WEST VIRGINIA STATE RAIL AUTHORITY

A COMPONENT UNIT OF THE STATE OF WEST VIRGINIA
AND THE WEST VIRGINIA DEPARTMENT OF TRANSPORTATION

FINANCIAL STATEMENTS WITH ADDITIONAL INFORMATION

YEAR ENDED JUNE 30, 2007

AND

INDEPENDENT AUDITORS' REPORT

TABLE OF CONTENTS

#8 Stonecrest Drive
Huntington, WV 25701

HAYFLICH & STEINBERG

Certified Public Accountants

Phone: (304) 697-5700
Fax: (304) 697-5704
www.hayflich.net

INDEPENDENT AUDITORS' REPORT

To the Members of the
West Virginia State Rail Authority
Moorefield, West Virginia

We have audited the accompanying basic financial statements of the West Virginia State Rail Authority (the Authority), a component unit of the West Virginia Department of Transportation and the State of West Virginia, as of and for the year ended June 30, 2007, as listed in the table of contents. 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 audit.

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

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

The management's discussion and analysis on pages 3 through 9 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information, and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 26, 2007, 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 should be considered in assessing the results of our audit.

Hayflich & Steinberg, CPA's, PLLC

October 26, 2007

WEST VIRGINIA STATE RAIL AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS

The management of the West Virginia State Rail Authority (Authority) offers readers of our financial statements the following narrative overview and analysis of our financial activities for the year ended June 30, 2007. Please read it in conjunction with the Authority's basic financial statements and notes to the financial statements which follow this section.

FINANCIAL HIGHLIGHTS

- The Authority's net assets increased $1,747,194 as a result of this year's operations. This was due to continual capital improvement projects and upgrades to both the South Branch Valley Railroad (SBVR) and the West Virginia Central Railroad (WVCR).

- Operating expenses decreased by approximately $100,000 during the year ended June 30, 2007 and operating revenues increased approximately $175,000. This resulted in an operating loss decrease of approximately $280,000. Operating expenses were about the same as last year with costs such as, rail car hire rates, diesel fuel costs, and liability and property insurance rates being the largest operating expenses. Freight revenue increased because more revenue cars were handled during the fiscal year ended June 30, 2007. This increase was attributable to an increase in the number of corn cars handled for our largest customer Pilgrim's Pride as well as a slight increase in our overall rate structure. In addition, Greer Limestone shipped 100 more cars in fiscal year ended June 30, 2007. This company had been trucking their product and their revenue shipments had decreased over the past few years. However, with the rising price of fuel cost it became more economical for them to go back to shipping by rail. Thus we have seen a steady increase in the amount of cars shipped.

- Non-operating revenues (expenses) were ($22,400) in the year ended June 30, 2007 compared to non-operating revenues (expenses) of ($179,114) in the year ended June 30, 2006. The decrease in total non-operating revenues (expenses) can be attributed to a decrease in interest expense, a decrease in losses on disposition of assets and an increase in interest income.

- The Authority completed approximately $2.38 million in capital improvements in the year ended June 30, 2007 including approximately $1.03 million for SBVR, approximately $1.12 for the WVCR, approximately $114,000 for new equipment and approximately $110,000 for upgrades to the Maryland Rail Commuter (MARC) trains stations in the Eastern Panhandle.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report includes management's discussion and analysis report, the independent auditor's report and the basic financial statements of the Authority. The financial statements also include notes that explain in more detail some of the information in the financial statements.

REQUIRED FINANCIAL STATEMENTS

The financial statements of the Authority report information using accounting methods similar to those used by private sector companies. These statements offer short and long term financial information about its activities. The Statement of Net Assets includes all of the Authority's assets and liabilities and provides information about the investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for evaluating the capital structure of the Authority and assessing the liquidity and financial flexibility of the Authority.

All of the current year's revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Assets. This statement measures the success of the Authority's operations over the past year and can be used to determine whether the Authority's costs are recovered from revenues and how much of the cost is supplemented by appropriations from the State of West Virginia.

The final required financial statement is the Statement of Cash Flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operating, investing, and financing activities. It provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

CONDENSED FINANCIAL STATEMENTS

Condensed financial information from the statement of net assets and statements of revenues, expenses and changes in net assets for the years ended June 30, 2007 and 2006 are as follows:

Condensed Statement of Net Assets

	2007	2006
Current assets	$ 3,275,052	$ 3,008,033
Capital assets, net	35,854,329	34,908,032
Total assets	39,129,381	37,916,065
Current liabilities	1,295,357	1,413,009
Noncurrent liabilities	132,913	549,139
Total liabilities	1,428,270	1,962,148
Net assets		
Invested in capital assets net of related debt	35,429,329	34,071,360
Unrestricted	2,271,782	1,882,557
Total net assets	$ 37,701,111	$ 35,953,917

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

	2007	2006
Operating revenues		
Freight	$ 2,000,003	$ 1,845,028
Miscellaneous	121,051	101,122
Total operating revenues	2,121,054	1,946,150
Depreciation expense	1,334,965	1,273,518
Other operating expenses	2,192,917	2,358,371
Total operating expenses	3,527,882	3,631,889
Operating loss	(1,406,828)	(1,685,739)
Non-operating revenues (expenses)	(22,400)	(179,114)
Income (loss) before transfers	(1,429,228)	(1,864,853)
Transfers in	3,176,422	3,159,111
Change in net assets	1,747,194	1,294,258
Total net assets - beginning	35,953,917	34,659,659
Total net assets - ending	$ 37,701,111	$ 35,953,917

FINANCIAL ANALYSIS

- The Authority's budget for the fiscal year ended June 30, 2007 consisted of funds received from the State of West Virginia General Fund, operating revenues from SBVR, revenues from the operator of the WVCR, and miscellaneous revenues received from the leases and licenses on railroad right-of -ways.

- The Authority received an approximate $3.2 million appropriation from the general fund of the State of West Virginia for capital improvement projects and maintenance projects on the SBVR and WVCR, upkeep of the MARC train stations in the eastern panhandle, and the general operation of the Authority. This appropriation is about 60% of the total funds received. The rehabilitation of the SBVR is planned to be completed in June 2008. After this rehabilitation program is complete, appropriations will be used for continued maintenance projects on the SBVR and more funding will be shifted to projects on the WVCR in order to safely maintain the condition of both railroads.

- Freight revenue of approximately $2 million was earned from the operations of the SBVR which was in line with the year ended June 30, 2007 budgeted projections. Miscellaneous revenues of approximately $121,000 were earned in addition to the freight revenue. The miscellaneous revenue is made up of Right of Way leases on the SBVR and income received from the excursion train operator. This revenue is used to pay the operating expenses of the SBVR. Total operating revenues increased by 9% in the fiscal year ended June 30, 2007.

- The bond payment of $426,450 is about 9% of total cash expenditures for the year ended June 30, 2007. The last bond payment is scheduled for repayment in July 2007, which will increase cash available to pay operating expenses on the SBVR.

The following graphs provide a visual representation of the funding (revenue and other income sources) and expenditures (cash outlays) for the fiscal year ended June 30, 2007.

<u>Chart 1 - Expenditures (cash outlays) Breakdown - Year ended June 30, 2007</u>

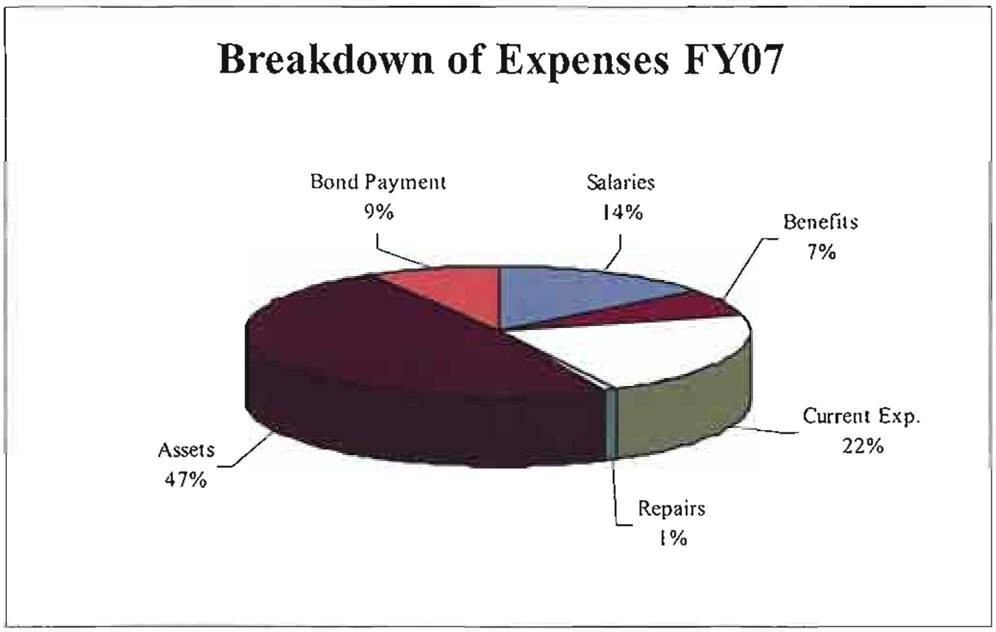
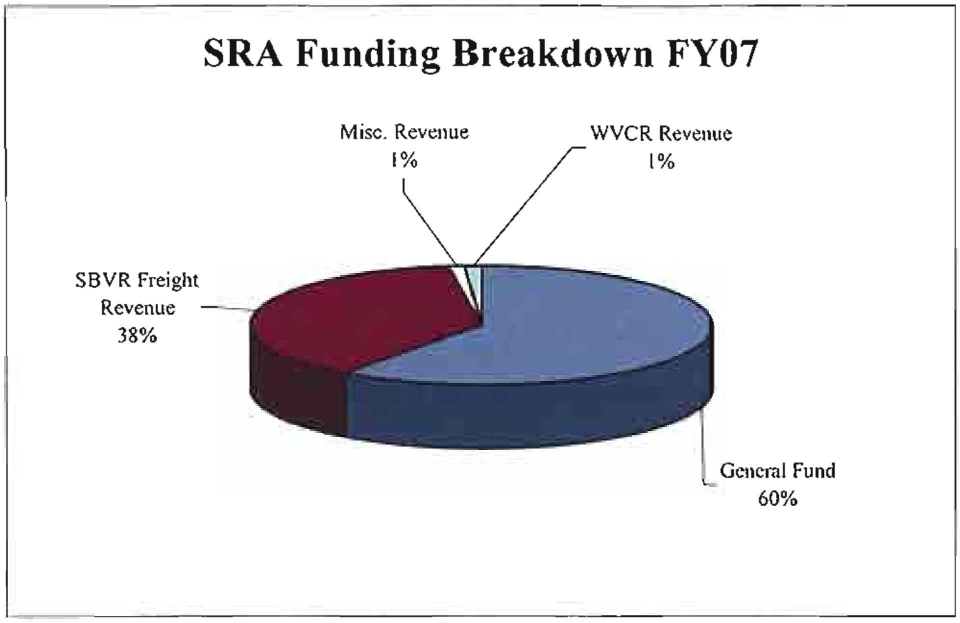


Chart 2 - Funding Breakdown - Year ended June 30, 2007



CAPITAL ASSET AND DEBT ADMINISTRATION

CAPITAL ASSETS

The Authority's net capital assets as of June 30, 2007 and 2006 amounted to $35,854,329 and $34,908,032, respectively. This investment in capital assets includes land, rail properties, transportation and other equipment, and office buildings and equipment.

The Authority primarily acquires its assets with proceeds from the general fund appropriation from the State of West Virginia. Rehabilitation and improvements to the SBVR and WVCR are part of the Authority's capital investment program.

Capital asset additions included the following for the years ended June 30:

	2007	2006
Land	$ -	$ -
Rail properties	2,261,844	1,887,297
Transportation and other equipment	114,223	101,192
Office building and equipment	-	-
Total	$ 2,376,067	$ 1,988,489

LONG TERM DEBT

With the 1992 expansion of the Wampler-Longacre feed mill in Hardy County, the traffic on the SBVR doubled. The increase in traffic required the SBVR to make several major improvements. The Authority sold $4 million dollars of Commercial Development Revenue Bonds to finance these improvements. The debt on these bonds runs from July 1993 through July 2007. In the year ended June 30, 2007, $455,285 was paid toward this debt and related interest expense from operating (freight) revenue received by the SBVR. The following table shows the schedule for the remaining debt and interest expense.

Year ending June 30	2008
	$456,450

The bond debt will be paid off in July 2007 enhancing the Authority's cash flow by approximately $450,000 per year.

Readers interested in more detailed information regarding capital assets and debt administration should review the accompanying notes 4 and 5 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The SBVR's track structure has improved significantly over the past seven years. By establishing a long term capital improvement program, the Authority has been able to increase the weight restrictions on railcars. Track safety has also improved resulting in fewer derailments. Because of the improved track structure, the operating speeds on the SBVR have increased. This has allowed the SBVR to increase the turnaround time for rail cars supplying the Pilgrim's Pride feed mill in Moorefield. Pilgrim's Pride is the largest employer in the Potomac Valley so it is vital that the Authority continue to upgrade the rail infrastructure and maintain the track to promote the economic success of the area it serves. The SBVR capital improvements planned for the fiscal year ending June 30, 2008 include continuing to upgrade and repair bridges and adding ballast and surfacing.

The Authority's year ended June 30, 2008 budget includes $2,864,430 from the State of West Virginia and $2,968,589 from projected freight revenue. This funding will be used to complete the long-term rehabilitation projects started on the SBVR and also continue to maintain the WVCR. The capital improvement projects planned on the WVCR for the fiscal year ending June 30, 2008 include culvert & tie replacement, ballast spreading, surfacing and adding a side track to assist in train operations. This railroad has completed eight years of operations and continues to be a strong economic factor to the areas that it serves.

The Authority will continue to maintain commuter facilities at Harpers Ferry, Duffields and Martinsburg for the MARC train service. This offers West Virginia citizens in the eastern panhandle the advantage of using commuter train service to Washington, DC.

REQUESTS FOR INFORMATION

This financial report is designed to provide an overview of the finances of the Authority for those with an interest in this organization. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the West Virginia State Rail Authority at 120 Water Plant Drive, Moorefield, West Virginia, 26836.

WEST VIRGINIA STATE RAIL AUTHORITY
STATEMENT OF NET ASSETS
JUNE 30, 2007

ASSETS

Current assets		
Cash and cash equivalents	$	1,919,678
Restricted cash and cash equivalents		565,645
		2,485,323
Trade receivables		21,611
Inventories		51,040
Due from other governmental entities		708,760
Other current assets		8,318
Total current assets		3,275,052
Noncurrent assets		
Capital assets		49,526,690
Accumulated depreciation		(13,672,361)
Total noncurrent assets		35,854,329
Total assets	$	39,129,381

LIABILITIES

Current liabilities		
Accounts payable	$	714,366
Accrued expenses		58,914
Compensated absences		59,181
Due to other governmental entities		37,896
Current maturities of long-term debt		425,000
Total current liabilities		1,295,357
Noncurrent liabilities		
Compensated absences		132,913
Total noncurrent liabilities		132,913
Total liabilities		1,428,270

NET ASSETS

Invested in capital assets, net of related debt		35,429,329
Unrestricted		2,271,782
Total net assets	$	37,701,111

The accompanying notes are an integral part of the financial statements.

WEST VIRGINIA STATE RAIL AUTHORITY
STATEMENT OF REVENUES EXPENSES AND CHANGES IN FUND NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2007

Operating revenues		
Freight	$	2,000,003
Miscellaneous		121,051
Total operating revenues		2,121,054
Depreciation expense		1,334,965
Other operating expenses		2,192,917
Total operating expenses		3,527,882
Operating income (loss)		(1,406,828)
Nonoperating revenues (expenses)		
Interest income		103,855
Interest expense		(31,450)
Gain (loss) on disposition of assets		(94,805)
Total nonoperating revenues (expenses)		(22,400)
Income (loss) before transfers		(1,429,228)
Transfers in		3,176,422
Change in net assets		1,747,194
Total net assets - beginning		35,953,917
Total net assets - ending	$	37,701,111

The accompanying notes are an integral part of the financial statements.

WEST VIRGINIA STATE RAIL AUTHORITY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2007

Cash flows from operating activities	
Cash received from customers and government	$ 2,151,603
Cash paid to employees	(654,866)
Cash paid to suppliers and government	(1,653,402)
Net cash provided (used) by operating activities	(156,665)
Cash flows from noncapital financing activities	
Transfers in from State of West Virginia	3,311,502
Net cash provided (used) by noncapital financing activities	3,311,502
Cash flows from capital and related financing activities	
Purchase of capital assets	(2,376,067)
Interest paid	(31,450)
Principal paid	(395,000)
Net cash provided (used) by capital and related financing activities	(2,802,517)
Cash flows from investing activities	
Receipts of interest	103,855
Net cash provided (used) by investing activities	103,855
Increase (decrease) in cash and cash equivalents	456,175
Cash and cash equivalents, beginning of year including restricted cash	2,029,148
Cash and cash equivalents, end of year including restricted cash	$ 2,485,323
Reconciliation of operating income to net cash provided (used) by operating activities	
Operating loss	$ (1,406,828)
Adjustments to reconcile operating income to net cash provided by operating activities	
Depreciation	1,334,965
Amortization	(16,672)
Changes in operating assets and liabilities	
(Increase) decrease in trade receivables	30,549
(Increase) decrease in inventories	26,208
(Increase) decrease in other current assets	(2,682)
Increase (decrease) in operating accounts payable	(144,117)
Increase (decrease) in accrued expenses	(11,568)
Increase (decrease) in compensated absences	7,120
Increase (decrease) in due to other governmental entities	26,360
Net cash provided (used) by operating activities	$ (156,665)

The accompanying notes are an integral part of the financial statements.

NOTE 1 - DESCRIPTION OF ORGANIZATION AND FINANCIAL REPORTING ENTITY

In 1975, the West Virginia Legislature created the West Virginia State Rail Authority (the Authority) under the provisions of Chapter 29, Article 18 of the Code of West Virginia, 1931, as amended, known as the "West Virginia Railroad Maintenance Act." The Authority was created to participate in the rehabilitation, improvement, and restoration of the financial stability of the railway system in the State of West Virginia and enable it to remain viable in the public sector as a mode of transportation. The Authority maintains the South Branch Valley Railroad, and the West Virginia Central Railroad, and is responsible for the rails-to-trails program operation. The Secretary of Transportation serves as a member of the Authority and the remaining six members are appointed by the Governor.

In evaluating how to define the Authority for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity is made by applying the criteria set forth in accounting principles generally accepted in the United States of America. Accounting principles generally accepted in the United States of America define component units as those entities which are legally separate governmental organizations for which the appointed members of the Authority are financially accountable, or other organizations for which the nature and significance of their relationship with the Authority are such that exclusion would cause the Authority's financial statements to be misleading. Since no such organizations exist which meet the above criteria, the Authority has no component units. The Authority is an enterprise fund and a component unit of the West Virginia Department of Transportation and the State of West Virginia. Accordingly, the Authority's financial statements are discretely presented in the financial statements of the West Virginia Department of Transportation and in the financial statements of the State of West Virginia.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF ACCOUNTING - The Authority is considered an enterprise fund and uses the flow of economic resources measurement focus and the accrual method of accounting. Under this method, revenues are recorded when earned and expenses are recorded when incurred. Enterprise funds are operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expense, including depreciation) of providing goods and services to the general public on a continuing basis be financed or recovered primarily through user charges. As permitted by Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting,* the Authority elected not to adopt Financial Accounting Standards Board (FASB) statements and interpretations issued after November 30, 1989, unless the GASB specifically adopts such FASB statements or interpretations.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

FINANCIAL STATEMENT PRESENTATION - The Authority prepares its financial statements in accordance with GASB Statement No. 34, *Basic Financial Statements and Management Discussion and Analysis - for States and Local Governments*, as amended.

USE OF ESTIMATES - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from management's estimates.

CASH AND CASH EQUIVALENTS - Cash and cash equivalents include short-term investments with original maturities of 90 days or less. Cash and cash equivalents principally consist of amounts on deposit in the State Treasurer's Office (STO) that are pooled funds managed by the West Virginia Board of Treasury Investments (BTI). These funds are transferred to the BTI and the BTI is directed by the State Treasurer to invest the funds in specific external investment pools. Balances in the investment pools are recorded at fair value or amortized cost which approximates fair value. Fair value is determined by a third-party pricing service based on asset portfolio pricing models and other sources, in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools.* Fair value and investment income are allocated to participants in the pools based upon the funds that have been invested. The amounts on deposit are available for immediate withdrawal and, accordingly, are presented as cash and cash equivalents in the accompanying financial statements. In addition, the Authority makes interest-earning deposits in certain investment pools maintained by BTI that are available to the Authority with overnight notice.

The BTI maintains the Consolidated Fund which consists of five investment pools and participant-directed accounts, in which the state and local governmental agencies invest. These pools have been structured as multiparticipant variable net asset funds to reduce risk and offer investment liquidity diversification to the Fund participants. Funds not required to meet immediate disbursement needs are invested for longer periods. A more detailed discussion of the BTI's investment operations pool can be found in its annual report. A copy of those annual reports can be obtained from the following address: 1900 Kanawha Blvd., E., Room E-122, Charleston, West Virginia 25305 or http://www.wvbti.com.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Permissible investments for all agencies include those guaranteed by the United States of America, its agencies and instrumentalities (U.S. Government obligations); corporate debt obligations, including commercial paper, which meet certain ratings; certain money market funds; repurchase agreements; reverse repurchase agreements; asset-backed securities; certificate of deposit; state and local government securities (SLGS); and other investments. Other investments consist primarily of investments in accordance with the Linked Deposit Program, a program using financial institutions in West Virginia to obtain certificates of deposit, loans approved by the legislature and any other program investments authorized by the legislature.

RESTRICTED CASH AND CASH EQUIVALENTS - Restricted cash and cash equivalents of $565,645 at June 30, 2007 are invested in a U.S. Government securities money market mutual fund reported at fair value. The carrying amounts of these deposits do not differ materially from the bank balance of these deposits at June 30. These deposits are subject to the terms of a loan agreement and bond covenants, which restrict the deposits to resources accumulated for debt service payments.

INVENTORIES - Inventories are valued using the weighted average cost method.

CAPITAL ASSETS - Purchases of capital assets are capitalized at cost and, except for land which is not depreciated, are depreciated using the straight-line method over the estimated useful lives of the assets ranging from five to forty years. Buildings and land with an initial cost of $25,000 or more and furniture and equipment with an initial cost of $5,000 or more are recorded at cost. When assets are disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized in operations. The cost of maintenance and repairs is charged to operations as incurred; significant renewals and betterments are capitalized.

COMPENSATED ABSENCES, INCLUDING POSTRETIREMENT BENEFITS - Employees fully vest in all earned but unused annual leave and the Authority accrues for obligations that may arise in connection with compensated absences for vacation at the current rate of employee pay. In accordance with State personnel policies, employees vest in any remaining unused sick leave only upon retirement, at which time any unused compensated absence time can be converted into employer paid premiums for postretirement health care coverage through the West Virginia Public Employees Insurance Agency, or be converted into a greater retirement benefit under the State's Public Employees' Retirement System. The estimated obligation for such benefits, as they relate only to those persons employed directly by the Authority presently or in the past, is recorded as a liability in the accompanying financial statements.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

OPERATING REVENUES AND EXPENSES - Balances classified as operating revenues and expenses are those which comprise the Authority's ongoing operations. Principal operating revenues are charges to customers for use of the rail lines. Principal operating expenses are the costs of providing the goods and services and include administrative expenses and depreciation of capital assets. Other revenues and expenses are classified as non-operating in the financial statements.

NET ASSETS - As required by GASB 34, the Authority displays net assets in three components, if applicable: invested in capital assets, net of related debt; restricted, and unrestricted.

INVESTMENT IN CAPITAL ASSETS, NET OF RELATED DEBT - This component of net assets consists primarily of capital assets, including restricted capital assets (if any), 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 those assets.

RESTRICTED NET ASSETS - Restricted net assets are assets whose use or availability has been restricted and the restrictions limit the Authority's ability to use the resources to pay current liabilities. When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first, then unrestricted resources as needed. For the year ended June 30, 2007 there were no restricted net assets.

UNRESTRICTED NET ASSETS - Unrestricted net assets consist of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt." In the governmental environment, net assets are often designated to indicate that management does not consider them to be available for general operations. These types of constraints on resources are internal and management can remove or modify them. Such internal designations are not reported on the face of the statement of net assets.

TRANSFERS - Transfers represent legally authorized appropriations under West Virginia State Code by the West Virginia Legislature.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

RECENT STATEMENTS ISSUED BY GASB - No statements were adopted by the Authority during the fiscal year ended June 30, 2007;

The GASB has issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*, effective for fiscal years beginning after December 15, 2006. This statement provides standards for the measurement, recognition and display of other postemployment benefit expenditures, assets, and liabilities, including applicable note disclosures and required supplementary information. Effective July 1, 2007, the Authority will adopt GASB Statement No. 45. During fiscal year 2006, House Bill No. 4654 was established to create a trust fund for postemployment benefits for the State of West Virginia. The Authority is required to participate in this multiple employer cost sharing plan sponsored by the State of West Virginia. Details regarding this plan can be obtained by contacting Public Employees Insurance Agency, State Capitol Complex, Building 5, Room 1001, 1900 Kanawha Boulevard, East, Charleston, West Virginia, 25305-0710 or http://www.wvpeia.com. No liability related to this plan existed for the Authority at June 30, 2007.

The GASB has issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, effective for fiscal years beginning after December 15, 2006. This statement addresses whether an exchange of an interest in expected cash flows for collecting specific receivables of specific future revenues for an immediate lump sum should be regarded as a sale or as a collateralized borrowing resulting in a liability. It establishes criteria to determine whether proceeds should be reported as revenue or a liability. The Authority has not yet determined the effect that the adoption of GASB Statement No. 48 may have on the financial statements.

The GASB has issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, effective for fiscal years beginning after December 15, 2007. This statement addresses the obligations of existing pollution events. It provides guidance on whether any components of a remediation should be recognized as a liability. The Authority has not yet determined the effect that the adoption of GASB Statement No. 49 may have on the financial statements.

The GASB has issued Statement No. 50. *Pensions Disclosures* (an amendment of GASB Statements No. 25 and No. 27), effective for fiscal years beginning after June 15, 2007. This statement more closely aligns the financial reporting requirements for pension with those for other postemployment benefits, thus enhancing the information disclosed on the notes to the financial statements or presented as required supplementary information. The Authority has not yet determined the effect that the adoption of GASB Statement No. 50 may have on the financial statements.

NOTE 3 - CASH AND CASH EQUIVALENTS

The composition of cash and cash equivalents were as follows at June 30:

	Amortized Cost	Estimated Fair Value
Cash on deposit with State Treasurer	$ 992	$ 992
Cash on deposit with State Treasurer invested in BTI cash liquidity pool	1,918,686	1,918,686
Cash in bank, restricted for debt repayment	565,645	565,645
	$ 2,485,323	$ 2,485,323

Cash on deposit with the State Treasurer is a non-safeguarded deposit in accordance with GASB Statement No. 3, *Deposits with Financial Institutions, Investments, (including Repurchase Agreements), and Reverse Repurchase Agreements*. Additionally, such deposits are subject to the following BTI policies and procedures.

West Virginia Board of Treasury Investments (BTI) Cash Liquidity Pool

The BTI has adopted an investment policy in accordance with the "Uniform Prudent Investor Act." The "prudent investor rule" guides those with responsibility for investing the money for others. Such fiduciaries must act as a prudent person would be expected to act, with discretion and intelligence, to seek reasonable income, preserve capital, and, in general, avoid speculative investments. The BTI's investment policy to invest assets in a manner that strives for maximum safety, provides adequate liquidity to meet all operating requirements, and achieves the highest possible investment return consistent with the primary objectives of safety and liquidity. The BTI recognizes that risk, volatility, and the possibility of loss in purchasing power are present to some degree in all types of investments. Due to the short-term nature of BTI's Consolidated Fund, the BTI believes that it is imperative to review and adjust the investment policy in reaction to interest rate market fluctuations/trends on a regular basis and has adopted a formal review schedule. Investment policies have been established for each investment pool and account of the BTI's Consolidated Fund.

NOTE 3 - CASH AND CASH EQUIVALENTS (Continued)

Cash Liquidity Pool

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Neither the BTI nor any of the BTI's Consolidated Fund pools or accounts has been rated for credit risk by any organization. Of the BTI's Consolidated Fund pools and accounts which the Commission may invest in, three are subject to credit risk: Cash Liquidity Pool, Government Money Market Pool, and Enhanced Yield Pool.

The BTI limits the exposure to credit risk in the Cash Liquidity Pool by requiring all corporate bonds to be rated AA- by Standard & Poor's (or its equivalent) or higher. Commercial paper must be rated at least A-1 by Standard & Poor's and P1 by Moody's. The pool must have at least 15% of its assets in U.S. Treasury issues. The following table provides information on the credit ratings of the Cash Liquidity Pool's investments (in thousands):

	Credit Rating *		2007	
Security Type	Moody's	S&P	Carrying Value	Percent of Pool Assets
Investments:				
Commercial paper	P1	A-1	$ 1,015,926	48.89%
Corporate bonds and notes	Aaa	AAA	98,999	4.76
	Aa3	AA	20,001	0.96
	Aa3	A	23,002	1.11
	Aa2	AA	15,000	0.72
	Aa2	A	27,000	1.30
	Aa1	AA	77,023	3.71
			261,025	12.56
U.S. agency bonds	Aaa	AAA	46,994	2.26
U.S. Treasury bills	Aaa	AAA	358,725	17.27
Negotiable certificates of deposit	P1	A-1	76,500	3.68
U.S. agency discount notes	P1	A-1	21,655	1.04
Money market funds	Aaa	AAA	185	0.01
Repurchase agreements (underlying securities):				
U.S. agency notes	Aaa	AAA	246,821	11.88
Deposits:				
Nonnegotiable certificates of deposit	NR	NR	50,000	2.41
			$ 2,077,831	100.00%

NOTE 3 - CASH AND CASH EQUIVALENTS (Continued)

At June 30, 2007 the Authority's ownership represents .09% of these amounts held by the BTI.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. All the BTI's Consolidated Fund pools and accounts are subject to interest rate risk.

The overall weighted average maturity of the investments of the Cash Liquidity Pool cannot exceed 60 days. Maximum maturity of individual securities cannot exceed 397 days from date of purchase. The following table provides information on the weighted average maturities for the various asset types in the Cash Liquidity Pool:

	2007	
Security Type	Carrying Value (In Thousands)	WAM (Days)
Repurchase agreements	$ 246,821	2
U.S. Treasury bills	358,725	30
Commercial paper	1,015,926	52
Certificates of deposit	126,500	76
U.S. agency discount notes	21,655	113
Corporate notes	261,025	58
U.S. agency bonds/notes	46,994	156
Money market funds	185	1
	$ 2,077,831	48

Other Investment Risks

Other investment risks include concentration of credit risk, custodial credit risk, and foreign currency risk. None of the BTI's Consolidated Fund's investment pools or accounts is exposed to these risks as described below.

NOTE 3 - CASH AND CASH EQUIVALENTS (Continued)

Concentration of credit risk is the risk of loss attributed to the magnitude of the BTI Consolidated Fund pool or account's investment in a single corporate issuer. The BTI investment policy prohibits those pools and accounts permitted to hold corporate securities from investing more than 5% of their assets in any one corporate name of one corporate issue.

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the BTI will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. Repurchase agreements are required to be collateralized by at least 102% of their value, and the collateral is held in the name of the BTI. Securities lending collateral that is reported on the BTI's Statement of Fiduciary Net Assets is invested in the lending agent's money market fund in the BTI's name. In all transactions, the BTI or its agent does not release cash or securities until the counterparty delivers its side of the transaction.

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. None of the BTI's Consolidated Fund's investment pools or accounts holds interests in foreign currency or interests valued in foreign currency.

Deposits

Custodial credit risk of deposits is the risk that in the event of failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. Deposits include nonnegotiable certificates of deposit. The Cash Liquidity Pool contains nonnegotiable certificates of deposit valued at $50,000,000, which represents 2.41% of the pool's assets. The BTI does not have a deposit policy for custodial credit risk.

Restricted Cash and Cash Equivalents for Debt Service Repayment

Credit Risk

The West Virginia State Rail Authority limits the exposure to credit risk in the funds invested for debt service repayment by requiring in the bond trust indenture that investments be rated AA or higher. At June 30, 2007 these funds were invested with the Bank of New York Trust Company, N.A. in the JPMorgan 100% U.S. Treasury Securities Money Market Fund. This Fund invests only in obligations of the U.S. Treasury, including Treasury bills, bonds, and notes. The Fund does not buy securities issued or guaranteed by agencies of the U.S. government. The following table provides information on the credit ratings of this investment.

NOTE 3 - CASH AND CASH EQUIVALENTS (Continued)

Security Type	Moody's	S&P	Carrying Value	Percentage of Assets
U.S. Government securities money market mutual fund	Aaa	AAAm-G	$ 565,645	100%

Concentration of credit risk

The Authority bond trust indenture places no limit on the amount the Authority may invest in any one issuer. All of the investments for debt service repayment are in the JPMorgan 100% U.S. Treasury Securities Money Market Fund.

Custodial credit risk

Custodial credit risk is the risk that in the event of a failure of the counter party, the Authority will not be able to recover the value of the investment that is in the possession of an outside party. The Authority does not have a policy for custodial credit risk. As of June 30, 2007, $565,645 of the Authority's investment was invested in obligations of the U.S. Treasury.

Interest rate risk

The weighted average maturity of the JPMorgan 100% U.S. Treasury Securities Money Market Fund generally will be 90 days or less and the Fund will buy only those instruments that have remaining maturities of 397 days or less. The following table provides the investment maturity in years for the funds invested for debt service repayment.

		Investment Maturity in Years			
Security Type	Carrying Value	Less than 1	1-5	6-10	More than 10
U.S. Government securities money market mutual fund	$ 565,645	$ 565,645	-	-	-

Foreign Currency Risk

The investments for debt service repayment have no securities that are subject to foreign currency risk.

NOTE 3 - CASH AND CASH EQUIVALENTS (Continued)

Railroad Bond Reserve

As part of the State of West Virginia policy, the West Virginia Economic Development Authority (WVEDA) has established a railroad bond reserve which consists of a U.S. Treasury bill in the amount of $450,000. This account is the property of the WVEDA and is held as a bond reserve in trust until all final payments have been made by the Authority.

NOTE 4 - CAPITAL ASSETS

Capital assets balances and the activity for the year ended June 30, 2007 is summarized below:

	June 30,2006 Balance	Additions	Deletions	June 30,2007 Balance
Capital assets				
Land	$ 4,835,588	$ -	$ -	$ 4,835,588
Rail properties	40,922,983	2,261,844	162,320	43,022,507
Transportation and other equipment	1,103,002	114,223	-	1,217,225
Office building and equipment	451,370	-	-	451,370
Total capital assets	$ 47,312,943	$ 2,376,067	$ 162,320	$ 49,526,690
Accumulated depreciation				
Rail properties	$ 11,444,156	$ 1,229,332	$ 67,515	$ 12,605,973
Transportation and other equipment	658,796	94,235	-	753,031
Office building and equipment	301,959	11,398	-	313,357
Total accumulated depreciation	$ 12,404,911	$ 1,334,965	$ 67,515	$ 13,672,361

NOTE 5 - LONG-TERM DEBT

Long-term debt consists of notes payable to the County Commissions of Hardy County and Hampshire County, West Virginia, payable in monthly installments ranging from $37,852 to $37,748, including interest ranging from 6.7% to 7.4%, with the final payment due July 2007. In July 1998, in consideration of a one-time payment in the amount of $150,000, the Authority agreed to surrender its right to redeem the notes in accordance with the original trust indenture. This payment is recorded as a premium on the notes payable and is being amortized over the life of the notes, offsetting the related interest expense, using the straight-line method. At June 30, 2007, the Authority's premium on notes payable was $0 and amortization expense related to the premium was $0 per year. The notes are secured by gross operating receipts of the Authority, excluding any transfers from the State of West Virginia.

NOTE 5 - LONG-TERM DEBT (Continued)

Total notes payable at June 30, 2006	$	836,672
Less principle retirement		(395,000)
Less amortization of premium		(16,672)
Total notes payable at June 30, 2007		425,000
Less current portion		425,000
Long-term notes payable	$	-

Maturities of long-term debt as well as the related interest to be paid for each of the next five years and thereafter are as follows:

Year ending June 30	Principal	Interest	Total
2008	$ 425,000	$ 31,450	$ 456,450

NOTE 6 - COMPENSATED ABSENCES

The following is a summary of the compensated absences for the year ended June 30, 2007:

Year ending June 30	Short term Compensated Absences	Long term Compensated Absences
2007	$59,181	$ 132,913

NOTE 7- DUE TO/FROM OTHER GOVERNMENTAL ENTITIES AND TRANSFERS

At June 30, 2007, the Authority had amounts due from the State of West Virginia of $708,760. The Office of the Secretary General of Administration Finance Division transferred from FIMS fund 0506-099 $2,923,113 and FIMS fund 0506-913 $253,309 to the Authority for the year ended June 30, 2007.

NOTE 8- SIGNIFICANT CUSTOMERS AND FUNDING SOURCES

During the year ended June 30, 2007, approximately 92.8% of the Authority's freight traffic was attributable to a single customer. In addition, during the year ended June 30, 2007 the Authority received transfers of $3,176,422 in appropriated funds from the State of West Virginia. A significant decrease in this revenue or assistance would have a significant effect on the operations of the Authority.

NOTE 9- RISK MANAGEMENT

The Authority is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; employee health and life coverage; and natural disasters. The State of West Virginia established the Board of Risk and Insurance Management (BRIM) and the Public Employees Insurance Agency (PEIA) to account for and finance uninsured risks of losses for state agencies, institutions of higher education, and component units.

BRIM is a public entity risk pool that provides coverage for general, liability and property damage in the amount of $1,000,000 per occurrence. There have been no settlements that have exceeded this coverage in the last three years. PEIA is also a public entity risk pool and provides coverage for employee and dependent health, life and prescription drug insurance.

Through its participation in the PEIA, the Authority has obtained health, life and prescription drug coverage for all its employees. The Authority, through a third-party insurer has obtained coverage for job related injuries for its employees. In exchange for payment of premiums to PEIA and a third-party insurer, the Authority has transferred its risks related to health, life, prescription drug coverage, and job related injuries.

Workers' Compensation

West Virginia has a single private insurance company, BrickStreet Insurance, which provides workers' compensation coverage to all employers in the state. Other private insurance companies can begin to offer coverage to private-sector employers beginning July 1, 2008 and to government employers July 1, 2012. Nearly every employer in the State, who have a payroll must have coverage. The cost of all coverage is paid by the employers.

BrickStreet retains the risk related to the compensation of injured employees under the program.

NOTE 10- RETIREMENT PLAN

PLAN DESCRIPTION - The Authority contributes to the West Virginia Public Employees' Retirement System (PERS), a cost-sharing multiple-employer defined benefit pension plan administered by the West Virginia Consolidated Public Retirement Board. Chapter 5, Article 10 of the West Virginia State Code assigns the authority to establish and amend benefits provisions to the PERS Board of Trustees. Employees who retire at or after age 60 with five or more years of contributory service or who retire at or after age 55 and have completed 25 years of credited service are eligible for retirement benefits as established by State statute. Retirement benefits are payable monthly for life, in the form of a straight-line annuity equal to two percent of the employee's final average salary multiplied by the number of years of the employee's credited service at the time of retirement. PERS also provides deferred retirement, early retirement, death and disability benefits to plan members and beneficiaries. The West Virginia Consolidated Public Retirement Board issues a publicly available financial report that includes financial statements and required supplementary information for PERS. That report may be obtained by writing to the West Virginia Consolidated Public Retirement Board, 1900 Kanawha Boulevard East, Building Five, Charleston, West Virginia 25305 or by calling (304) 558-3570.

FUNDING POLICY - The PERS funding policy has been established by action of the State Legislature. State statute requires that plan participants contribute 4.5% of compensation. The current combined contribution rate is 15% of annual covered payroll, including the Authority's contribution of 10.5% which is established by PERS. The Authority's contributions to PERS for the years ended June 30, 2007, 2006, and 2005 were $66,393, $66,924, and $65,164.

NOTE 11 - POST EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

Upon retirement, an employee may apply unused sick leave or annual leave, or both to reduce their future insurance premiums paid to the West Virginia Public Employees Insurance Agency or to obtain a greater benefit under PERS. Substantially all employees hired prior to July 1, 2001, may become eligible for these benefits if they reach normal retirement age while working for the Authority. According to West Virginia State Code, employees hired prior to June 30, 1988, can receive health care credit against 100% of their health care coverage. Employees hired between June 30, 1988 and June 30, 2001, can receive health care credit against 50% of their health care cost. Employees hired July 1, 2001, or later, may not convert sick leave into a health care benefit. The obligation associated with retiree health care benefits is funded on a pay-as-you-go basis.

NOTE 11 - POST EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS (Continued)

The estimated liability for sick leave postretirement benefits for the years ended June 30, 2007, 2006, and 2005 were $132,913, $124,139, and $119,337, and is included in noncurrent liabilities in the statement of net assets. As of June 30, 2007, the Authority had one retiree eligible for these benefits of which the Authority paid approximately $4,700 for post-retirement benefits.

#8 Stonecrest Drive
Huntington, WV 25701

HAYFLICH & STEINBERG

Certified Public Accountants

Phone: (304) 697-5700
Fax: (304) 697-5704
www.hayflich.net

INDEPENDENT AUDITORS' 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*

To the Members of the
West Virginia State Rail Authority
Moorefield, West Virginia

We have audited the financial statements of the West Virginia State Rail Authority (the Authority) as of and for the year ended June 30, 2007, and have issued our report thereon dated October 26, 2007. 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.

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 generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements 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 a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of 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 internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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*.

This report is intended solely for the information and use of management, the Members of the Authority, and the West Virginia Legislature and is not intended to be and should not be used by anyone other than those specified parties.

Hayflich & Steinberg, CPA's, PLLC

October 26, 2007

HAYFLICH & STEINBERG, CPA's, PLLC
Engagement Manager's Checklist
Audited Financial Statements
(Risk-Based Governmental Audits)

Client: West Virginia State Rail Authority   Balance Sheet Date: 6/30/07

INSTRUCTIONS: This form should be completed for all audited financial statements by the Engagement Manager / supervisor, prior to submission of the financial statements for final review and signing. This form is designed to insure that the financial statements have been prepared, reviewed, and processed in accordance with the firm policies. This form should accompany the financial statements until the statement is signed and then should be scanned and filed in the engagement binder along with a signed scanned copy of the financial statements released to the client. The firm partner signing the financial statements must also sign this form.

Initials

1. The following **Required Checklists, Programs and Forms** are in the file and I have reviewed them: (See *PPC Guide to Audits of Local Governments)*

2003a	a) Preliminary Audit Planning Form (H&S)	g) Audit Difference Evaluation Form	3106
2000	b) Engagement Acceptance/Continuation Form	h) Supervision, Review, and Approval Form	2024
2006	c) Governmental Audit Planning Form	i) Governmental Disclosure Checklist	3210
N/A	d) Single Audit Determination and Planning	j) Single Audit Report Checklist (if applicable)	N/A
2004	e) Planning Materiality Worksheet	k) Other Single Audit Checklist (as required, see *Guide to Single Audits)*	N/A
2008	f) General Audit Procedures		

2. The representation letter signed by the client is in the file. 2309
3. There are no unresolved audit questions or procedures that would preclude us from issuing the financial statements.
4. Our report is appropriate, is supported by the audit evidence in the audit files and is properly dated.
   a. Our report is standard and agrees to standard report wording **(attach photo of PPC example)**
   b. Report has been modified for PPC examples in EPACE FILE **(attach photo of PPC example)** N/A
   c. Our report is to be dated as of 10/26/07 in accordance with SAS 103.
   d. Per SAS 103 the engagement binder must be finalized as of 12/25/07 (60 days from report date)
   e. I have completed the detailed review section of GRX-27: Supervision, Review, and Approval Form and I believe that our audit was conducted in accordance with auditing standards generally accepted in the United States of America and and the applicable governmental auditing standards that our audit adheres to the audit documentation requirements of SAS 103. I agree with the release of this report.

      Engagement Manager / Supervisor Chris T. [signature]   Date 10/30/07

   f. I have completed the partner review section of GRX-27: Supervision, Review, and Approval Form.
   g. I have completed the GRX-38 Audit Documentation Checklist and believe that our audit was conducted in accordance with auditing standards generally accepted in the United States of America and the applicable governmental auditing standards and that our audit adheres to the audit documentation requirements of SAS 103. I agree with the release of this report.

      Audit Partner / Manager [signature]   Date 10/30/07

   h. I have reviewed the GRX-38 Audit Documentation Checklist and believe that our audit was conducted in accordance with auditing standards generally accepted in the United States of America and the applicable governmental auditing standards and that our audit adheres to the audit documentation requirements of SAS 103.
   i. I agree with the release of this report and I have read the typed financial statement prior to signing it:

      Signing Partner [signature]   Date 10/30/07

Report disposition:

Mailed by [initials]   Date 11/2/07

Mailed to Cindy Butler   # of copies 12 (LF) ~~(SF)~~

By request of ____ we mailed 8 (LF) ~~(SF)~~ copy(s) to Tina Perdue

By request of ____ we mailed 3 (LF) ~~(SF)~~ copy(s) to Chris Sforza

(If more space is needed, attach a continuation sheet)

(LF) = Long form (SF) = Short form