short-term debt obligations from FY2007 levels.

CONDITIONS AFFECTING FUTURE FINANCIAL POSITION

After a long, arduous negotiating process, Port Authority's Board of Directors and the membership of the Amalgamated Transit Union Local #85 (ATU #85) approved a four-year contract agreement in December 2008. The agreement provides Port Authority certainty in its cost structure over the next four years, but with limited operating budget savings in the short-term. Most importantly, the contract allows significant reductions in Port Authority's Other Post Employment Benefits Expense (OPEB) over the next four years.

While the new agreement provides a framework for developing Port Authority's cost structure over the next four years, the company is faced with growing uncertainty due to the recent developments in the World, U.S., and State of Pennsylvania economies. Prior to the recent market correction, Port Authority's prospects for significant increases in aid from the Commonwealth of Pennsylvania were not encouraging. The Commonwealth of Pennsylvania's increase in State Operating Assistance to Port Authority grew by less than 1% from FY2008 to FY2009. Most likely, the current funding structure of the Act 44 legislation will need to be re-visited as the centerpiece of the legislation to either toll Interstate Highway #80 or lease the Pennsylvania Turnpike which was never approved by the State legislature.

The combination of limited, near-term contractual labor savings with scarce growth potential in State Operating Assistance will require Port Authority to re-evaluate how it deploys its assets. Volatility in the energy markets has caused more commuters to consider alternatives to the personal automobile. Port Authority will need to focus on increasing the productivity of its services and returns of the assets it has in place.

Port Authority has just begun a formal review in the areas of overtime, sick-time, workers compensation, and leave of absence usage. These items are prime examples of resource utilization with limited productivity enhancements. Port Authority will also review its inventory procedures in an effort to reduce the quantity of spare parts and materials that are purchased but remain idle.

Another operating budget item that will merit attention in the short-term is the company's pension expense. The downturn in the Stock Market has negatively impacted Port Authority's defined benefit pension plans. These plans have experienced returns consistent with the overall market. Absent a market recovery, the downturn could result in higher future pension expense for Port Authority.

With regard to capital programs, the Port Authority is focused on its infrastructure to keep its system in a state of good repair and finishing construction of the North Shore Connector Project.

The Federal Transit Administration has committed to funding \$348 million toward the cost of the North Shore Connector Project and construction is currently underway. The 1.2-mile extension represents the most significant transit construction work downtown Pittsburgh has experienced since the early 1980's, when Port Authority built Stage I of the existing subway system. Revenue service is scheduled to begin in 2011 on the North Shore Connector.

From a long-term perspective, Port Authority is also committed to reviewing its current service patterns and its integration with regional transportation demands.

The company is in the midst of Connect '09 project which is an 18-month initiative to analyze current service versus regional population growth patterns. A centerpiece of Connect '09 will be to develop a Smartcard system at Port Authority that is adaptable for other regional transit agencies. These future partnerships would allow riders to travel throughout the region without having to worry about proprietary fare collection systems. It is hoped that Connect '09 will position Port Authority and its regional transportation partners to address the transportation needs of Southwestern Pennsylvania in the foreseeable future.

THE PORT AUTHORITY OF ALLEGHENY COUNTY

GLOSSARY OF TERMS

ACCESS Program - A program that provides subsidized door-to-door, advance reservation transportation services for the elderly and handicapped residents of Allegheny County (The Port Authority's demand responsive service).

Balanced Budget - A budget where total Revenues, Grants, and Operating Assistance equals total expenses.

Base Fare - Cash fare that is charged to an adult for regular local transit service.

Capital Improvement Program - A financial plan for the allocation of Capital Project funds necessary to acquire, improve, or maintain the Port Authority's fixed assets.

Fixed Guideway - A separate right-of-way for the exclusive use of public transportation vehicles.

Fixed Route - An established route where transit vehicles follow a schedule over a prescribed route.

Incline - A fixed facility that is comprised of two (2) vehicles operating in opposite directions on angled, parallel tracks.

Light Rail - A type of electric rail transit system that typically operates on dedicated right of way or in mixed traffic with other vehicles. Typically involves short distances between stops.

Operating Plan - Combines the financial plan for the allocation of projected revenues and expenses consumed in the daily operations of the transit system and specific programs to support achievement of the Port Authority's mission statement.

North Shore Connector Project- 1.2 mile extension of Port Authority's Light Rail Transit System of which the centerpiece is a tunnel underneath the Allegheny River.

Paratransit - Flexible forms of public transportation services that are not provided over a fixed route (the Port Authority's ACCESS Program).

Passenger Revenues - Revenues consisting of farebox collections, ticket sales, school permits and pass sales, weekend fare receipts, weekly permit sales, monthly pass sales, and special event fare receipts.

Peak Period - Morning and afternoon time periods when transit riding is heaviest due to commuters traveling to and from their place of work.

Ridership - Number of customers using Port Authority's services.

Stage II - The second phase of the Port Authority's LRT system serving the South Hills area and connecting with the downtown subway. It consists of the Drake, Library, and Overbrook trolley lines.

Vehicle Improvement Program - The terminology used by the Port Authority for rehabilitation of its revenue vehicle fleet.

SOURCE: American Public Transit Association, *A Glossary of Transit Terminology*, September 1984.

PORT AUTHORITY OF ALLEGHENY COUNTY

STATEMENTS OF NET ASSETS

JUNE 30, 2008 AND 2007

Assets	2008	2007
Current assets:		
Cash and cash equivalents	\$ 56,553,767	\$ 68,850,908
Capital grants receivable	26,002,498	20,722,463
Due from Allegheny County	27,453,060	-
Other receivables	1,074,684	1,501,531
Prepaid expenses	2,358,314	346,069
Materials and supplies	8,873,137	9,006,933
Total current assets	122,315,460	100,427,904
Non-current assets:		
Restricted assets for capital lease obligation	103,411,358	105,461,203
Restricted assets for capital additions and related debt	70,536,969	66,641,277
Other non-current assets	964,446	1,077,938
Capital assets, net of accumulated depreciation	1,488,348,376	1,468,681,066
Total non-current assets	1,663,261,149	1,641,861,484
Total Assets	\$ 1,785,576,609	\$ 1,742,289,388
Liabilities and Net Assets		
Liabilities:		
Current liabilities:		
Accounts payable	\$ 34,748,100	\$ 26,689,560
Accrued compensation, benefits, and withholdings	16,154,552	15,907,421
Deferred credits	73,934,259	69,951,808
Reserves for claims and settlements	9,889,000	7,167,686
Current portion of capital lease obligation	3,591,413	3,330,183
Current portion of bonds payable	25,191,697	23,915,386
Accrued pension liability	3,430,854	2,649,543
Other current liabilities	6,278,792	7,035,624
Total current liabilities	173,218,667	156,647,211
Non-current liabilities:		
Capital lease obligation	60,717,793	64,309,207
Bonds payable, net	313,616,499	339,126,170
Reserves for claims and settlements	6,222,419	6,871,810
Accrued OPEB liability	81,505,302	39,350,449
Deferred interest payable - capital lease	39,102,152	37,821,813
Deferred credits	9,915,323	10,192,209
Total non-current liabilities	511,079,488	497,671,658
Total Liabilities	684,298,155	654,318,869
Net Assets:		
Invested in capital assets, net of related debt	1,220,077,149	1,172,280,787
Unrestricted net assets	(118,798,695)	(84,310,268)
Total Net Assets	1,101,278,454	1,087,970,519
Total Liabilities and Net Assets	\$ 1,785,576,609	\$ 1,742,289,388

See accompanying notes to financial statements.

PORT AUTHORITY OF ALLEGHENY COUNTY

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
Operating Revenues:		
Passenger revenues:		
Bus, trolley, and light rail	\$ 70,834,957	\$ 65,098,901
Senior Citizen Free Transit program	-	10,100,399
ACCESS program services	12,969,007	11,941,366
Other income	3,600,954	3,583,356
Total operating revenues	87,404,918	90,724,022
Operating Expenses:		
Wages and salaries	133,930,757	140,662,872
Employee benefits	108,870,681	103,110,936
OPEB expense	42,154,853	39,350,449
Materials and supplies	37,175,180	37,270,853
ACCESS program services	25,394,315	24,573,849
Provision for injuries and damages	4,627,858	549,370
Utilities	7,917,147	7,466,236
Purchased services	8,001,752	7,811,857
Other expenses	11,257,852	11,632,003
	379,330,395	372,428,425
Less amounts capitalized	(17,134,641)	(22,369,631)
Total operating expenses	362,195,754	350,058,794
Operating Loss	(274,790,836)	(259,334,772)
Non-Operating Revenues (Expenses):		
Subsidies:		
County	27,453,060	15,853,429
State	-	99,060,976
State - Act 44	183,020,400	-
Vehicle improvement program	2,500,000	2,829,259
Asset maintenance	-	30,010,713
Preventative maintenance	494,000	44,600,000
Safety renewal program	16,000,000	17,118,595
Capital cost of contracting	15,000,000	15,000,000
Interest income	1,651,250	2,653,363
Interest expense	(886,756)	(1,675,697)
Total non-operating revenues (expenses)	245,231,954	225,450,638
Net Revenues Over Expenses		
 Before Capital Related Items	(29,558,882)	(33,884,134)
Capital grant contribution revenue	159,652,797	103,578,797
Interest income	13,159,809	14,404,527
Interest expense	(27,698,658)	(26,613,434)
Unrealized gain (loss) on investments	(59,893)	58,285
Depreciation expense	(102,187,238)	(99,705,515)
Change in Net Assets	13,307,935	(42,161,474)
Total net assets - beginning	1,087,970,519	1,130,131,993
Total net assets - ending	\$ 1,101,278,454	\$ 1,087,970,519

See accompanying notes to financial statements.

PORT AUTHORITY OF ALLEGHENY COUNTY

STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
Cash Flows From Operating Activities:		
Receipts from customers	\$ 87,831,765	\$ 91,502,005
Payments for goods and services	(79,945,275)	(64,562,409)
Payments to employees	(241,772,996)	(250,037,285)
Net cash provided by (used in) operating activities	(233,886,506)	(223,097,689)
Cash Flows From Non-Capital Financing Activities:		
Proceeds from issuance of grant anticipation notes	20,405,000	34,200,000
Payment of grant anticipation notes	(20,405,000)	(34,200,000)
Interest paid on grant anticipation notes	(886,756)	(1,675,697)
Operating subsidies	218,841,506	208,412,588
Net cash provided by (used in) non-capital financing activities	217,954,750	206,736,891
Cash Flows From Capital and Related Financing Activities:		
Capital grants received	156,528,107	139,595,791
Investments in transit operating property	(111,488,749)	(151,639,479)
Proceeds from bond issuance	-	65,702,560
Payments on bonds	(23,915,385)	(56,018,911)
Interest paid on bonds	(26,787,607)	(27,088,973)
Capital lease payments	(3,330,184)	(3,087,953)
Deferred lease gain	(276,886)	(276,886)
Net cash provided by (used in) capital and related financing activities	(9,270,704)	(32,813,851)
Cash Flows From Investing Activities:		
Proceeds from restricted investments	7,115,825	47,230,546
Interest and dividends on investments	5,789,494	9,313,728
Net cash provided by (used in) investing activities	12,905,319	56,544,274
Net Increase (Decrease) in Cash and Cash Equivalents	(12,297,141)	7,369,625
Cash and Cash Equivalents:		
Beginning of year	68,850,908	61,481,283
End of year	\$ 56,553,767	\$ 68,850,908
Reconciliation of Operating Loss and Depreciation Expense to Net Cash Provided By (Used In) Operating Activities:		
Operating loss and depreciation expense	\$ (376,978,074)	\$ (359,040,287)
Adjustments to reconcile operating loss and depreciation expense to cash and cash equivalents provided by (used in) operating activities:		
Depreciation	102,187,238	99,705,515
Change in assets and liabilities:		
Other receivables	426,847	777,983
Materials and supplies	133,796	(175,765)
Prepaid expenses and other current assets	(2,012,245)	2,113,710
Other non-current assets	113,492	113,492
Accounts payable	(2,307,259)	2,720,490
Accrued compensation, benefits, and withholdings	247,131	(192,339)
Reserves for claims and settlements	2,071,923	(3,555,514)
Accrued pension liability	781,311	(6,071,138)
Accrued OPEB liability	42,154,853	39,350,449
Other current liabilities	(705,519)	1,155,715
Total adjustments	143,091,568	135,942,598
Net cash provided by (used in) operating activities	\$ (233,886,506)	\$ (223,097,689)

See accompanying notes to financial statements.

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

1. ORGANIZATION

The Port Authority of Allegheny County (Authority) was established under the Second-Class County Port Authority Act of 1956 and is responsible for the management and operation of certain transit facilities serving the County of Allegheny, Pennsylvania (County) and portions of adjacent counties. The Authority is not subject to federal or state income taxes.

The financial reporting status of the Authority has been determined to be a component unit of the County for financial reporting purposes in accordance with the Governmental Accounting Standards Board (GASB) Statement No. 14, "*The Financial Reporting Entity*." The County Chief Executive appoints the Authority's Board of Directors and the County provides substantial operating subsidies and capital funding.

As discussed in Note 7, the Authority contracts with Veolia Transportation Services, Inc. for professional services to coordinate ACCESS, a paratransit system, which provides transit service within the Authority's jurisdiction. ACCESS financial statements have not been included in the reporting entity because the Authority has neither control, financial responsibility, nor accountability for ACCESS.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Authority have been prepared in conformity with accounting principles generally accepted in the United States of America as applicable to governmental units. GASB is the authoritative standard-setting body for the establishment of governmental accounting and financial reporting principles. In applying the provisions of GASB Statement No. 20, "*Accounting and Financial Reporting for Proprietary Funds*," the Authority applies all GASB pronouncements and all FASB pronouncements, Accounting Principles Board Opinions, and Accounting Research Bulletins issued on or before November 30, 1989 which do not conflict with or contradict GASB pronouncements. The more significant of these accounting policies are as follows:

Basis of Accounting

The Authority's accounts are reported as an Enterprise Fund on the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

Operating revenues and expenses consist of those revenues and expenses that result from ongoing principal operations of the Authority. Operating revenues consist primarily of user charges. Non-operating revenues and expenses consist of those revenues and expenses that are related to grants and other financing and investing types of activities.

When an expense is incurred for purposes for which there are both restricted and unrestricted net assets available, it is the Authority's policy to apply those expenses to restricted net assets to the extent such are available and then to unrestricted net assets.

Cash and Cash Equivalents

Cash and cash equivalents include amounts in demand deposits, as well as short-term investments, with a maturity date within three months of the date acquired by the Authority.

Materials and Supplies

The Authority maintains spare parts and supplies that are used to maintain transit equipment. The inventory is stated at cost net of an allowance for obsolete parts of \$167,779 at June 30, 2008 and \$792,563 at June 30, 2007.

Capital Assets

Transit operating property and equipment are recorded at cost and include certain property acquired from predecessor private mass transportation companies. Transit operating property and equipment also include certain capitalized labor and overhead expenses incurred to ready such property and equipment for use. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed. During both fiscal years 2008 and 2007, no interest expense was capitalized.

Depreciation is recorded using the straight-line method based on estimated useful lives that generally range from 4 to 30 years.

Projects in progress primarily consist of the North Shore Connector project, rehabilitation of 55 existing light rail vehicles, and Stage II light rail transit construction. The Authority has entered into various construction contracts related to the completion of these projects.

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

Revenue, Receivables, and Deferred Revenues

Passenger fares are recorded as revenue at the time services are performed. Revenues from ticket sales are recognized at the point of sale. Weekly and monthly passes are sold on a consignment basis to vendors who maintain the right of return on unsold passes. Revenues from pass sales are generally recognized upon receipt.

The Federal Transit Authority (FTA), the Pennsylvania Department of Transportation, and the County provide financial assistance and make grants directly to the Authority for operation, acquisition of property and equipment, and other capital related expenditures. Operating grants and subsidies made on the basis of entitlement periods are recorded as grant receivables and revenues over the entitlement period. Operating grants and subsidies in the accompanying statement of revenues and expenses include only operating grants from the indicated sources. Capital grants for the acquisition of property and equipment and other capital related expenditures are recorded as capital grant contribution revenue.

In fiscal year 2008, Act 44 was enacted by the Commonwealth of Pennsylvania. The Act created a dedicated source of funding called the Public Transportation Trust Fund (PTTF) which provides both operating and capital assistance to the Authority as well as all other transit agencies in the Commonwealth of Pennsylvania. The Public Transportation Trust Fund includes several existing sources of state funding as well as some new sources. Also, it eliminates the filing of separate applications to receive those funds.

The sources of revenue available to the Commonwealth of Pennsylvania to fund PTTF are:

- a. A percentage from sales tax (4.4%) (This source was formerly used to provide General Fund operating and Act 3 grants)
- b. Lottery funds for the Free Transit for Senior Citizens Program in FY07-08.
- c. State bond funding for capital projects.
- d. Remainder of PTAF after funding payments on existing debt.
- e. Annual payments from the Turnpike Commission.

Five program accounts have been created within the new trust fund: Transit Operating Assistance, Asset Improvement Program, Capital Improvements Program, New Initiatives, and Programs of Statewide Significance. Local matching funds are required to receive assistance under most of the programs.

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

The Port Authority received \$183,020,400 in operating assistance for fiscal year 2008 under Act 44. This funding required local matching funds of \$27,453,060 which was provided by the County.

Because of existing debt agreements, the Port Authority received capital funding under PTAF totaling \$41.7 million to use for debt service. Local matching share required for this funding was \$1.4 million. As required by Act 44, there were offsets to other capital programs to accommodate the PTAF funding.

The Authority also received \$30 million in capital funding under Act 44. Approximately \$18.5 million was used for Infrastructure Safety and Renewal Programs and Vehicle Overhaul which do not require County matching funds. Approximately \$11.5 million was used for other capital projects and requires County matching funds of approximately \$2.3 million.

Capital costs of contracting included in non-operating revenues and expenses in the accompanying statements of revenues, expenses, and changes in net assets is the portion of federal capital grants utilized by the Authority to obtain reimbursement for the capital component of amounts paid to ACCESS (see Note 7).

Financial Statement Classifications

With the enactment of Act 44, previous Commonwealth of Pennsylvania funding classifications were eliminated. Amounts presented on the statement of revenues, expenses, and changes in net assets for 2007 as state subsidies, asset maintenance, preventative maintenance, and Senior Citizen Free Transit represent these previous funding classifications. For 2008, funding for these components is classified as state subsidy – Act 44.

Certain amounts reported for 2007 have been reclassified to more appropriately indicate these funding changes.

Amounts Capitalized

The Authority is permitted to utilize certain capital funds for operating expenses including labor, fringe benefits, materials and supplies, and other expense classifications. Amounts capitalized are subsidies applied to these expenses, or transfers of these expenses to capital assets.

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

Compensated Absences

The Authority follows the provisions of GASB Statement No. 16, "*Accounting for Compensated Absences*." The Authority accrues vacation benefits earned by its employees.

Self-Insurance

The Authority has a self-insurance program for public liability, property damage, and workers' compensation claims. Estimated cost of these self-insurance programs are accrued in the year the expenses are incurred, based upon the estimates of the claim liabilities made by management and legal counsel of the Authority. Estimates of claim liabilities are accrued based on projected settlements for claims and include estimates for claims incurred but not reported. Any adjustments made to previously recorded reserves are reflected in current operating results.

Bond Issue Costs

Bond issue costs related to debt issued are deferred and amortized over the life of the related bonds using the effective interest method. The unamortized balance is maintained as an asset on the statements of net assets.

Refunding Transactions

In accordance with GASB Statement No. 23, "*Accounting and Reporting for Refunding of Debt for Proprietary Activities*," the excess of the reacquisition price over the net carrying amount of refunded debt is recorded as a reduction to long-term debt on the statement of net assets and amortized as a component of interest expense over the shorter of the term of the refunding issue or refunded bonds.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Classification of Net Assets

GASB Statement No. 34, "*Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*," requires the

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

classification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of these assets.
- Restricted – This component of net assets consists of constraints placed on net asset use through external restrictions.
- Unrestricted – This component of net assets consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

Pending Pronouncements

In June 2008, GASB issued Statement No. 53, “*Accounting and Financial Reporting for Derivative Instruments*.” This Statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. This Statement is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The Statement specifically requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the accrual basis of accounting. The guidance in this Statement also addresses hedge accounting requirements and will be effective for the Authority’s financial statements for the year ended June 30, 2010. The Authority is current considering the impact that this new pronouncement will have on the financial statements.

3. CASH AND INVESTMENTS

The investment and deposit policy of the Authority funds is governed by the by-laws of the Authority and the Second-Class County Port Authority Act. In accordance with these regulations, the Authority has established investment procedures that require that monies be deposited with FDIC-insured banks in demand deposit accounts or certificates of deposit (which are required to be 100% collateralized by separately identified United States obligations, if not covered by FDIC insurance). Investments are limited to United States obligations and repurchase agreements.

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

Repurchase agreements must be purchased from banks located within the Commonwealth and the underlying collateral securities must have a market value of at least 100% of the cost of the related repurchase agreement. The Authority's investment procedures do not require the delivery of the underlying securities to the Authority; however, it is the obligation of the bank to deposit the pledged obligations with either the Federal Reserve Bank, the trust department of the financial institution issuing the repurchase agreement, or another bank, trust company, or depository satisfactory to the Authority. There were no deposit or investment transactions during 2008 and 2007 that were in violation of either state statutes or the policies of the Authority. The Authority does not have a formal investment policy which addresses custodial credit risk, interest rate risk, credit risk, or concentration of credit risk.

The Authority's unrestricted cash and investments are available for general operating purposes and restricted cash and investments are available for acquisition of assets under capital projects and scheduled payments of the Special Revenue Transportation Bonds (Note 5), Grant Anticipation Notes outstanding (Note 6), and a Capital Lease Obligation (Note 12).

GASB Statement No. 40, "*Deposit and Investment Risk Disclosures*," requires disclosures related to the following deposit and investment risks: credit risk (including custodial credit risk and concentrations of credit risk), interest rate risk, and foreign currency risk. The following is a description of the Authority's deposit and investment risks:

Custodial Credit Risk - Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. As of June 30, 2008 and 2007, respectively, \$49,176,030 and \$64,098,981 of the Authority's bank balance of \$49,603,627 and \$64,426,562 was exposed to custodial credit risk, which is collateralized in accordance with Act 72 of the Pennsylvania state legislature which requires the institution to pool collateral for all governmental deposits and have the collateral held by an approved custodian in the institution's name. These deposits have carrying amounts of \$47,339,336 and \$52,944,831 as of June 30, 2008 and 2007, respectively, of which \$1,337,933 and \$11,101,788, respectively, are reported as current assets in the statements of net assets.

In addition to the deposits noted above, included in cash and cash equivalents on the statements of net assets are the following short-term investments: mutual funds of \$14,050,819 and \$533,315, repurchase agreements of \$0 and \$6,738,000, and \$41,165,015 and \$50,477,805 invested in INVEST at June 30, 2008 and 2007, respectively. The Authority's repurchase agreements are purchased from banks

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

located within the Commonwealth and have underlying collateral securities with a market value of at least 100% of the cost of the related repurchase agreement.

At June 30, 2008, the Authority held the following investment balances:

	Fair market value	Maturity in years				15-16 years
		Less than 1 year	1-5 years	6-10 years	11-15 years	
U.S. Treasuries:						
Interest only strips	\$ 40,699,537	\$ 100,253	\$ 40,599,284	\$ -	\$ -	\$ -
FHLMC	10,019,000	10,019,000	-	-	-	-
Guaranteed investment contracts	69,900,456	15,512,277	41,205,898	8,486,127	4,696,154	-
Mutual funds	21,378,750	21,378,750	-	-	-	-
INVEST	41,165,015	41,165,015	-	-	-	-
Total	\$183,162,758	\$ 88,175,295	\$ 81,805,182	\$ 8,486,127	\$ 4,696,154	\$ -

The fair value of the Authority's investments is the same as their carrying amount. The fair value of the Authority's investments in the external investment pool (INVEST) is the same as the value of the pool shares. All investments in an external investment pool that is not SEC registered are subject to oversight by the Commonwealth.

Interest Rate Risk - Interest rate risk is the risk that changes in interest rates will adversely affect the fair market value of the Authority's investments.

Credit Risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. As of June 30, 2008, the Authority's investment in the state investment pool (INVEST) was rated AAA by Standard & Poor's. The Authority's investments in mutual funds are also rated AAA by Standard & Poor's. The Authority's investment in FHLMC is rated A-1+ by Standard & Poor's. Additionally, At June 30, 2008, the Authority had various guaranteed investment contracts that were unrated.

Subsequent to year-end, the Authority received notification of a downgrade of the rating of AIG, the Provider to a \$7.2 million investment agreement between AIG and the Authority. Pursuant to the terms of the agreement, the downgrade triggered a requirement that AIG either repay the invested funds or deliver collateral. AIG elected to repay the principal and accrued interest on the investment which was wired to the Authority's Trustee on September 29, 2008. The investment agreement with

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

AIG was scheduled to mature on June 1, 2009 and carried an interest rate of 6.24%. The Authority invested the returned funds in a certificate of deposit that is scheduled to mature on June 1, 2009, at 3.58%.

The remaining guaranteed investment contracts relate to lease transactions and are more fully described in Note 12.

Risks and Uncertainties

Financial instruments, which potentially expose the Authority to concentrations of credit risk, include cash and investments in marketable securities. As a matter of policy, the Authority maintains cash balances only with financial institutions having a high credit quality. Concentration of credit risk for investments in marketable securities is mitigated by the overall diversification of managed investment portfolios. Investment securities are also exposed to various other risks such as interest rate and market risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in values of investment securities will occur in the near term and that such change could materially affect the amount reported on the statements of financial position.

4. CAPITAL ASSETS/ACCUMULATED DEPRECIATION

A summary of changes in capital assets is as follows:

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

	June 30, 2007	Increases	Decreases	June 30, 2008
Capital assets, not being depreciated:				
Land	\$ 100,313,289	\$ 372,073	\$ -	\$ 100,685,362
Projects in progress	176,412,958	60,084,205	-	236,497,163
Total capital assets, not being depreciated	<u>276,726,247</u>	<u>60,456,278</u>	<u>-</u>	<u>337,182,525</u>
Capital assets, being depreciated:				
Buildings	216,793,404	1,457,196	-	218,250,600
Transportation equipment	614,646,675	33,081,621	(16,888,733)	630,839,563
Track, roadway, and subway stations	1,268,821,532	23,870,565	(96,892)	1,292,595,205
Other property, equipment, and assets	108,882,848	2,998,956	(17,833,221)	94,048,583
Total capital assets being depreciated	<u>2,209,144,459</u>	<u>61,408,338</u>	<u>(34,818,846)</u>	<u>2,235,733,951</u>
Less accumulated depreciation for:				
Buildings	(100,165,631)	(7,188,680)	-	(107,354,311)
Transportation equipment	(305,152,788)	(44,555,465)	16,811,570	(332,896,683)
Track, roadway, and subway stations	(531,871,999)	(45,433,750)	86,839	(577,218,910)
Other property, equipment, and assets	(79,999,222)	(4,946,983)	17,848,009	(67,098,196)
Total accumulated depreciation	<u>(1,017,189,640)</u>	<u>(102,124,878)</u>	<u>34,746,418</u>	<u>(1,084,568,100)</u>
Total capital assets, being depreciated, net	<u>1,191,954,819</u>	<u>(40,716,540)</u>	<u>(72,428)</u>	<u>1,151,165,851</u>
Total capital assets, net	<u>\$ 1,468,681,066</u>	<u>\$ 19,739,738</u>	<u>\$ (72,428)</u>	<u>\$ 1,488,348,376</u>

5. SPECIAL REVENUE TRANSPORTATION BONDS

On July 14, 1999, the Authority issued \$71,960,000 of the Subordinate Lien Special Revenue Transportation Bonds Series of 1999 (the 1999 Sub Bonds). The proceeds from the sale of the 1999 Sub Bonds were used primarily to acquire 200 mass transit buses. Further, the proceeds may also be used to make other capital additions and improvements, fund the Debt Service Reserve Fund related to the 1999 Sub Bonds, and pay for the costs of issuing the 1999 Sub Bonds.

Interest on the 1999 Sub Bonds is payable semiannually on each June 1 and December 1, commencing December 1, 1999. Interest rates range from 4.50% to 5.50% throughout the term of the 1999 Sub Bonds.

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

The 1999 Sub Bonds' premium of \$1,592,387 and the 1999 Sub Bonds' issuance costs of \$703,579 are being amortized over the ten-year term of the 1999 Sub Bonds. At June 30, 2008, \$1,427,586 of the 1999 Sub Bonds premium and \$630,762 of the 1999 Sub Bonds issuance costs have been amortized. At June 30, 2007, \$1,268,345 of the 1999 Sub Bonds premium and \$560,404 of the 1999 Sub Bonds issuance costs have been amortized.

On November 4, 1999, the Authority issued \$225,000,000 of the Special Revenue Transportation Bonds Series of 1999 (the 1999 Bonds). The proceeds from the sale of the 1999 Bonds were used primarily to fund certain capital additions and improvements to the Authority's public transit system.

On March 1, 2001, the Authority issued \$250,695,000 of the Special Revenue Transportation Bonds Series of 2001 (the 2001 Bonds). Approximately, \$240 million of the proceeds from the sale of the 2001 Bonds were used to advance refund the 1999 Bonds. An additional \$7.5 million was realized for capital projects.

In connection with this advance refunding, a portion of the proceeds of the 2001 Bonds was deposited into an irrevocable trust with an escrow agent to provide for certain debt service payments on the refunded bonds. The advance refunding resulted in a deferred refunding adjustment of \$15,771,597 that will be amortized over the life of the 2001 Bonds. At June 30, 2008 and 2007, \$4,130,654 and \$3,567,383 have been amortized, respectively.

Interest on the 2001 Bonds is payable semiannually on each March 1 and September 1, commencing September 1, 2001. Interest rates range from 3.75% to 5.75% throughout the terms of the 2001 Bonds.

The 2001 Bonds' discount of \$1,564,785 and the 2001 Bonds' issuance costs of \$1,207,946 are being amortized over the twenty-eight year term of the 2001 Bonds. At June 30, 2008, \$409,913 of the 2001 Bonds premium and \$316,367 of the 2001 Bonds issuance costs have been amortized. At June 30, 2007, \$353,939 of the 2001 Bonds premium and \$273,226 of the 2001 Bonds issuance costs have been amortized. Debt considered defeased for financial reporting purposes but still outstanding at June 30, 2008 amounted to approximately \$225,000,000.

The bond agreements, for the above issues, require among other things, that the Authority maintain a Debt Service Reserve Fund for each issue. The Debt Service Reserve Fund is required to be funded at all times in an amount equal to the relevant debt service requirement relating to each series of bonds outstanding.

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

During fiscal year 2003, the Authority entered into an agreement with Koch Financial Corporation (Koch) for the purchase of fixed assets, primarily buses. As of June 30, 2008 and 2007, the Authority had incurred \$131,631,500 of debt related to this financing. This debt is secured by an equity interest in the purchased fixed assets.

Interest on the Koch Bonds are payable semiannually on each March 1 and September 1, commencing September 1, 2003. Interest rates are set at the time of the draw down, current Koch Bonds outstanding bear interest at 5.25%.

The Koch Bonds were issued at a premium of \$6,004,713 which is being amortized over the ten-year term of the Koch Bonds. At June 30, 2008 and 2007, \$3,403,522 and \$2,625,637 have been amortized, respectively.

The following is a summary of debt transactions of the Authority for the year ended June 30, 2008:

	Balance at July 1, 2007	Issuance	Amortization/ Payments and Retirements	Balance at July 1, 2008
Series of 1999 Sub Bonds	\$ 23,250,000	\$ -	\$ (11,315,000)	\$ 11,935,000
Series of 2001 Bonds	246,440,000	-	(955,000)	245,485,000
Koch Bonds	103,066,754	-	(11,645,385)	91,421,369
	<u>372,756,754</u>	-	<u>(23,915,385)</u>	<u>348,841,369</u>
Net bond premium	2,489,016	-	(881,246)	1,607,770
Deferred amount on refunding	(12,204,214)	-	563,271	(11,640,943)
Net outstanding	<u>\$ 363,041,556</u>	<u>\$ -</u>	<u>\$ (24,233,360)</u>	<u>338,808,196</u>
Less current amounts:				
Series of 1999 Sub Bonds				(11,935,000)
Series of 2001 Bonds				(995,000)
Koch Bonds				<u>(12,261,697)</u>
Total current bonds payable				<u>(25,191,697)</u>
Total long-term bonds payable				<u>\$ 313,616,499</u>

The annual debt service requirements related to the Bonds are as follows:

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

Year Ending June 30,	Principal	Interest	Total
2009	\$ 25,191,697	\$ 17,924,302	\$ 43,115,999
2010	20,063,885	16,589,415	36,653,300
2011	21,160,763	15,491,412	36,652,175
2012	22,289,175	14,361,680	36,650,855
2013	23,481,064	13,171,643	36,652,707
2014-2018	72,664,785	51,357,339	124,022,124
2019-2023	63,755,000	34,997,725	98,752,725
2024-2028	81,430,000	17,313,000	98,743,000
2029	18,805,000	940,250	19,745,250
Total	<u>\$ 348,841,369</u>	<u>\$ 182,146,766</u>	<u>\$ 530,988,135</u>

Restricted assets include approximately \$24.5 million of cash invested in a debt service reserve fund restricted for debt service on the above bonds.

6. GRANT ANTICIPATION NOTES

The Authority entered into a Note Agreement on July 3, 2006, for the issuance of and sale of \$34,200,000 of 4.50% Grant Anticipation Notes, Series of 2006, due June 30, 2007 (the 2006 Notes). These 2006 Notes were repaid in full on June 30, 2007.

The Authority entered into a Note Agreement on August 2, 2007, for the issuance of and sale of \$20,415,000 of 4.50% Grant Anticipation Notes, Series of 2007, due June 30, 2008. These 2007 Notes were repaid in full on June 30, 2008.

7. ACCESS PROGRAM SERVICES

The Authority has a contract with Veolia Transportation Services, Inc. which provides professional services to coordinate the paratransit system, ACCESS, which provides transit services within the County for elderly and handicapped individuals. Expenses under this contract amounted to \$25,394,315 in fiscal year 2008 and \$24,573,849 in fiscal year 2007.

The Authority currently receives partial reimbursement for these services from the Commonwealth in the form of a grant. The amount is based on ridership and average

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

fare statistics. Revenue under this program totaled \$12,969,007 in fiscal year 2008 and \$11,941,366 in fiscal year 2007.

8. PUBLIC LIABILITY, PROPERTY DAMAGE, AND WORKERS' COMPENSATION CLAIMS

The Supreme Court of Pennsylvania has held the Authority to be a Commonwealth Agency as defined in the Political Subdivision Tort Claims Act. As such, the Authority is immune from certain claims and its liability is limited to \$1,000,000 per occurrence and \$250,000 per plaintiff claim arising out of an occurrence. As the result of this holding, it has not been necessary for the Authority to purchase excess public liability insurance, and it is self-insured for public liability claims.

The Authority is self-insured for its compensation and occupational disease liability in accordance with the provisions of Article III, Section 305 of the Pennsylvania Workmen's Compensation Act (Act). On a yearly basis, the Authority carries excess workers' compensation insurance in the amount of \$5,000,000 over its self-insurance retention of \$1,000,000 per occurrence to further ensure that it can meet its obligation under the Workers' Compensation Act. The Authority maintains an estimate of its potential liability related to claims that have been filed as of June 30, 2008. The reserve balance is \$10,506,293 at June 30, 2008 and \$9,016,607 at June 30, 2007.

9. COMMITMENTS AND CONTINGENCIES

In the ordinary course of the Authority's operations and capital grants projects, there have been various legal proceedings brought against the Authority. The Authority has estimated and accrued for a provision of approximately \$5.3 million of potential losses resulting from all of the cases it is currently aware of. Based on an evaluation that included consultation with an outside legal counsel concerning the legal and factual issues involved, management is of the opinion that these matters will not result in material adverse effect on the Authority's operations and financial position.

The Authority is subject to state and federal audits by grantor agencies. These laws and regulations are complex and subject to interpretation. The Authority is not aware of any pending audit involving prior or current years; however, compliance with such laws and regulations can be subject to future reviews and interpretation which could result in disallowed costs.

The Authority has entered into a full funding grant agreement with the Federal Transit Administration for the North Shore Connector project. It involves extending

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

the Authority's existing Light Rail Transit system (LRT) in Pittsburgh's urban core. The project will create a 1.5 mile extension of the LRT from the Gateway Center Station to Pittsburgh's North Shore via twin bored tunnels under the Allegheny River. The capital costs of this project are estimated to be \$435 million and are will be paid from federal, state, and local sources. As of June 30, 2008, approximately \$194 million of project costs had been incurred and the Authority's contract commitments related to this project approximated \$65.4 million.

10. PENSION PLANS

Plan Descriptions. All full-time employees of the Authority are eligible to participate in one of three retirement and disability allowance plans to which the Authority contributes. The three plans are as follows: Plan for Employees Represented by Local 85 of the Amalgamated Transit Union (the ATU Plan), Plan for Employees Represented by Local Union 29 of the International Brotherhood of Electrical Workers (the IBEW Plan), and Plan for Employees who are Not Represented by a Union (the NonRep Plan).

Under each of the three plans, employees' eligibility for normal benefits begins at age 65 at which time the individual is entitled to an annual retirement benefit, payable monthly for life. This benefit is equal to 2.25% of the average annual compensation for the last 16 quarters of employment times the years and months of continuous service or the average of the highest four of the last eight years immediately preceding the date of retirement, whichever is highest.

Early retirement is available to all participants who have reached the age of 55 and have at least 10 years of service or who meet certain continuous service requirements. Early retirement with full benefits is available after 25 years of continuous service for all plans. Early retirement with full benefits is also available after age 55 to those participants meeting certain service requirements. Individuals not meeting these requirements who retire after age 55 but prior to the date for normal benefits receive reduced benefits. The cost sharing of health care benefits is provided from Authority operating revenues.

For new hires, the Plans have been amended to replace the eligibility requirement for unreduced early retirement benefits from 25 years of service without regard to age, to 25 years of service and age 55. These amendments were effective as of December 1, 2005 for the ATU and NonRep Plans and May 1, 2006 for the IBEW Plan.

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

Benefit provisions for the ATU and IBEW Plans are established and amended by the Retirement and Disability Allowance Committee's for each plan, as stated in written agreements. All three plans issue separate audited financial statements that can be obtained from the Authority's Finance Department.

Funding Policy. Participants in the NonRep and ATU Plans contribute 4.5% of pension earnings to their respective plan. IBEW employees contributed 3% of pension earnings to the IBEW plan through April 30, 2008 and began contributing 4% effective May 1, 2008. The Authority's contributions to the plans are based on actuarially determined rates.

Annual Pension Cost and Net Pension Obligation

The Authority's annual pension costs and net pension obligations to the plans for the current year were as follows, as well as the assumptions used to calculate the required contribution:

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

	ATU Plan	IBEW Plan	NonRep Plan
Annual required contribution	\$ 12,913,315	\$ 1,118,643	\$ 4,544,228
Interest on net pension obligation	206,224	8,195	(2,455)
Adjustment to annual required contribution	(259,597)	(27,911)	2,836
Annual pension cost	12,859,942	1,098,927	4,544,609
Contributions made	14,956,447	660,960	4,081,996
Increase (decrease) in net pension obligation	(2,096,505)	437,967	462,613
Net pension obligation (asset) beginning of year	2,577,800	102,434	(30,690)
Net pension obligation (asset) end of year	<u>\$ 481,295</u>	<u>\$ 540,401</u>	<u>\$ 431,923</u>
Actuarial valuation date	1/1/2007	1/1/2007	1/1/2007
Actuarial cost method	Entry Age Normal	Entry Age Normal	Entry Age Normal
Amortization method	Level Dollar Monthly Payments	Level Dollar Monthly Payments	Level Dollar Monthly Payments
Asset valuation method	Smoothed Mkt	Smoothed Mkt	Smoothed Mkt
Remaining amortization period			
UAL (at 1/1/05 for ATU and Non-Rep)	23 years	4.5 years	24 years
2005 Actuarial loss	14 years		15 years
2006 Actuarial loss	15 years		
Actuarial assumptions:			
Investment rate of return	8.0%	8.0%	8.0%
Projected salary increases	3.0% thru 6/30/08 3.5% thereafter	3.5%	3.5%

Mortality Table – RP-2000 for healthy lives; for disabled lives, mortality is in accordance with the mortality table specified in the IRS Revenue Ruling 96-7 for disabilities occurring prior to 1995.

Retirement Age – Retirement probabilities at each age applied, beginning with the earliest eligibility for retirement and ending at age 65.

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

Three-Year Trend Information

	<u>Year Ending</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation (Asset)</u>
<u>ATU Plan</u>	June 30, 2008	\$ 12,859,942	116%	\$ 481,295
	June 30, 2007	10,158,512	155%	2,577,800
	June 30, 2006	8,283,901	4%	8,131,777
<u>IBEW Plan</u>	June 30, 2008	1,098,927	60%	540,401
	June 30, 2007	495,687	110%	102,434
	June 30, 2006	336,169	77%	153,683
<u>NonRep Plan</u>	June 30, 2008	4,544,609	90%	431,923
	June 30, 2007	3,759,720	106%	(30,691)
	June 30, 2006	3,456,142	92%	178,351

Funded Status and Funding Progress

The funded status of each plan as of January 1, 2007, the most recent actuarial valuation date, is as follows (dollar amounts in thousands):

	<u>Actuarial Value of Assets (a)</u>	<u>Actuarial Accrued Liability (AAL) Entry Age (b)</u>	<u>Unfunded AAL (UAAL) (b-a)</u>	<u>Funded Ratio (a/b)</u>	<u>Covered Payroll (c)</u>	<u>UAAL as a percentage of Covered Payroll ((b-a)/c)</u>
ATU	\$ 706,909	\$ 754,026	\$ 47,117	93.8%	\$ 129,386	36.4%
IBEW	20,798	23,774	2,976	87.5%	3,252	91.5%
NonRep	68,630	107,269	38,639	64.0%	17,481	221.0%

The schedules of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, present multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AALs for benefits. For the actuarial valuations as of January 1, 2007, the following actuarial assumptions were changed to better reflect anticipated experience: 1) the interest assumption was reduced from 8.5% to 8.0%, 2)

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

the salary increase assumption was reduced from 4.5% to 3.5%, and 3) the mortality assumption was changed to reflect updated mortality tables.

11. POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS

Plan Descriptions. In addition to the pension benefits described in Note 11, the Authority provides certain post-retirement healthcare benefits to its retirees. In accordance with the ATU, IBEW, and NonRep Retirement and Disability Allowance Plans, post-retirement benefits are provided to those who become entitled to receive a pension allowance or a disability allowance. Post-retirement benefits consisting of medical, hospital, prescription, dental, and vision insurance coverage, and Medicare Part B premium reimbursement are provided for the retiree.

Benefit provisions for the ATU and IBEW Plans are established and amended through negotiations between the Authority and the respective unions. For the NonRep Plan, that authority rests with the Authority's Board of Directors. The Plans do not issue publicly available financial reports.

Funding Policy. The Authority's contribution is based on projected pay-as-you-go financing requirements. For fiscal years 2008 and 2007, the Authority contributed \$26,717,462 and \$25,054,913, respectively, to the plans. Plan members receiving benefits contributed \$1,833,812 and \$1,889,727, respectively, through their contributions as required by the cost sharing provisions of the Plans. Under these provisions, retirees receiving benefits pay a certain percentage of any cost increases after the base year, as determined by the respective plans. Retiree cost sharing percentages for the ATU, IBEW, and NonRep plans are 20%, 15%, and 20%, respectively. Base years for the ATU, IBEW, and NonRep plans are November 30, 1991, May 1, 1993, and May 1, 1989, respectively.

Annual OPEB Cost. The Authority's annual OPEB cost (expense) for each plan is calculated based on the annual required contribution of *the employer (ARC)*, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions. Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

Annual OPEB Cost and Net OPEB Obligation

The Authority's annual OPEB costs and net OPEB obligations to the plans for the current year were as follows, as well as the assumptions used to calculate the required contribution:

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

	ATU Plan	IBEW Plan	NonRep Plan
Annual required contribution	\$ 64,171,217	\$ 1,744,822	\$ 3,570,374
Interest on net OPEB obligation	1,480,162	50,349	43,507
Adjustment to annual required contribution	(2,057,642)	(69,993)	(60,481)
Annual OPEB cost	63,593,737	1,725,178	3,553,400
Contributions made	22,543,646	374,173	3,799,643
Increase (decrease) in net OPEB obligation	41,050,091	1,351,005	(246,243)
Net OPEB obligation (asset) beginning of year	37,004,046	1,258,736	1,087,667
Net OPEB obligation (asset) end of year	\$ 78,054,137	\$ 2,609,741	\$ 841,424

Note: methods and assumptions are the same for each of the three plans

Actuarial valuation date	1/1/2007
Actuarial cost method	Projected unit credit
Amortization method	Level dollar
Asset valuation method	N/A - the plans are unfunded
Remaining amortization period	30 years
Actuarial assumptions:	
Investment rate of return	4.0%
Projected salary increases	3.5%
Health care inflation rate	
Medical trend	10% in 2007, grading to 5% in 2012
Dental trend	5% in 2007, grading to 3% in 2011
Vision trend	2% per year
Mortality	RP-2000 table, sex distinct, no collar adjustment

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

Three-Year Trend Information

	<u>Year Ending</u>	<u>Annual OPEB Cost (AOC)</u>	<u>Percentage of AOC Contributed</u>	<u>Net OPEB Obligation (Asset)</u>
ATU Plan	June 30, 2008	\$ 63,593,737	35%	\$ 78,054,137
	June 30, 2007	59,168,282	38%	37,004,046
	June 30, 2006	N/A	N/A	N/A
IBEW Plan	June 30, 2008	1,725,178	22%	2,609,741
	June 30, 2007	1,622,094	22%	1,258,736
	June 30, 2006	N/A	N/A	N/A
<u>NonRep Plan</u>	June 30, 2008	3,553,400	107%	841,424
	June 30, 2007	3,614,986	70%	1,087,667
	June 30, 2006	N/A	N/A	N/A

N/A - Not Applicable, 2007 is implementation year for GASB Statement No. 45

Funded Status and Funding Progress

The funded status of each plan as of January 1, 2007, the most recent actuarial valuation date, is as follows (dollar amounts in thousands):

	<u>Actuarial Value of Assets (a)</u>	<u>Actuarial Accrued Liability (AAL) Projected Unit Credit (b)</u>	<u>Unfunded AAL (UAAL) (b-a)</u>	<u>Funded Ratio (a/b)</u>	<u>Covered Payroll (c)</u>	<u>UAAL as a percentage of Covered Payroll ((b-a)/c)</u>
ATU	\$ -	\$ 612,832	\$ 612,832	0.0%	\$ 112,656	544.0%
IBEW	-	15,442	15,442	0.0%	3,049	506.5%
NonRep	-	62,246	62,246	0.0%	14,023	443.9%

The schedules of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, present multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AALs for benefits.

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

12. LEASE TRANSACTIONS

On June 11, 1997, the Authority entered into a sale-leaseback transaction related to some of its existing light rail vehicles (US Lease). The terms of the US Lease arrangement are 14 years and provide an option for the Authority to repurchase the light rail vehicles at the end of the initial US Lease term in 2011. This transaction meets the requirements of a capital lease obligation. A deferred gain of \$3,737,955 is being amortized over the life of the US Lease arrangement. Restricted assets for capital lease obligation includes investments purchased by the Authority to meet future cash flow needs of the US Lease. As part of the US lease arrangement, the Authority entered into a payment undertaking arrangement with a subsidiary of AIG Insurance Company (AIG), the purpose of which was to deposit funds with a subsidiary of AIG to meet future cash flow needs of the US Lease. Thus, the Authority has a receivable in the amount of \$62,704,395 and \$68,546,711 at June 30, 2008 and 2007, respectively, which is guaranteed by AIG. Additionally, the Authority has treasury securities in the amount of \$40,706,963 and \$36,914,492 at June 30, 2008 and 2007, respectively, which are restricted for US Lease payments. Interest only payments began in fiscal year 2002 and interest and principal payments began in fiscal year 2005. Interest payable in conjunction with this US Lease is \$39,102,152 at June 30, 2008 and \$37,821,813 at June 30, 2007.

The US Lease documents require the Authority to replace AIG as the payment undertaker in the event that (a) the long-term unsecured debt obligations of AIG are not rated A- by Standard & Poor's or A3 by Moody's and (b) the Authority is directed to do so by an equity investor (First Hawaiian Corporation and EntreCap Financial). This replacement is required to occur within 60 days of receipt of the direction and would be at the sole cost of the Authority.

AIG's ratings are currently A- and A3 (January 5, 2008) which means that any further downgrade would require the Authority to replace AIG if requested by an equity investor.

In addition, the Authority also has another agreement related to the US Lease with Ambac Indemnity Corporation (Ambac). The documents require that the Authority replace Ambac in the event that (a) the long-term unsecured debt obligations of Ambac are not rated AA- by Standard & Poor's and Aa3 by Moody's and (b) the Authority is directed to do so by an equity investor. This replacement is required to occur within 60 days of receipt of the direction and would be at the sole cost of the Authority.

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

Ambac's ratings are currently BBB and Ba1 (as of January 5, 2009). During the fourth quarter of 2008, the Authority was notified by both equity investors that given the decline in the credit rating of the equity strip provider (Ambac), and pursuant to the terms of the documents, the Authority was required to replace the Agreement and provider within 60 days of the notification.

The Authority has requested time extensions and is currently negotiating replacement and alternative arrangements with both equity investors. Given that the Authority has the ability to exercise a buyout option in 2011, it is anticipated that there will not be a material adverse effect on the Authority's financial situation.

The following are the net minimum lease payments due under the above capital leases at June 30:

Year Ending	US Lease	
	Principal	Interest
2009	\$ 3,591,414	\$ 7,420,103
2010	2,872,090	7,138,380
2011	41,348,502	38,246,013
2012	16,497,200	486,857
Minimum lease payments	<u>\$ 64,309,206</u>	<u>\$ 53,291,353</u>

13. SWAPTION

During fiscal year 2004, the Authority entered into a swaption contract that provided the Authority an up-front payment of \$10.1 million. As a synthetic refunding of its 2001 Bonds, this payment represents the present-value, risk-adjusted savings of a refunding as of March 1, 2011, without issuing refunding bonds at March 2004. The swaption gave the counterparty the option to make the Authority enter into a pay-fixed, receive-variable interest rate swap on the first day of each March or September during the period commencing on, and including, March 1, 2011 and terminating on, March 1, 2014.

If the option is exercised, the Authority intends to current refund the existing 2001 Bonds as of the exercise date and issue Variable Rate Refunding Bonds (Refunding Bonds). The intention of the swap is to effectively change the Authority's variable interest rate on the Refunding Bonds to a synthetic fixed rate of 4.53%.

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

Per the swap agreement, the Authority would receive interest at the variable rate of 67% of 1 month LIBOR (London Interbank Offered Rate) while paying a fixed rate of 4.53%. The interest payments are calculated based on a notional amount of \$234,470,000, which reduces beginning on March 1, 2012 so that the notional amount approximates the principal outstanding on the Refunding Bonds. The swap would expire on March 1, 2029 consistent with the last principal payment on the Refunding Bonds.

If the option is exercised, the Authority would make net swap payments as required by the terms of the contract, that is, receiving a variable rate as noted above for the term of the swap from the counterparty and making a fixed rate payment to the counterparty.

The Authority recorded a long-term deferred credit of \$9.5 million until such a time as the option component of the swaption either expires or is exercised.

As of June 30, 2008 and 2007, the swaption had a fair value of (\$20,840,279) and (\$11,562,245), respectively. The mark to market value is calculated using a combination of the zero-coupon method and an option pricing model.

The Authority has the ability to early terminate the swaption and to cash settle the transaction on any business day by providing at least five business days written notice to the counterparty. Evidence that the Authority has sufficient funds available to pay any amount payable to the counterparty must be provided at the time notice is given. At early termination, the Authority will be required to pay or receive a settlement amount which is comprised of the market value of the terminated transaction based on market quotations and any amounts accrued under the contract.

In connection with this transaction, the Authority has issued a Subordinate Lien Special Revenue Transportation Note, Series of 2004 (2004 Note). The 2004 Note was issued for the purpose of evidencing and securing the Authority's uninsured payment obligations with respect to the interest rate swap. The amount due under this 2004 Note agreement is dependent on the swap, but at no time may exceed \$38,750,000. As of June 30, 2008 and 2007, this 2004 Note had not been drawn on and, as such, there was no balance outstanding.

Through the use of derivative instruments such as this swaption, the Authority is exposed to a variety of risks, including credit risk, interest rate risk, termination risk, market-access risk, and basis risk.

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

- Credit risk is the risk that a counterparty will not fulfill its obligations. Although the underlying swap exposes the Authority to credit risk should the swap be executed, the swaption itself does not expose the Authority to credit risk. On June 30, 2008, the swaption counterparty is rated A2 by Moody's Investors Services, Inc. and A by Standard & Poor's, Inc., nationally recognized statistical rating organizations. If the option was exercised and the counterparty failed to perform according to the terms of the swap agreement, there is some risk of loss to the Authority, up to the fair market value of the swaption. Performance of the counterparty as it relates to this transaction is guaranteed by the counterparty's parent company. In the event that the counterparty's rating is downgraded to a certain level (and based on the fair value of the swap at the time of the downgrade) the counterparty would be required to post collateral to support its obligations under the swap.
- Interest rate risk is the risk that changes in interest rates will adversely affect the fair values of the Authority's financial instruments or the Authority's cash flows. If the option is exercised, the Authority could be exposed to interest rate risk if the long-term interest rates are less than 4.53%.
- Termination risk is the risk that a derivative's unscheduled end will affect the Authority's asset/liability strategy or will present the Authority with potentially significant unscheduled termination payments to the counterparty. The counterparty to the transaction does not have the ability to voluntarily terminate the swaption; however, the Authority is exposed to termination risk in the event that the counterparty defaults.
- Market-access risk is the risk that the Authority will not be able to enter credit markets or that credit will be more costly. If the option is exercised, the Authority would be subject to market-access risk in the event that they are unable to obtain variable rate financing or that the financing is more expensive than anticipated. To reduce this exposure, the Authority has obtained insurance from a third party, Financial Security Assurance (FSA), to cover payment of principal and interest on the Refunding Bonds if they are issued. The Authority is still exposed to market-access risk to the extent that the credit quality of the third party deteriorates.
- Basis risk is the risk that arises when variable interest rates on a derivative and an associated bond or other interest-paying financial instrument are based on different indexes. If the option is exercised, the Authority would be subject to basis risk if the interest index on the variable rate arm of the swap is based on 1-month LIBOR and the variable interest rate on the Refunding Bonds is

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

based on a different index, such as a tax-exempt index like the Bond Market Association Municipal Swap Index (BMA). Although expected to correlate, the relationships between different indexes vary and that variance could adversely affect the Authority's calculated payments, and as a result cost savings or synthetic interest rates may not be realized.

In October of 2008, the counterparty served notice to the Authority of a required collateral call related to the swaption. As of the opinion date, this collateral call had not been executed and it is management understanding that the counterparty is in the process of rescinding said collateral call. As of January 2, 2009, the fair value of the swap had declined to (\$48,925,733).

14. SUBSEQUENT EVENTS

During the period, three labor contracts expired and were successfully negotiated.

- The contract with the Port Authority Transit Police Association expired on July 31, 2008 and was ratified by both parties as of October 17, 2008.
- First level supervisors and rank and file employees are represented by Local 85 of the Amalgamated Transit Union. The first level supervisors' contract expired on July 31, 2008 while the rank and file employees' contract expired June 30, 2008. New contracts were ratified by both the union and the Port Authority as of December 15, 2008.

Retiree healthcare and pension costs were at issue in all of these contracts in that the Authority required significant changes in order to reduce ongoing legacy costs.

In addition, Allegheny County which was required to provide operating assistance in accordance with Act 44, elected to withhold the FY 2008 payment of \$27,453,060 until such savings in legacy costs were achieved through the collective bargaining process.

As a result of negotiations, the Authority experienced a significant reduction in its legacy costs, and thereby satisfied Allegheny County's stipulation relative to releasing the operating assistance payment. As of December 31, 2008, all funds had been received by the Authority.

REQUIRED
SUPPLEMENTARY INFORMATION

PORT AUTHORITY OF ALLEGHENY COUNTY

SCHEDULE OF FUNDING PROGRESS

PENSION PLANS

YEAR ENDED JUNE 30, 2008
(dollars in thousands)

Actuarial Valuation Date	(a) Actuarial Value of Asset	(b) Actuarial Liability Entry Age	(Overfunded) Unfunded Actuarial Accrued Liability	(a/b) Funded Ratio	(c) Covered Payroll	(Overfunded)/Unfunded Actuarial Accrued Liability (b-a) as a Percentage of Covered Payroll ((b-a)/c)
ATU Plan:						
01/01/07	\$ 706,909	\$ 754,026	\$ 47,117	93.8%	\$ 129,386	36.4%
01/01/06	690,376	711,093	20,717	97.1%	128,006	16.2%
01/01/05	703,755	706,123	2,368	99.7%	128,433	01.8%
01/01/04	721,160	690,477	(30,683)	104.4%	125,550	-24.4%
01/01/03	721,999	672,207	(49,792)	107.4%	123,070	-40.5%
01/01/02	770,659	659,213	(111,446)	116.9%	122,908	-90.7%
IBEW Plan:						
01/01/07	\$ 20,798	\$ 23,774	\$ 2,976	87.5%	\$ 3,252	91.5%
01/01/06	20,293	21,012	719	96.6%	3,233	22.2%
01/01/05	20,235	20,183	(52)	100.3%	3,107	-1.7%
01/01/04	20,274	19,483	(791)	104.1%	3,091	-25.6%
01/01/03	20,539	19,154	(1,385)	107.2%	3,010	-46.0%
01/01/02	20,972	18,685	(2,287)	112.2%	3,038	-75.3%
Non-Rep Plan:						
01/01/07	\$ 68,630	\$ 107,269	\$ 38,639	64.0%	\$ 17,481	221.0%
01/01/06	65,570	96,734	31,164	67.8%	17,039	182.9%
01/01/05	65,904	94,345	28,441	69.9%	16,687	170.4%
01/01/04	66,038	89,304	23,266	73.9%	16,089	144.6%
01/01/03	60,062	84,401	24,339	71.2%	17,053	142.7%
01/01/02	68,884	77,901	9,017	88.4%	19,265	46.8%

PORT AUTHORITY OF ALLEGHENY COUNTY

SCHEDULE OF FUNDING PROGRESS

OTHER POST EMPLOYMENT BENEFIT PLANS

YEAR ENDED JUNE 30, 2008
(dollars in thousands)

Actuarial Valuation Date	(a) Actuarial Value of Asset	(b) Actuarial Accrued Projected Unit Credit	(Overfunded) Unfunded Actuarial Accrued Liability	(a/b) Funded Ratio	(c) Covered Payroll	(Overfunded)/Unfunded Actuarial Accrued Liability (b-a) as a Percentage of Covered Payroll ((b-a)/c)
ATU Plan:						
01/01/07	\$ -	\$ 612,832	\$ 612,832	0.0%	\$ 112,656	544.0%
IBEW Plan:						
01/01/07	\$ -	\$ 15,442	\$ 15,442	0.0%	\$ 3,049	506.5%
Non-Rep Plan:						
01/01/07	\$ -	\$ 62,246	\$ 62,246	0.0%	\$ 14,023	443.9%

Note: Valuations as of 01/01/07 represent the initial valuations for the plans as required under GASB Statement No. 45 (implemented in 2007).

ADDITIONAL INFORMATION

PORT AUTHORITY OF ALLEGHENY COUNTY

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2008

<u>Federal Grantor / Pass-Through Grantor / Program Title</u>	<u>Federal CFDA Number</u>	<u>Grantor's Number</u>	<u>Expenditures</u>
DEPARTMENT OF TRANSPORTATION:			
FEDERAL TRANSIT ADMINISTRATION			
<u>Federal Transit - Capital Investment Grants:</u>			
Airport Busway-Wabash HOV	20.500	PA-03-0227	\$ 219,650
1995 Fixed Guideway	20.500	PA-03-0261	(514,254)
FY 03/04 Bus Procure	20.500	PA-03-0367	3,323
1998 Fixed Guideway	20.500	PA-03-0285	215,224
1999 Fixed Guideway	20.500	PA-03-0302	1,030,865
Section 5309 North Shore Connector	20.500	PA-03-0315	68,895,261
2006 Fixed Guideway	20.500	PA-05-0066	25,293,207
2008 Fixed Guideway	20.500	PA-05-0069	908,684
Total CFDA 20.500			96,051,960
<u>Federal Transit - Formula Grants:</u>			
1995 Block Grant	20.507	PA-90-0301	16,802
1996 Block Grant	20.507	PA-90-0321	260,808
1999 Block Grant	20.507	PA-90-0380	(236)
Flex Grant	20.507	PA-90-0359	775,880
2007 Flex	20.507	PA-90-0016	1,172,200
2001 Block Grant	20.507	PA-90-0430	194,762
North Shore Flex	20.507	PA-90-0535	2,940,860
2006 Flex	20.507	PA-90-0572	744,630
2006 Block Grant	20.507	PA-90-0569	3,048,211
2003 Block Grant	20.507	PA-90-0482	149,691
2004 Block Grant	20.507	PA-90-0513	522,058
2008 Block Grant	20.507	PA-90-0661	4,149,786
2007 B.G.	20.507	PA-90-0646	13,243,987
FY06 North Shore Flex	20.507	PA-90-0618	2,085,282
Edgewood Train Station	20.507	PA-95-0009	52,643
Total CFDA 20.507			29,357,364
Job Access - Reverse Commute	20.516	PA-37-X025	2,881,654
<u>Passed through the Southwestern Pennsylvania Corporation</u>			
<u>Federal Transit - Metropolitan Planning Grants -</u>			
Technical Studies Grant	20.505	03-04	141,130
TOTAL FEDERAL TRANSIT ADMINISTRATION			128,432,108
FEDERAL RAILROAD ADMINISTRATION			
High Speed Ground Transportation - Next Generation High Speed Rail Program	20.312	CFRA99	716
High Speed Ground Transportation - Next Generation High Speed Rail Program	20.312	CFRA03	(1,425)
High Speed Ground Transportation - Next Generation High Speed Rail Program	20.312	CFRA04	2,559
High Speed Ground Transportation - Next Generation High Speed Rail Program	20.312	CRRA05	45,303
High Speed Ground Transportation - Next Generation High Speed Rail Program	20.312	CRRA06	156,704
Total CFDA 20.312			203,857
TOTAL DEPARTMENT OF TRANSPORTATION			128,635,965
DEPARTMENT OF HOMELAND SECURITY:			
<u>Passed through the Commonwealth of Pennsylvania</u>			
State Domestic Preparedness Equipment Support Program	97.004	CPEMA06	640,119
Rail and Transit Security Grant Program	97.075	CPEMA06	3,465
TOTAL DEPARTMENT OF HOMELAND SECURITY			643,584
TOTAL FEDERAL AWARDS			\$ 129,279,549

See accompanying notes to schedule of expenditures of federal awards.

PORT AUTHORITY OF ALLEGHENY COUNTY

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2008

1. GENERAL

The accompanying schedule of expenditures of federal awards presents the activity of all federal award programs of the Port Authority of Allegheny County.

2. BASIS OF ACCOUNTING

The accompanying schedule of expenditures of federal awards is presented using the accrual basis of accounting.

Negative amounts reported in individual grants represent transfers of eligible costs incurred in prior years to other federal grants in the current year.

PORT AUTHORITY OF ALLEGHENY COUNTY

INDEPENDENT AUDITOR'S REPORTS IN ACCORDANCE
WITH OMB CIRCULAR A-133

YEAR ENDED JUNE 30, 2008

MaherDuessel

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Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

Board of Directors
Port Authority of Allegheny County

We have audited the financial statements of the Port Authority of Allegheny County (Authority) as of and for the year ended June 30, 2008 and have issued our report thereon dated January 16, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies or material weaknesses. However, as discussed below, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America, such that there is more than a remote likelihood that a misstatement of the Authority's financial statements that is more than inconsequential will not be prevented or detected by the Authority's internal control over financial reporting. We consider the deficiency described in the accompanying schedule of findings and questioned costs as finding 08-1 to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Authority's internal control. Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we consider the significant deficiency described above to be a material weakness.

Board of Directors
Port Authority of Allegheny County
Independent Auditor's Report on Internal Control over
Financial Reporting and on Compliance and Other Matters

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Authority in a separate letter dated January 16, 2009.

The Authority's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the Authority's responses, and, accordingly, we express no opinion on them.

* * * * *

This report is intended solely for the information and use of the Board of Directors, management, and others within the Authority and is not intended to be and should not be used by anyone other than these specified parties.

Maher Duessel

Pittsburgh, Pennsylvania
January 16, 2009

MaherDuessel

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Independent Auditor's Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133

Board of Directors
Port Authority of Allegheny County

Compliance

We have audited the compliance of the Port Authority of Allegheny County (Authority) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2008. The Authority's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Authority's management. Our responsibility is to express an opinion on the Authority's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on its major federal programs occurred. An audit includes examining, on a test basis, evidence about the Authority's compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Authority's compliance with those requirements.

In our opinion, the Authority complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2008. However, the results of our auditing procedures disclosed an instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as item 08-2.

Internal Control over Compliance

The management of the Authority is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Authority's internal control over compliance with the requirements that could have a direct and material effect on its major federal programs in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over

Board Directors
Port Authority of Allegheny County
Independent Auditor's Report on Compliance
with Requirements Applicable to Each Major Program

compliance. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over compliance.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

* * * * *

This report is intended solely for the information and use of the Board of Directors, management, others within the Authority, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Mahe Duessel

Pittsburgh, Pennsylvania
January 16, 2009

PORT AUTHORITY OF ALLEGHENY COUNTY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2008

1. Summary of Auditor's Results:

- i. The auditor's report on the financial statements was an unqualified opinion.
- ii. There was a significant deficiency in internal control that was disclosed by the audit of the financial statements which was considered to be a material weakness.
- iii. The audit did not disclose noncompliance which was material to the financial statements, which would be required to be reported in accordance with *Government Auditing Standards*.
- iv. There were no significant deficiencies in internal control over each of its major federal programs that were disclosed by the audit.
- v. The auditor's report on compliance of each of its major federal programs was an unqualified opinion.
- vi. There were no current year audit findings that were required to be report in accordance with Section 510(a) of OMB Circular A-133.
- vii. The major federal programs were: Federal Transit Cluster; Federal Transit - Capital Investment Grants CFDA #20.500; Federal Transit - Formula Grants CFDA #20.507
- viii. The dollar threshold used to distinguish between type A and type B programs was \$3,000,000.
- ix. The Port Authority of Allegheny County (Authority) was evaluated as a low-risk auditee.

2. Findings related to financial statements, which are required to be reported in accordance with GAGAS.

Finding 08-1: Financial Statement Preparation

Statement of Condition: The Authority currently maintains two separate trial balances (capital and operating) that are consolidated for financial reporting purposes. The capital component is maintained to facilitate grant reporting and the Authority's year-end closing process results in conversion entries necessary to reflect accounting practices prescribed by accounting principles generally accepted in the United States of America (GAAP). During the 2008 audit, we identified additional material adjustments needed to present the financial statements in accordance with GAAP. The adjustments were primarily related to recording current year debt transactions, correcting receivable and revenue balances, and correcting unreconciled differences on the capital trial balance.

Criteria: Under current auditing standards, emphasis has been placed on determining an entity's ability to fully prepare their own external financial statements, including evaluation of all

PORT AUTHORITY OF ALLEGHENY COUNTY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2008

necessary financial statement disclosures and that reliance on auditors to ensure comprehensive financial reporting is considered to be a significant deficiency.

Cause: The Authority's current internal control structure does not facilitate the reporting of GAAP basis financial statements without reliance on auditors.

Effect: As interim financial reporting is based on the operating trial balance only, the Authority risks reliance on book balances that do not represent the Authority as a whole and balances that likely contain errors that are only detected through the year-end audit process.

Recommendation: We understand that the Authority may determine that it does not have the resources available to fully prepare their own external financial statements in accordance with accounting principles generally accepted in the United States of America. We recommend that management of the Authority consider whether it wishes to take measures to ensure that it can eliminate the deficiency outlined above.

Views of Responsible Officials: During FY2008, the Authority committed to developing a process by which the capital and operating trial balances would be formally closed and a consolidated balance sheet would be prepared on a monthly basis. The accounting process is being reengineered to meet practices prescribed by GAAP, resulting in greater efficiencies and improved recordkeeping. To this purpose, the Port Authority has implemented upgrades to its Peoplesoft Financial Accounting software and engaged consultants to assist in automating various accounting processes.

During FY2008, organizational changes contributed to delays in fully implementing the corrective action plan; however, the Authority has made a significant amount of progress and the corrective action plan became fully operational as of October 31, 2008.

3. Findings and questioned costs for federal awards.

Finding 08-2: Cash Management

Program: U.S. Department of Transportation - Federal Transit Cluster; Federal Transit - Capital Investment Grants CFDA #20.500; Federal Transit - Formula Grants CFDA #20.507

Questioned Costs: \$0

Statement of Condition: The Federal Transit Administration provides grant funding to the Authority on a reimbursement basis. During the year, the Authority drew federal funds amounting to approximately \$660,000 in excess of expenses incurred. The overdraw was only discovered as part of the audit.

Criteria: Applicable grant agreements require the Authority to draw on federal funds only after eligible expenses have been incurred.

PORT AUTHORITY OF ALLEGHENY COUNTY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2008

Cause: Funds were drawn for expenses that had been moved between grants and already previously funded.

Effect: The Authority made overdraws of federal funds and thus was not in compliance with cash management requirements.

Recommendation: The current amount overdrawn should be deducted from a subsequent federal drawdown. The Authority should implement procedures to ensure that federal drawdowns are made only when eligible expenses have been incurred.

Views of Responsible Officials: During FY2008, there were significant personnel changes in the Capital Accounting Department that contributed to circumstances that enabled the overdrawn condition to go unnoticed until year-end.

The overdrawn funds were returned to the FTA in December 2008. Procedures are now in place that would immediately identify overdraws and lead to their immediate investigation and resolution.

The overdrawn condition occurred due to a reclassification of costs for a project after funds had been drawn on the grant for these expenditures. Prior to FY2008, such reclassifications could be initiated by departments outside of the finance division. During FY2008, there were organizational changes that moved responsibility for cost transfers to the Grants and Capital Programs Department, which reports to the CFO. As a result, there is more effective communication with the Grants Accounting Department when there are revisions to capital grants.

PORT AUTHORITY OF ALLEGHENY COUNTY

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2008

Prior Year Audit Findings:

Finding 07-1: Financial Statement Preparation

Statement of Condition: The Authority currently maintains two separate trial balances (capital and operating) that are consolidated for financial reporting purposes. The capital component is maintained to facilitate grant reporting and the Authority's year-end closing process results in conversion entries necessary to reflect accounting practices prescribed by accounting principles generally accepted in the United States of America (GAAP). During the 2007 audit, we identified additional material adjustments needed to present the financial statements in accordance with GAAP. The adjustments were primarily related to recording current and prior year debt transactions and to correct unreconciled differences on the capital trial balance.

Status: Condition continues to exist. See finding 08-1.