

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, 2008

AND

INDEPENDENT AUDITORS' REPORT

TABLE OF CONTENTS

	<u>Page</u>
INDEPENDENT AUDITORS' REPORT	1-2
MANAGEMENT'S DISCUSSION AND ANALYSIS	3 - 9
FINANCIAL STATEMENTS	
Statement of Net Assets	10
Statement of Revenues, Expenses, and Changes in Fund Net Assets	11
Statement of Cash Flows	12
Notes to the Financial Statements	13 - 27
ADDITIONAL INFORMATION	
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 <i>Government Auditing Standards</i>	28 - 29

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying 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, 2008, 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances of, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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

As discussed in notes 2 and 9 to the financial statements, effective July 1, 2007, the Authority adopted Governmental Accounting Standards Board (GASB) Statement No. 45, *Accounting and Financial Reporting by Employees for Post Employment Benefits Other Than Pensions*.

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 25, 2008, 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.


October 25, 2008

(This page is intentionally blank)

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, 2008. 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 approximately \$1.4 million 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 increased by approximately \$791 thousand during the year ended June 30, 2008 and operating revenues increased approximately \$344 thousand. This resulted in an operating loss increase of approximately \$447 thousand. Operating expenses were higher due to an increase in fuel prices and rail car hire expenses. Salaries and benefits, car hire, diesel fuel, and liability and property insurance rates are the largest operating expenses. Freight revenue increased because more revenue cars were handled during the fiscal year ended June 30, 2008. This increase was attributable to the addition of a new customer, Appalachian Railcar Services which received 67 cars for repair at their facility. In addition, Greer Limestone shipped 90 more cars in fiscal year ended June 30, 2008. This is the second year in a row that this company has increased the amount of railcars shipped.
- Non-operating revenues (expenses) were approximately \$392 thousand in the year ended June 30, 2008 compared to non-operating revenues (expenses) of approximately (\$22 thousand) in the year ended June 30, 2007. The decrease in total non-operating revenues (expenses) can be attributed to a decrease in interest expense and the revenue received from the federal government for flood mitigation.
- The Authority completed approximately \$2.2 million in capital improvements in the year ended June 30, 2008 including approximately \$783 thousand for SBVR, approximately \$1.2 million for the WVCR and approximately \$287 thousand for new equipment.

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.

**WEST VIRGINIA STATE RAIL AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

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, 2008 and 2007 are as follows:

Condensed Statement of Net Assets

	<u>2008</u>	<u>2007</u>
Current assets	\$ 3,529,251	\$ 3,275,052
Capital assets, net	<u>36,631,787</u>	<u>35,854,329</u>
Total assets	<u>40,161,038</u>	<u>39,129,381</u>
Current liabilities	942,640	1,295,357
Noncurrent liabilities	<u>29,474</u>	<u>132,913</u>
Total liabilities	<u>972,114</u>	<u>1,428,270</u>
Net assets		
Invested in capital assets net of related debt	36,631,787	35,429,329
Unrestricted	<u>2,557,137</u>	<u>2,271,782</u>
Total net assets	<u>\$ 39,188,924</u>	<u>\$ 37,701,111</u>

**WEST VIRGINIA STATE RAIL AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

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

	<u>2008</u>	<u>2007</u>
Operating revenues		
Freight	\$ 2,312,592	\$ 2,000,003
Miscellaneous	<u>152,707</u>	<u>121,051</u>
Total operating revenues	<u>2,465,299</u>	<u>2,121,054</u>
Depreciation expense	1,429,698	1,334,965
Other operating expenses	<u>2,889,372</u>	<u>2,192,917</u>
Total operating expenses	<u>4,319,070</u>	<u>3,527,882</u>
Operating loss	(1,853,771)	(1,406,828)
Non-operating revenues (expenses)	<u>391,696</u>	<u>(22,400)</u>
Income (loss) before transfers	(1,462,075)	(1,429,228)
Transfers in	<u>2,816,975</u>	<u>3,176,422</u>
Change in net assets before cumulate effect of adoption of Accounting principles	1,354,900	1,747,194
Cumulative effect of adoption of accounting principles	132,913	-
Total net assets - beginning	<u>37,701,111</u>	<u>35,953,917</u>
Total net assets - ending	<u>\$ 39,188,924</u>	<u>\$ 37,701,111</u>

FINANCIAL ANALYSIS

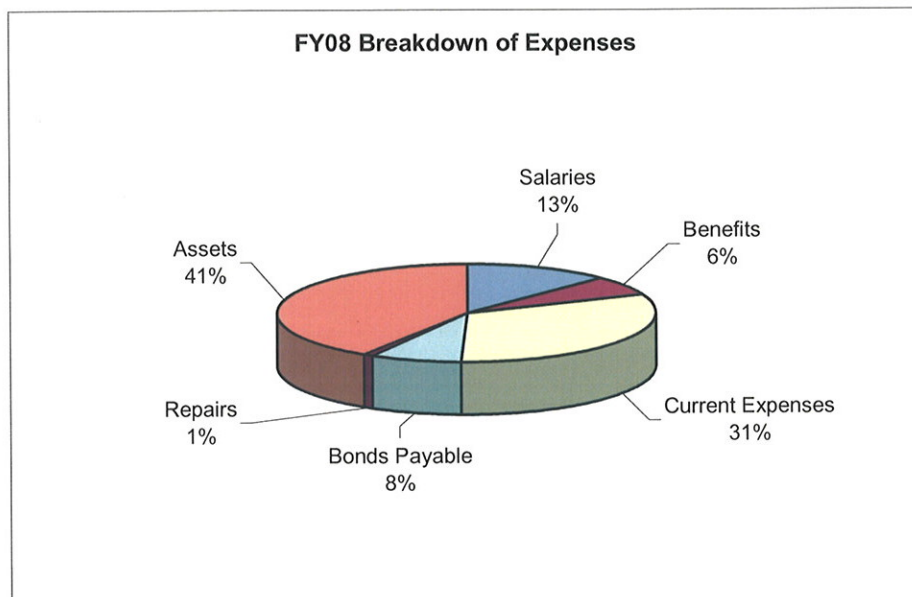
- The Authority's budget for the fiscal year ended June 30, 2008 consisted of funds received from the State of West Virginia General Fund, operating revenues from SBVR, revenues from the operator of the WVCR, and miscellaneous revenues received from the leases and licenses on railroad right-of-ways.
- The Authority received an approximate \$2.8 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 52% of the total funds received. The rehabilitation of the SBVR is planned to be completed in June 2009. 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.

**WEST VIRGINIA STATE RAIL AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

- Freight revenue of approximately \$2.3 million was earned from the operations of the SBVR which was in line with the year ended June 30, 2008 budgeted projections. Miscellaneous revenues of approximately \$153 thousand 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 16% in the fiscal year ended June 30, 2008.
- The last bond payment was made in July 2007, which will increase cash available to pay operating expenses on the SBVR.

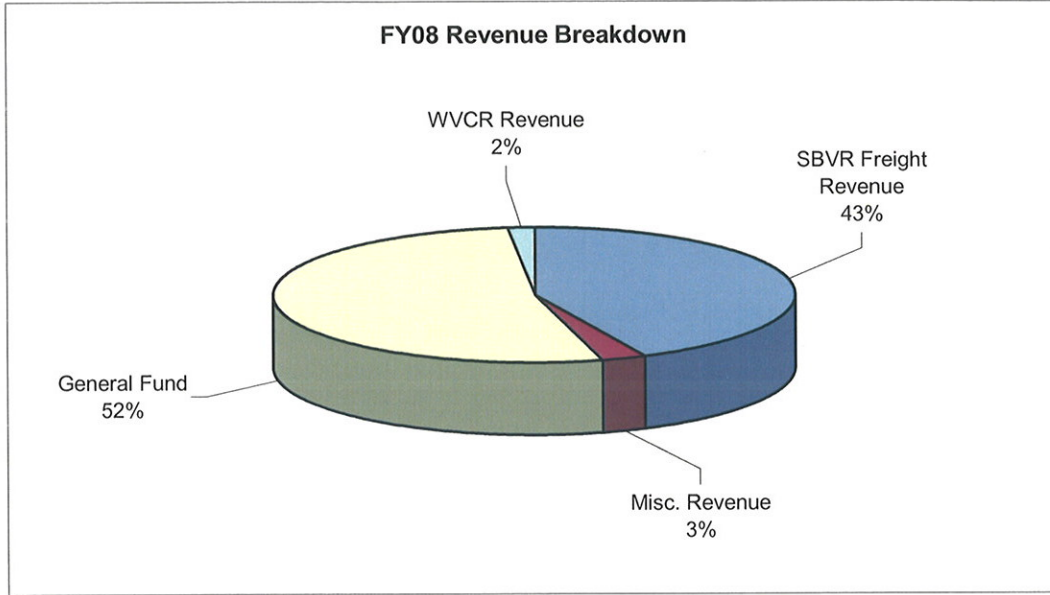
The following graphs provide a visual representation of the funding (revenue and other income sources) and expenditures (cash outlays) for the fiscal year ended June 30, 2008.

Chart 1 - Expenditures (cash outlays) Breakdown - Year ended June 30, 2008



**WEST VIRGINIA STATE RAIL AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Chart 2 - Funding Breakdown - Year ended June 30, 2008



CAPITAL ASSET AND DEBT ADMINISTRATION

CAPITAL ASSETS

The Authority's net capital assets as of June 30, 2008 and 2007 amounted to \$36.6 million and \$35.9 million, 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:

	<u>2008</u>	<u>2007</u>
Land	\$ -	\$ -
Rail properties	1,951,151	2,261,844
Transportation and other equipment	286,931	114,223
Office building and equipment	-	-
Total	<u>\$ 2,238,082</u>	<u>\$ 2,376,067</u>

WEST VIRGINIA STATE RAIL AUTHORITY MANAGEMENT'S DISCUSSION AND ANALYSIS

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 2008. In the year ended June 30, 2008, the final payment of \$455 thousand was paid toward this debt and related interest expense from operating (freight) revenue received by the SBVR.

The bond debt was paid off in July 2007 enhancing the Authority's cash flow by approximately \$450 thousand per year.

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

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The SBVR's track structure has improved significantly over the past eight 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, 2009 include continuing to upgrade and repair bridges, replace ties and adding ballast and surfacing.

The Authority's year ending June 30, 2009 budget includes approximately \$2.8 million from the State of West Virginia and approximately \$3.0 million 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, 2009 include tie replacement, ballast spreading, surfacing, adding a side track to assist in train operations and replacement of a bridge deck. This railroad has completed nine 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.

**WEST VIRGINIA STATE RAIL AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

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, 2008

ASSETS

Current assets	
Cash and cash equivalents	\$ 2,698,899
Restricted cash and cash equivalents	156
	<u>2,699,055</u>
Trade receivables	65,729
Inventories	47,320
Due from other governmental entities	711,673
Other current assets	5,474
	<u>3,529,251</u>
Total current assets	
Noncurrent assets	
Capital assets	51,714,621
Accumulated depreciation	(15,082,834)
	<u>36,631,787</u>
Total noncurrent assets	
	<u>\$ 40,161,038</u>

LIABILITIES

Current liabilities	
Accounts payable	\$ 417,789
Accrued expenses	46,975
Compensated absences	67,091
Due to other governmental entities	410,785
	<u>942,640</u>
Total current liabilities	
Noncurrent liabilities	
Other post employment benefit liability	29,474
	<u>29,474</u>
Total noncurrent liabilities	
	<u>972,114</u>

NET ASSETS

Invested in capital assets, net of related debt	36,631,787
Unrestricted	2,557,137
	<u>39,188,924</u>
Total net assets	
	<u>\$ 39,188,924</u>

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, 2008

Operating revenues	
Freight	\$ 2,312,592
Miscellaneous	<u>152,707</u>
Total operating revenues	<u>2,465,299</u>
Depreciation expense	1,429,698
Other operating expenses	<u>2,889,372</u>
Total operating expenses	<u>4,319,070</u>
Operating income (loss)	<u>(1,853,771)</u>
Nonoperating revenues (expenses)	
Interest income	99,800
Federal railroad rehabilitation assistance	298,222
Payment on behalf of WVSRA	24,600
Gain (loss) on disposition of assets	<u>(30,926)</u>
Total nonoperating revenues (expenses)	<u>391,696</u>
Income (loss) before transfers	(1,462,075)
Transfers in	<u>2,816,975</u>
Change in net assets before cumulative effect of adoption of accounting principles	1,354,900
Cumulative effect of adoption of accounting principle (Note 9)	132,913
Total net assets - beginning	<u>37,701,111</u>
Total net assets - ending	<u><u>\$ 39,188,924</u></u>

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, 2008

Cash flows from operating activities	
Cash received from customers and government	\$ 2,421,181
Cash paid to employees	(662,700)
Cash paid to suppliers and government	<u>(2,093,752)</u>
Net cash provided (used) by operating activities	<u>(335,271)</u>
Cash flows from noncapital financing activities	
Transfers in from State of West Virginia	<u>3,112,284</u>
Net cash provided (used) by noncapital financing activities	<u>3,112,284</u>
Cash flows from capital and related financing activities	
Purchase of capital assets	(2,238,082)
Principal paid	<u>(425,000)</u>
Net cash provided (used) by capital and related financing activities	<u>(2,663,082)</u>
Cash flows from investing activities	
Receipts of interest	<u>99,801</u>
Net cash provided (used) by investing activities	<u>99,801</u>
Increase (decrease) in cash and cash equivalents	213,732
Cash and cash equivalents, beginning of year including restricted cash	<u>2,485,323</u>
Cash and cash equivalents, end of year including restricted cash	<u>\$ 2,699,055</u>
Reconciliation of operating income to net cash provided (used) by operating activities	
Operating loss	\$ (1,853,771)
Adjustments to reconcile operating income to net cash provided by operating activities	
Depreciation	1,429,698
Amortization	
Expenses paid on behalf of entity	24,600
Changes in operating assets and liabilities	
(Increase) decrease in trade receivables	(44,118)
(Increase) decrease in inventories	3,720
(Increase) decrease in other current assets	2,844
Increase (decrease) in operating accounts payable	(296,577)
Increase (decrease) in accrued expenses	(11,939)
Increase (decrease) in compensated absences	37,383
Increase (decrease) in due to other governmental entities	<u>372,889</u>
Net cash provided (used) by operating activities	<u>\$ (335,271)</u>
Non cash transactions	
Cumulative effect of adoption of accounting principle	<u>\$ 132,913</u>

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

**WEST VIRGINIA STATE RAIL AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2008**

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).

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). The BTI was established by the West Virginia State Legislator and is subject to oversight by the West Virginia State Legislator. 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 in accordance with West Virginia Code, policies set by the BTI and by provisions of bond indentures and trust agreements, when applicable. 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.wvbt.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 \$156 at June 30, 2008 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.

ALLOWANCE FOR DOUBTFUL ACCOUNTS - It is the Authority's policy to provide for future losses on uncollectible accounts, contracts, grants, and loans receivable based on an evaluation of the underlying account, contract, grant and loan balances, the historical collectability experienced by the Authority on such balances and such other factors which, in the Authority's judgment, require consideration in estimating doubtful accounts.

INVENTORIES - Inventories are stated at the lower-of-cost or market, cost is 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. Capital assets are reviewed annually for impairment.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

COMPENSATED ABSENCES AND OTHER POST EMPLOYMENT 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. Effective July 1, 2007, the Authority adopted GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*. This statement provided standards for the measurement, recognition, and display of other postemployment benefit (“OPEB”) expenditures, assets, and liabilities, including applicable note disclosures and required supplementary information. 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 “State”). Effective July 1, 2007, The Authority was required to participate in this multiple employer cost-sharing plan, the West Virginia Retiree Health Benefit Trust Fund sponsored by the State of West Virginia. Details regarding this plan can be obtained by contacting Public Employees Insurance Agency (“PEIA”), State Capitol Complex, Building 5, Room 1001, 1900 Kanawha Boulevard, East, Charleston, WV 25305-0710 or <http://www.wvpeia.com>.

These statements require entities to accrue for employees’ rights to receive compensation for vacation leave or payments in lieu of accrued vacation or sick leave, as such benefits are earned and payment becomes probable.

The Authority’s full-time employees earn up to two vacation leave days for each month of service and are entitled to compensation for accumulated, unpaid vacation leave upon termination. Full-time employees also earn 1 ½ sick leave days for each month of service and are entitled to extend their health or life insurance coverage upon retirement in lieu of accumulated, unpaid sick leave. Generally, two days of accrued sick leave extend health insurance for one month of single coverage and three days extend health insurance for one month of family coverage. For employees hired after 1988, the employee shares in the cost of the extended benefit coverage to the extent of 50% of the premium required for the extended coverage. Employees hired July 1, 2001, or later are not eligible for these benefits. During 2008, the legislature passed a bill allowing regular full time employees hired before July 1, 2001, having accumulated at least 65 days of sick leave, to be paid, at their option, for a portion of their unused sick leave, not to exceed the number of sick leave days that would reduce the employee’s sick leave balance to less than fifty days. The employee shall be paid at a rate equal to one quarter of their usual rate of daily pay during that calendar year. The liability is now provided for under the multiple employer cost-sharing plan sponsored by the State of West Virginia.

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, 2008 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 – 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. 51, *Accounting and Financial Reporting for Intangible Assets*, effective for fiscal years beginning after June 15, 2009. This statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. Such guidance should be applied in addition to the existing authoritative guidance for capital assets. The Authority has not yet determined the effect that the adoption of GASB Statement No. 51 may have on the financial statements.

The GASB has issued Statement No. 53 *Accounting and Financial Reporting for Derivative Instruments*, effective for periods beginning after June 15, 2009. This statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. Derivative instruments are often complex financial arrangements used by governments to manage specific risks or to make investments. By entering into these arrangements, governments receive and make payments based on market prices without actually entering into the related financial or commodity transactions. Derivative instruments can be used as effective risk management or investment tools. Derivative instruments can also expose governments to significant risks and liabilities. The Authority has not yet determined the effect that the adoption of GASB Statement No. 53 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 <u>Cost</u>	Estimated Fair <u>Value</u>
Cash on deposit with State Treasurer	\$ 1,642	\$ 1,642
Cash on deposit with State Treasurer invested in BTI (WV Money Market Pool)	2,697,257	2,697,257
Cash in bank, restricted for debt repayment	<u>156</u>	<u>156</u>
	<u>\$ 2,699,055</u>	<u>\$ 2,699,055</u>

Amounts with the State Treasurer as of June 30, 2008 are comprised of the following investment pools, which are subject to the following BTI policies and limits.

West Virginia Board of Treasury Investments (BTI) WV Money Market 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)

WV Money Market Pool (Formerly Cash Liquidity Pool)

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. For the year ended June 30, 2008, the WV Money Market Pool has been rated AAAM by Standard & Poor's. A fund rated "AAAM" has extremely strong capacity to maintain principal stability and to limit exposure to principal losses due to credit, market, and/or liquidity risks. "AAAM" is the highest principal stability fund rating assigned by Standard & Poor's. As this pool has been rated in the current year, specific information on the credit ratings of the underlying investments of the pool have not been provided for the year ended June 30, 2008.

The BTI limits the exposure to credit risk in the WV Money Market 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.

NOTE 3 - CASH AND CASH EQUIVALENTS (Continued)

At June 30, 2008 the Authority's ownership represents .11% of these amounts held by the BTI (in thousands).

Security Type	Credit Rating *		2008	
	Moody's	S&P	Carrying Value	Percent of Pool Assets
Investments:				
Commercial paper	P1	A-1	\$ 658,879	27.94%
Corporate bonds and notes	Aaa	AAA	40,000	1.70
	Aa1	AA	71,000	3.01
	Aa2	A	27,000	1.14
	Aa3	AA	<u>20,000</u>	<u>0.85</u>
Total Corporate Bonds and Notes			158,000	6.70
U.S. agency bonds	Aaa	AAA	254,019	10.77
U.S. Treasury bills	Aaa	AAA	406,426	17.23
Negotiable certificates of deposit	P1	A-1	147,001	6.23
U.S. agency discount notes	P1	A-1	212,924	9.03
Money market funds	Aaa	AAA	150,058	6.36
Repurchase agreements (underlying securities):				
U.S. Treasury notes*	Aaa	AAA	62,265	2.64
U.S. agency notes	Aaa	AAA	<u>308,898</u>	<u>13.10</u>
Total Repurchase Agreements			<u>371,163</u>	<u>15.74</u>
			<u>\$ 2,358,470</u>	<u>100.00%</u>

*U.S. Treasury issues are explicitly guaranteed by the United States government and are not subject to credit risk.

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.

NOTE 3 - CASH AND CASH EQUIVALENTS (Continued)

The overall weighted average maturity of the investments of the WV Money Market 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 WV Money Market Pool:

Security Type	2008	
	Carrying Value (In Thousands)	WAM (Days)
Repurchase agreements	\$ 371,163	1
U.S. Treasury bills	406,426	31
Commercial paper	658,879	29
Certificates of deposit	147,001	95
U.S. agency discount notes	212,924	84
Corporate bonds and notes	158,000	21
U.S. agency bonds/notes	254,019	111
Money market funds	<u>150,058</u>	1
	<u>\$ 2,358,470</u>	40

Other Investment Risks

Other risks of investing can 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.

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.

NOTE 3 - CASH AND CASH EQUIVALENTS (Continued)

Other Investment Risks (Continued)

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. None of the above pools contain non-negotiable certificates of deposit. The BTI does not have a deposit policy for custodial credit risk.

NOTE 4 - CAPITAL ASSETS

Capital assets balances and the activity for the year ended June 30, 2008 is summarized below:

	June 30,2007			June 30,2008
	<u>Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u>
Capital assets				
Land	\$ 4,835,588	\$ -	\$ -	\$ 4,835,588
Rail properties	43,022,507	1,951,151	44,651	44,929,007
Transportation and other equipment	1,217,225	286,931	5,500	1,498,656
Office building and equipment	451,370	-	-	451,370
Total capital assets	<u>\$ 49,526,690</u>	<u>\$ 2,238,082</u>	<u>\$ 50,151</u>	<u>\$ 51,714,621</u>
Accumulated depreciation				
Rail properties	\$ 12,605,973	\$ 1,307,105	\$ 13,725	\$ 13,899,353
Transportation and other equipment	753,031	111,442	5,500	858,973
Office building and equipment	313,357	11,151	-	324,508
Total accumulated depreciation	<u>\$ 13,672,361</u>	<u>\$ 1,429,698</u>	<u>\$ 19,225</u>	<u>\$ 15,082,834</u>

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%. The final payment was made in July of 2007.

Total notes payable at June 30, 2007	\$425,000
Less principle retirement	<u>425,000</u>
Total notes payable at June 30, 2008	<u>\$ -</u>

NOTE 6 - DUE TO/FROM OTHER GOVERNMENTAL ENTITIES AND TRANSFERS

At June 30, 2008, the Authority had amounts due from the State of West Virginia of \$413,451 and amount due from the federal government of \$298,222. The Office of the Secretary General of Administration Finance Division transferred from FIMS fund 0506-099 \$2,611,016 and FIMS fund 0506-913 \$205,959 to the Authority for the year ended June 30, 2008.

NOTE 7 - SIGNIFICANT CUSTOMERS AND FUNDING SOURCES

During the year ended June 30, 2008, approximately 89.9% of the Authority's freight traffic was attributable to a single customer. In addition, during the year ended June 30, 2008 the Authority received transfers of \$2,816,975 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.

Subsequent to year-end, the credit and liquidity crisis in the United States and throughout the global financial system triggered significant events and substantial volatility in world financial markets and the banking system that have had a significant negative impact on foreign and domestic financial markets. If the aforementioned single customer is affected it could have a significant impact on the future operations of the Authority.

NOTE 8 - 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) public entity risk pools 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. Such coverage may be provided to the Authority by BRIM through self-insurance programs maintained by BRIM or policies underwritten by BRIM that may involve experience – related premiums or adjustments to BRIM. BRIM engages an independent actuary to assist in the determination of its premiums so as to minimize the likelihood of premium adjustments to the Authority or other participants in BRIM'S insurance program. As a result, management does not expect significant differences between the premiums the Authority is currently charged by BRIM and the ultimate cost of that insurance based on the Authority's actual loss experience. Furthermore, there have been no settlements that have exceeded this coverage in the last three years.

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 the third-party insurer, the Authority has transferred its risks related to health, life, prescription drug coverage, and job related injuries. . PEIA issues publicly available financial reports that include financial statements and required supplementary information, these reports may be obtained by writing to West Virginia Public Employees Insurance Agency, 601 57th Street, Charleston, WV 25304 or by calling 1-888-680-7342.

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 began to offer coverage to private-sector employers beginning July 1, 2008 and to government employers beginning July 1, 2012. Nearly every employer in the State, who has 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 9 - POST EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

The OPEB Plan costs are accrued based upon invoices received from PEIA based upon actuarial determined amounts. At June 30, 2008, the noncurrent liability related to OPEB cost was \$29,474. For the year ended June 30, 2008, the Authority recorded a cumulative effect of the adoption of this accounting principle of \$132,913, an amount equal to the June 30, 2007 liability previously recorded in accordance with GASB Statement No. 16. The total OPEB expense incurred and the amount of OPEB expense that relates to retirees was \$94,056 and \$0 respectively during 2008. As of the year ended June 30, 2008, there were no retiree's receiving their benefits.

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, 4101 MacCorkle Avenue, SE Charleston, West Virginia 25304 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, 2008, 2007, and 2006 were \$66,589, \$66,393 and \$66,924.

NOTE 11 - COMMITMENTS/CONTINGENCIES

Periodic Audits – Under the terms of federal grants, periodic audits are required and certain costs may be questioned as not being appropriate expenditures under the terms of the grants. Such audits could lead to reimbursement to the grantor agencies. The Authority management believes disallowances, if any, will not have a significant financial impact on the Authority’s financial position.

Litigation – Periodically, there are various claims and legal proceedings against the Authority arising from the normal course of business. Although counsel is unable to predict with certainty the ultimate outcome, in the opinion of management these claims are matters incidental to the normal business conducted by the Authority. In the opinion of management, based upon consultation with the Authority’s outside legal counsel, such proceedings are substantially covered by insurance, and the ultimate disposition of such proceedings are not expected to have a material adverse effect on the Authority’s financial statements.

Environmental Liabilities – Some of the Authority’s past and present operations involve activities that are subject to extensive and changing federal and state environmental regulations that can give rise to environmental issues. The Authority manages these risks on an active and timely basis and provides for accrual of any such liabilities when they are identified. As of June 30, 2008, management is not aware of any such liabilities.

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, 2008, and have issued our report thereon dated October 25, 2008 which contained a matter of emphasis paragraph regarding an accounting change for the implementation of Governmental Accounting Standards Board (GASB) Statement No. 45, *Accounting and Financial Reporting by Employees for Post Employment Benefits Other Than Pensions*. 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.


October 25, 2008

