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, 2005

AND

INDEPENDENT AUDITORS' REPORT

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Suttle & Stalnaker
CERTIFIED PUBLIC ACCOUNTANTS

Business Advisors and Consultants

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, 2005, 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 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 financial position of the Authority as of June 30, 2005, 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.

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CPA

In accordance with *Government Auditing Standards*, we have also issued a report dated August 26, 2005, 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.

The management's discussion and analysis on pages 5 through 10 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.

Suttle & Stalnaker, PLLC

August 26, 2005

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, 2005. 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 $1,781,317 as a result of this year's operations. This was due to the approximately $3.4 million appropriation from the general fund of the State of West Virginia for capital improvements and operation costs and an increase in freight revenue.

- Operating expenses increased by approximately $165,000 during the year ended June 30, 2005 and operating revenues increased approximately $359,000. This resulted in an operating loss decrease of approximately $193,000. Operating expenses were higher due to an increase in rail car hire rates, diesel fuel costs, and liability and property insurance rates. Freight revenue increased because more revenue cars were handled during the fiscal year ended June 30, 2005.

- Non-operating revenues (expenses) were ($184,711) in the year ended June 30, 2005 compared to non-operating revenues (expenses) of ($358,820) in the year ended June 30, 2004. The decrease in total non-operating revenues (expenses) can be attributed to decreases in both interest expense and losses on disposition of assets.

- The Authority completed approximately $2.3 million in capital improvements in the year ended June 30, 2005 including approximately $1.25 million for South Branch Valley Railroad, approximately $585,000 for the West Virginia Central Railroad, approximately $130,000 for restoration of rail cars, and approximately $300,000 for new or upgraded equipment.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report includes this 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 operations, 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, 2005 and 2004 are as follows:

Condensed Statement of Net Assets

	2005	2004
Current assets	$ 2,362,484	$ 1,772,980
Capital assets, net	34,376,506	33,492,963
Total assets	36,738,990	35,265,943
Current liabilities	1,123,322	1,038,562
Noncurrent liabilities	956,009	1,349,039
Total liabilities	2,079,331	2,387,601
Net assets		
Invested in capital assets net of related debt	33,153,168	31,907,959
Unrestricted	1,506,491	970,383
Total net assets	$ 34,659,659	$ 32,878,342

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

	2005	2004
Operating revenues		
Freight	$ 2,158,928	$ 1,772,761
Miscellaneous	122,743	150,322
Total operating revenues	2,281,671	1,923,083
Depreciation expense	1,169,543	1,137,009
Other operating expenses	2,503,757	2,371,167
Total operating expenses	3,673,300	3,508,176
Operating loss	(1,391,629)	(1,585,093)
Non-operating revenues (expenses)	(184,711)	(358,820)
Income (loss) before other revenues, expenses, gains or losses	(1,576,340)	(1,943,913)
Forgiveness of Debt	-	259,570
Income (loss) before transfers	(1,576,340)	(1,684,343)
Transfers in	3,357,657	3,385,450
Change in net assets	1,781,317	1,701,107
Total net assets - beginning	32,878,342	31,177,235
Total net assets - ending	$ 34,659,659	$ 32,878,342

FINANCIAL ANALYSIS

- The Authority's budget for the fiscal year ended June 30, 2005 consisted of funds received from the State of West Virginia General Fund, operating revenues from South Branch Valley Railroad (SBVR), revenues form the operator of the West Virginia Central Railroad (WVCR), and miscellaneous revenues received from the leases and licenses on railroad right-of -ways.

- The Authority received an approximate $3.4 million appropriation from the general fund of the State of West Virginia for capital improvement projects and maintenance projects on the South Branch Valley Railroad and West Virginia Central Railroad, upkeep of the Maryland Rail Commuter (MARC) train stations in the eastern panhandle, and the general operation of the Authority. As in previous years, this appropriation is about 60% of the total funds received. The rehabilitation of the SBVR is planned to be completed in June 2007. 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 $2.2 million was earned from the operations of the SBVR which was higher than the amount projected in the budget. Miscellaneous revenues of approximately $123,000 were earned in addition to the freight revenue. The miscellaneous revenue is made up of Right of Way leases on the SBVR, sale of old rails and equipment, 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 18.6% in the fiscal year ended June 30, 2005.

- The bond payment of $456,000 is about 9% of total cash expenditures for the year ended June 30, 2005. The last bond payment is scheduled for repayment in July 2007, which will increase cash available to pay operating expenses on the South Branch Valley Railroad.

The following graphs provide a visual representation of the revenues and expenditures (cash outlays) for the fiscal year ended June 30, 2005.

Chart 1 - Expenditures (cash outlays) Breakdown - Year ended June 30, 2005

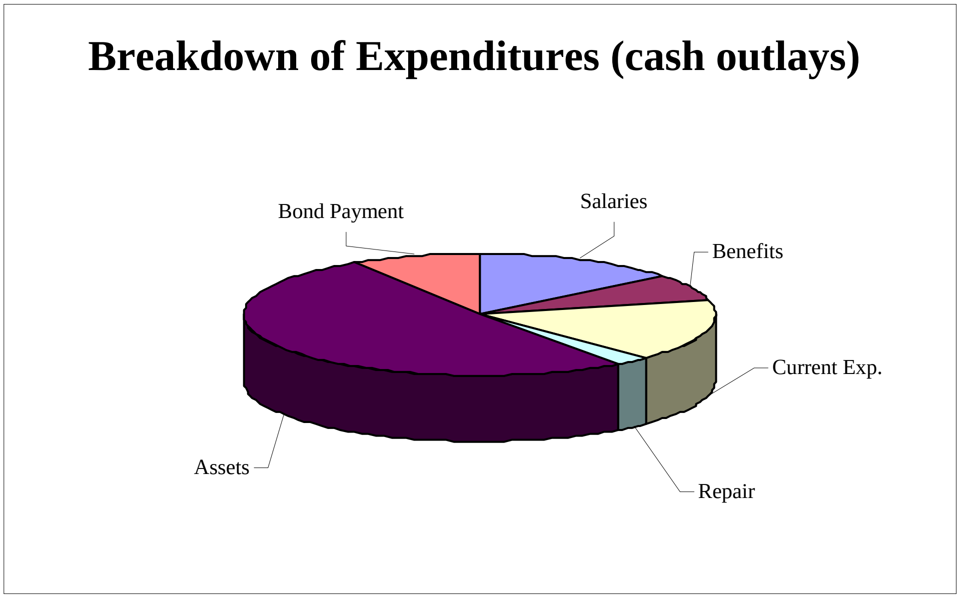
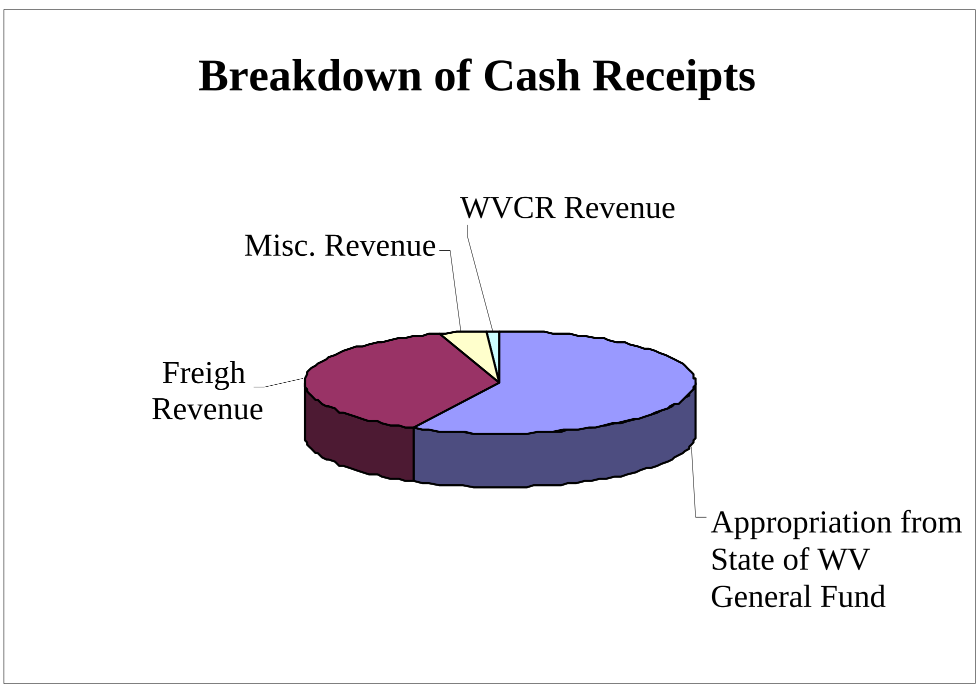


Chart 2 - Funding Breakdown - Year ended June 30, 2005



CAPITAL ASSET AND DEBT ADMINISTRATION

CAPITAL ASSETS

The Authority's net capital assets as of June 30, 2005 and 2004 amounted to $34,376,506 and $33,492,963, 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 South Branch Valley Railroad and West Virginia Central Railroad are part of the Authority's capital investment program.

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

	2005	2004
Land	$ -	$ 45,000
Rail properties	2,038,577	2,294,288
Transportation and other equipment	225,343	52,002
Office building and equipment	8,686	-
Total	$ 2,272,606	$ 2,391,290

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, 2005, $456,788 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	2006	2007	2008
	$456,925	$455,285	$456,450

The bond debt will be paid off in July of 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 5 and 6 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The South Branch Valley Railroad's (SBVR) track structure has improved significantly over the past six 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 turn around time for rail cars supplying the Pilgrims 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, 2006 include continuing to upgrade and repair bridges, realign track at Sycamore and add ballast and surface.

The Authority's year ended June 30, 2006 budget includes $3,172,814 from the State of West Virginia and $2,129,468 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, 2006 include tie replacement, ballast spreading and surfacing. This railroad has completed six 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 Maryland Rail Commuter (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, 2005

	2005
ASSETS	
Current assets	
Cash and cash equivalents	$ 1,281,257
Restricted cash and cash equivalents	549,737
	1,830,994
Trade receivables	39,282
Inventories	71,465
Due from other governmental entities	407,018
Other current assets	13,725
Total current assets	2,362,484
Noncurrent assets	
Capital assets	45,624,539
Accumulated depreciation	(11,248,033)
Total noncurrent assets	34,376,506
Total assets	36,738,990
LIABILITIES	
Current liabilities	
Accounts payable	581,270
Accrued expenses	98,313
Compensted absences	57,073
Current maturities of long-term debt	386,666
Total current liabilities	1,123,322
Noncurrent liabilities	
Long-term debt	836,672
Compensated absences	119,337
Total noncurrent liabilities	956,009
Total liabilities	2,079,331
NET ASSETS	
Invested in capital assets, net of related debt	33,153,168
Unrestricted	1,506,491
Total net assets	$ 34,659,659

The Accompanying Notes Are An Integral
Part Of These Financial Statements

WEST VIRGINIA STATE RAIL AUTHORITY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
YEAR ENDED JUNE 30, 2005

	2005
Operating revenues	
Freight	$ 2,158,928
Miscellaneous	122,743
Total operating revenues	2,281,671
Depreciation expense	1,169,543
Other operating expenses	2,503,757
Total operating expenses	3,673,300
Operating income (loss)	(1,391,629)
Nonoperating revenues (expenses)	
Interest income	25,659
Interest expense	(86,925)
Gain (loss) on disposition of assets	(123,445)
Total nonoperating revenues (expenses)	(184,711)
Income (loss) before transfers	(1,576,340)
Transfers in	3,357,657
Change in net assets	1,781,317
Total net assets - beginning	32,878,342
Total net assets - ending	$ 34,659,659

WEST VIRGINIA STATE RAIL AUTHORITY
STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2005

	2005
Cash flows from operating activities	
Cash received from customers and government	$ 2,337,821
Cash paid to employees	(697,565)
Cash paid to suppliers and government	(1,776,530)
Net cash provided (used) by operating activities	(136,274)
Cash flows from noncapital financing activities	
Transfers in from State of West Virginia	3,365,328
Net cash provided (used) by noncapital financing activities	3,365,328
Cash flows from capital and related financing activities	
Purchase of capital assets	(2,272,606)
Proceeds from sale of capital assets	175,651
Interest paid	(86,925)
Principal paid	(345,000)
Net cash provided (used) by capital and related financing activities	(2,528,880)
Cash flows from investing activities	
Receipts of interest	25,659
Net cash provided (used) by investing activities	25,659
Increase (decrease) in cash and cash equivalents	725,833
Cash and cash equivalents, beginning of year including restricted cash	1,105,161
Cash and cash equivalents, end of year including restricted cash	$ 1,830,994
Reconciliation of operating income to net cash provided (used) by operating activities	
Operating loss	$ (1,391,629)
Adjustments to reconcile operating income to net cash provided by operating activities	
Depreciation	1,169,543
Amortization	(16,666)
Changes in operating assets and liabilities	
(Increase) decrease in trade receivables	56,150
(Increase) decrease in inventories	(6,797)
(Increase) decrease in other current assets	(271)
Increase (decrease) in operating accounts payable	217,297
Increase (decrease) in accrued expenses	(18,820)
Increase (decrease) in compensated absences	(6,168)
Increase (decrease) in due to other governmental entities	(138,913)
Net cash provided (used) by operating activities	$ (136,274)

The Accompanying Notes Are An Integral
Part Of These 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 - During 2005, the Authority adopted GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, an amendment of GASB Statement No. 3. This statement changes the required financial statement disclosures for deposits and investments.

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 Investment Management Board (IMB). These funds are transferred to the IMB and the IMB is directed by the State Treasurer to invest the funds in specific external investment pools. In addition, the Authority makes interest-earning deposits in certain investment pools maintained by IMB that are available to the Authority with overnight notice. Interest income from these investments is prorated to the Authority at rates specified by IMB based on the balance of the Authority's deposits maintained in relation to the total deposits of all state agencies participating in the pool. Deposits in the IMB pools are reported at amortized costs, which approximates the fair value of underlying securities. Furthermore, then fair value of these investments approximates the value of the shares in the external investment pool.

The STO has statutory responsibility for the daily cash management activities of the State's agencies, departments, boards, and commissions. The STO determines which funds to transfer to the IMB for investment in accordance with the West Virginia Code, policies set by the IMB, and provisions of bond indentures and trust agreements when applicable. The IMB is governed by a thirteen-member Board of Trustees. The Governor, the State Auditor and the State Treasurer are members of the Board, and the other members are appointed by the Governor. The Board was formed in 1997 to serve as the Trustee to hold certain public pension funds and insurance funds, as well as to provide prudent fiscal administration, investment, and management of the Consolidated Pension Fund and the State's operating funds.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

RESTRICTED CASH AND CASH EQUIVALENTS - Restricted cash and cash equivalents of $549,737 at June 30, 2005 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.

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.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, 2005 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.

RECENT STATEMENTS ISSUED BY GASB - The GASB issued Statement No. 40, *Deposits and Investment Risk Disclosures.* This statement was adopted by the Authority during the fiscal year ended June 30, 2005; however, the statement did not have a significant effect on the operations of the Authority. The statement resulted in additional disclosure in the Authority's financial statements regarding custodial credit risk, concentration of credit risk, and interest rate risk related to deposits and investments.

The GASB issued Statement No. 42, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries effective for fiscal year beginning after December 15, 2004. This statement requires the Authority to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred and record impaired assets and impairment losses accordingly. This statement also addresses the appropriate recording of an insurance recovery associated with events or changes in circumstances resulting in impairment of capital asset. The Authority has not yet determined the effect that the adoption of GASB Statement No. 42 may have on the financial statements.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The GASB has also 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. The Authority has not yet determined the effect that the adoption of GASB Statement No. 45 may have on the financial statements.

The GASB has also issued Statement No. 46, *Net Assets Restricted by Enabling Legislation* (an amendment of GASB Statement No. 34), effective for fiscal years beginning after June 15, 2005. This statement provides guidance clarifying the meaning of the phrase "legally enforceable" as it applies restrictions imposed on net asset use by enabling legislation. The Authority has not yet determined the effect, if any, that the adoption of GASB Statement No. 46 may have on its financial statements.

The GASB has also issued Statement No. 47, *Accounting for Termination Benefits*, effective for fiscal years beginning after June 15, 2005. This statement provides standards for the measurement, recognition and display of voluntary termination benefit expenditures, assets, and liabilities, including applicable note disclosures. The Authority has not yet determined the effect that the adoption of GASB Statement No. 47 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	$ 36,273	$ 36,273
Cash on deposit with State Treasurer invested in IMB cash liquidity pool	1,244,984	1,244,984
Cash in bank, restricted for debt repayment	549,737	549,737
	$ 1,830,994	$ 1,830,994

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 IMB policies and procedures.

NOTE 3 - CASH AND CASH EQUIVALENTS (Continued)

West Virginia Investment Management Board (IMB) Cash Liquidity Pool

Credit risk

The IMB limits the exposure to credit risk in the Cash Liquidity pool by requiring all corporate bonds to be rated AA or higher. Commercial paper must be rated A1 by Standard & Poor's and P1 by Moody's. Additionally, the pool must have at least 15% of its assets in United States Treasury issues.

The following table provides information on the weighted average credit ratings of the Authority's investment in the IMB's Cash Liquidity pool.

Security Type	Moody's	S&P	Carrying Value	Percentage of Assets
Commercial paper	P1	A-1	$ 598,241,394	37.9%
U.S. Treasury bills	Aaa	AAA	259,397,648	16.4%
Corporate notes	Aaa	AAA	155,559,323	9.9%
Certificates of deposit	P1	A-1	152,998,937	9.7%
Agency bonds	Aaa	AAA	147,955,465	9.4%
Agency discount notes	P1	A-1	119,564,248	7.6%
Money market funds	Aaa	AAA	4,241,278	0.3%
Total rated investments			$ 1,437,958,293	91.2%

The entity's ownership represents .089% of these amounts held by the IMB. Unrated securities include repurchase agreements of $141,050,000. Acceptable collateral for the repurchase agreements include U.S. Treasury and government agency securities, all of which carry the highest credit rating.

Concentration of credit risk

West Virginia statutes prohibit the IMB's Cash Liquidity pool from investing more than 5% of its assets in securities issued by a single private corporation or association. At June 30, 2005, the pool did not have investments in any one private corporation or association that represented more than 5% of assets.

Custodial credit risk

At June 30, 2005, the IMB's Cash Liquidity pool held no securities that were subject to custodial credit risk. Repurchase agreements are collateralized at 102% and the collateral is held in the name of the IMB. Securities lending collateral that is reported in the Statement of Assets and Liabilities of the IMB are invested in the lending agent's money market fund.

NOTE 3 - CASH AND CASH EQUIVALENTS (Continued)

Interest rate risk

The weighted average maturity of the investments of the IMB's Cash Liquidity pool cannot exceed 60 days. The maturity of floating rate notes is assumed to be the next interest rate reset date. The following table provides the weighted average maturities (WAM) for the various asset types in the IMB's Cash Liquidity pool.

Security Type	Carrying Value	WAM
Commercial paper	$ 598,241,394	49
U.S. Treasury bills	259,397,648	30
Corporate notes	155,559,323	53
Certificates of deposit	152,998,937	42
Agency bonds	147,955,465	88
Repurchase agreements	141,050,000	1
Agency discount notes	119,564,248	52
Money market funds	4,241,278	1
Total assets	$ 1,579,008,293	45

Foreign currency risk

The IMB's Cash Liquidity pool has no securities that are subject to foreign currency risk.

<u>Restricted Cash and Cash Equivalents for Debt Service Repayment</u>

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, 2005 these funds were invested with J.P. Morgan Investment Management Inc. 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.

Security Type	Moody's	S&P	Carrying Value	Percentage of Assets
U.S. Government securities money market mutual fund	Aaa	AAAm-G	$ 549,737	100%

NOTE 3 - CASH AND CASH EQUIVALENTS (Continued)

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, 2005, $549,737 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	$ 549,737	$ 549,737	-	-	-

Foreign Currency Risk

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

NOTE 4 - CAPITAL ASSETS

Capital assets balances and the activity for the year ended June 30, 2005 is summarized below:

	June 30,2004 Balance	Additions	Deletions	June 30,2005 Balance
Capital assets				
Land	$ 4,835,588	$ -	$ -	$ 4,835,588
Rail properties	37,625,604	2,038,577	335,710	39,328,471
Transportation and other equipment	783,767	225,343	-	1,009,110
Office building and equipment	456,462	8,686	13,778	451,370
Total capital assets	$ 43,701,421	$ 2,272,606	$ 349,488	$ 45,624,539
Accumulated depreciation				
Rail properties	$ 9,402,906	$ 1,095,874	$ 116,466	$ 10,382,314
Transportation and other equipment	513,927	61,622	-	575,549
Office building and equipment	291,625	12,047	13,502	290,170
Total accumulated depreciation	$ 10,208,458	$ 1,169,543	$ 129,968	$ 11,248,033

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, 2005, the Authority’s premium on notes payable was $33,338 and amortization expense related to the premium was $16,666 per year. The notes are secured by gross operating receipts of the Authority, excluding any transfers from the State of West Virginia.

Total notes payable at June 30, 2004	$ 1,585,004
Less principle retirement	(345,000)
Less amortization of premium	(16,666)
Total notes payable at June 30, 2005	1,223,338
Less current portion	(386,666)
Long-term notes payable	$ 836,672

NOTE 5 - LONG-TERM DEBT (Continued)

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
2006	$ 370,000	$ 86,925	$ 456,925
2007	395,000	60,285	455,285
2008	425,000	31,450	456,450
	1,190,000	178,660	1,368,660
Premium	33,338	-	33,338
Amortization of premium	-	(33,338)	(33,338)
	$ 1,223,338	$ 145,322	$ 1,368,660

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

At June 30, 2005, the Authority had amounts due from the State of West Virginia of $407,018. The Office of the Secretary General of Administration Finance Division transferred from FIMS fund 0506-099 $3,086,783 and FIMS fund 0506-913 $270,874 to the Authority for the year ended June 30, 2005.

NOTE 7 - SIGNIFICANT CUSTOMERS AND FUNDING SOURCES

During the years ended June 30, 2005, approximately 94% of the Authority’s freight traffic was attributable to a single customer. In addition, during the year ended June 30, 2005 the Authority received a transfer of $3,357,657 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 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), the Public Employees Insurance Agency (PEIA), and the Workers’ Compensation Fund (WCC) to account for and finance uninsured risks of losses for state agencies, institutions of higher education, and component units.

NOTE 8 - RISK MANAGEMENT (Continued)

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. The WCC provides coverage for work related accidents and is considered an insurance enterprise fund.

Through its participation in the PEIA and WCC, the Authority has obtained health, life and prescription drug coverage, and coverage for job related injuries for its employees. In exchange for payment of premiums to PEIA and WCC, the Authority has transferred its risks related to health, life and prescription drug coverage, and job related injuries of employees.

NOTE 9 - 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, 2005, 2004 and 2003 were $65,164, $79,495, and $69,627, respectively.

NOTE 10 - 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.

The estimated liability for sick leave postretirement benefits for the years ended June 30, 2005, 2004 and 2003 were $119,337, $125,701, and $129,381, respectively, and is included in noncurrent liabilities in the statement of net assets.

ADDITIONAL INFORMATION

Suttle & Stalnaker
CERTIFIED PUBLIC ACCOUNTANTS

Business Advisors and Consultants

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, 2005, and have issued our report thereon dated August 26, 2005. 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 in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over financial reporting and its operation that we consider to be material weaknesses.

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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 then these specified parties.

Suttle & Stalnaker, PLLC

August 26, 2005