WEST VIRGINIA DEPARTMENT OF TRANSPORTATION, DIVISION OF HIGHWAYS

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

AUDITED FINANCIAL STATEMENTS
WITH ADDITIONAL INFORMATION

YEAR ENDED JUNE 30, 2006
AND
INDEPENDENT AUDITORS' REPORTS

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Suttle & Stalnaker
CERTIFIED PUBLIC ACCOUNTANTS

Business Advisors and Consultants

INDEPENDENT AUDITORS' REPORT

Joint Committee on Government and Finance
West Virginia Legislature

We have audited the accompanying financial statements of the governmental activities and each major fund, of the West Virginia Department of Transportation, Division of Highways, as of and for the year ended June 30, 2006, which collectively comprise the West Virginia Department of Transportation, Division of Highway's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the West Virginia Department of Transportation, Division of Highways' management. Our responsibility is to express opinions 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, but not for the purpose of expressing an opinion on the effectiveness of the West Virginia Department of Transportation, Division of Highway's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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 opinions.

As discussed in Note 1, the financial statements of the West Virginia Department of Transportation, Division of Highways are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and each major fund of the West Virginia Department of Transportation and of the State of West Virginia, that is attributable to the transactions of the Division of Highways. They do not purport to, and do not, present fairly, the financial position of the West Virginia Department of Transportation or the State of West Virginia as of June 30, 2006 and the changes in their financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the West Virginia Department of Transportation, Division of Highways, as of June 30, 2006, and the respective changes in financial position thereof and the respective budgetary comparison for the State Road (General) Fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 13, 2006 on our consideration of the West Virginia Department of Transportation, Division of Highways' internal control over financial reporting and on 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.

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The management's discussion and analysis on pages 5 through 13 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

October 13, 2006

MANAGEMENT’S DISCUSSION AND ANALYSIS

This section of the West Virginia Department of Transportation, Division of Highways (Division) annual financial report presents our discussion and analysis of the Division's financial performance during the fiscal year that ended June 30, 2006. This section introduces the basic financial statements and provides an analytical overview of the Division's financial activities. Please read it in conjunction with the Division's financial statements, which immediately follow this section.

FINANCIAL HIGHLIGHTS - PRIMARY GOVERNMENT

Net Assets - The Division's total combined net assets are $6.6 billion as of the close of fiscal year 2006.

Changes in Net Assets - During the year the Divisions' Net Assets increased $294 million or 4.65%. This percentage of increase is a slight improvement over the prior year, when Net Assets increased $236 or 3.88%.

Revenues and Expenses **-** Total revenues increased by $22.3 million or 2.10%. Total expenses decreased $36 million or 4.37%. There were no significant changes in the programs carried out by the Division during the year.

Governmental Funds - Fund Balances - As of the close of fiscal year 2006, the Division's governmental funds reported combined total fund equity of $232 million, an increase of $14 million in comparison with the prior year. Of this total amount, $197 million represents the "unreserved fund balances" with substantially all of that in the general fund. This is approximately 18.44% of the total governmental fund expenditures for the year.

Long-term Debt - The Division's total outstanding general obligation bonds, net of bond premiums, decreased by $22 million 4.40% during the current fiscal year.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The discussion and analysis serves as an introduction to the Division's basic financial statements. The Division's basic financial statements are comprised of three components, government-wide financial statements, fund financial statements, and notes to the financial statements.

Government-wide Statements

Government-wide financial statements provide both long-term and short-term information about the Division's financial condition. Changes in the Division's financial position may be measured over time by increases and decreases in the Statement of Net Assets. Information on how the Division's net assets changed during the fiscal year is presented in the Statement of Activities.

Fund Financial Statements

The fund financial statements focus on the individual parts of the Division, reporting the Division's operations in more detail than the government-wide financial statements. Fund financial statements can include the statements for governmental, proprietary, and fiduciary funds. The Division has only governmental funds.

Notes to the Financial Statements

Notes to the financial statements provide additional information that is essential to the full understanding of the data provided in the government-wide and fund financial statements.

CONDENSED FINANCIAL INFORMATION

Condensed Statement of Net Assets

The following condensed financial information was derived from the government-wide statement of net assets and summarizes the Division's net assets as of June 30, 2006 and 2005 (amounts in thousands).

Net Assets as of June 30

	2006	2005	% Change
Total current assets	$ 306,036	$ 310,074	(1.30%)
Capital assets, net of accumulated depreciation	6,953,347	6,693,030	3.89%
Other non-current assets	2,435	2,766	(11.97%)
Total assets	7,261,818	7,005,870	3.65%
Total current liabilities	115,336	135,160	(14.67%)
Long term liabilities	524,536	543,154	(3.43%)
Total liabilities	639,872	678,314	(5.67%)
Invested in capital assets, net of related debt	6,475,338	6,193,029	4.56%
Restricted	8,512	10,843	(21.50%)
Unrestricted	138,096	123,684	11.65%
Total net assets	$ 6,621,946	$ 6,327,556	4.65%

The largest component (97.79%) of the Division's net assets reflects its investment in capital assets (e.g. land, buildings, equipment, infrastructure and others) less any related debt outstanding (excluding debt proceeds that have yet to be expended for infrastructure construction) that was needed to acquire or construct the assets. The Division uses these capital assets to provide services to the citizens and businesses in the State; consequently, these net assets are not available for future spending. The remaining portion is classified as either restricted or unrestricted net assets the unrestricted net assets, may be used at the Division's discretion. The restricted net assets has constraints as to how these funds may be used, this enabling legislation directs the use of these funds.

Condensed Statement of Activities

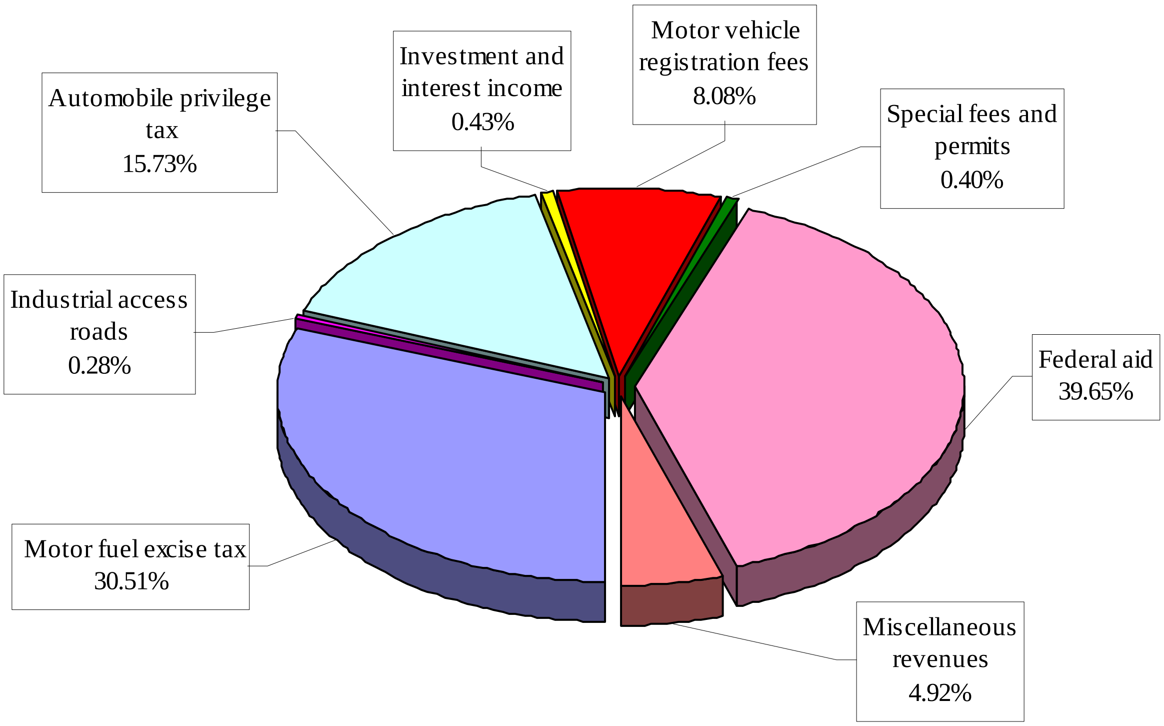
The following condensed financial information was derived from the government-wide statement of activities and reflects how the Division's net assets changed during the fiscal year (amounts in thousands):

	2006	2005	% Change
Revenues			
Taxes	$ 501,022	$ 499,654	0.27%
Investment and interest income	4,701	1,906	146.64%
Miscellaneous revenues	53,255	25,589	108.12%
Total general revenues	558,978	527,149	6.04%
Federal aid	429,583	440,579	(2.50%)
Industrial access roads	3,016	2,351	28.29%
Charges for service	91,824	91,020	0.88%
Total program revenues	524,423	533,950	(1.78%)
Total revenues	1,083,401	1,061,099	2.10%
Expenses			
Road maintenance	316,475	322,399	(1.84%)
Other road operations	366,874	382,831	(4.17%)
General and administration	81,349	99,006	(17.83%)
Interest on long-term debt	21,283	18,112	17.51%
Unallocated depreciation	3,030	2,690	12.64%
Total expenses	789,011	825,038	(4.37%)
Change in net assets	294,390	236,061	24.71%
Net assets, beginning	6,327,556	6,091,495	3.88%
Net assets, ending	$ 6,621,946	$ 6,327,556	4.65%

Over time, increases and decreases in net assets measure whether the Division's financial position is improving or deteriorating. During the fiscal year, the net assets of the governmental activities increased by $294 million or 4.65% percent.

The Division has decided to report "Licenses, fees and permits" as part of the line item "Charges for service."

The following chart depicts the revenues of the Division for the fiscal year.



Total revenues increased by approximately $22.3 million. Total tax revenues increased by approximately $1.4 million. Federal aid revenue decreased by approximately $11 million or (2.50%). The following summarizes revenues for the years ended June 30, 2006 and June 30, 2005 (amounts in thousands):

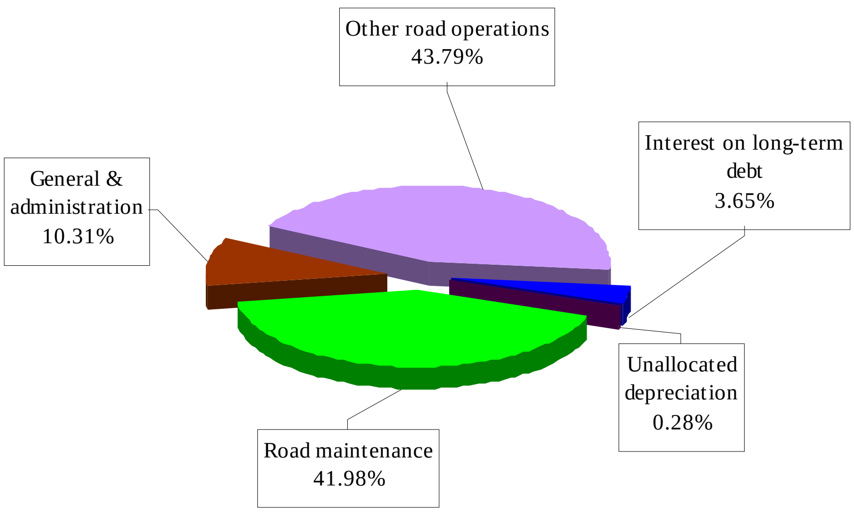
	2006	2005	Increase (decrease)	% Increase (decrease)
Motor fuel excise tax	$ 330,538	$ 320,891	$ 9,647	3.01%
Industrial access roads	3,016	2,351	665	28.29%
Automobile privilege tax	170,484	178,763	(8,279)	(4.63%)
Motor vehicle registration fees	87,534	86,466	1,068	1.24%
Special fees and permits	4,290	4,554	(264)	(5.80%)
Federal aid	429,583	440,579	(10,996)	(2.50%)
Investment and interest income	4,701	1,906	2,795	146.64%
Miscellaneous revenues	53,255	25,589	27,666	108.12%
	$ 1,083,401	$ 1,061,099	$ 22,302	2.10%

The Division's primary sources of revenue for funding of ongoing administration of the Division, general maintenance and construction of the State Road System and for providing resources to match available Federal funds are derived from fuel taxes, automobile privilege taxes, motor vehicle registration and license fees, net of costs incurred by the Division of Motor Vehicles in collecting funds for deposit into the State Road Fund.

Although tax collections grew during the past five fiscal years, they did not significantly exceed official estimates. From fiscal year 2002 through fiscal year 2006, actual cash revenues exceeded estimates by only .87%. While those extra dollars allowed the Division to deal with unexpected expenses, such as major floods and severe winter weather, they did not permit the Division to undertake many new projects. In fact, some areas of expenditures were reduced during periods of less than desirable fund equity levels. Revenues are projected to remain relatively flat through fiscal year 2007, while at the same time it is anticipated that nondiscretionary costs will continue to rise. As a consequence, many programs that are operated by the Division will experience little, if any, increase in the foreseeable future and some programs may revert to lower funding levels.

The Division also relies on federal funds as a source of revenue. The federal aid is obtained in the form of reimbursable grants. Federal transportation legislation and special spending authorizations provide funds that are available for obligation by the Federal Government in specific years, and the Division expects to continue to fully obligate available funds, thus ensuring that it captures all federal dollars. Revenue under these grants is recognized when expenditures occur on specific projects that have qualified for federal participation. Federal funds received during 2006 were authorized under the new Highway Transit Bill, the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU).

The following chart depicts expenses of the Division for the fiscal year.



Total expenses decreased by approximately $36 million (4.37%). The following summarizes expenditures for the years ended June 30, 2006 and June 30, 2005 (amounts in thousands):

	2006	2005	Increase (decrease)	% Increase (decrease)
Road maintenance	$ 316,475	$ 322,399	$ (5,924)	(1.84%)
Other road operations	366,874	382,831	(15,957)	(4.17%)
General and administration	81,349	99,006	(17,657)	(17.83%)
Interest on long-term debt	21,283	18,112	3,171	17.51%
Unallocated depreciation	3,030	2,690	340	12.64%
	$ 789,011	$ 825,038	$ (36,027)	(4.37%)

The maintenance expenses of the Division are comprised primarily of routine maintenance, small bridge repair, and contract paving.

Operating units are allocated yearly amounts for routine maintenance. The type of routine maintenance expenses incurred is dependent, to a degree, on the level of snow and ice removal that is required in a given year.

Other road operations expenditures reported in the Government-Wide Financial Statements include the total expended for all other road operations and small construction activities that fail to meet the criteria established for capitalization as infrastructure assets. A discussion of the change in actual funds expended is included in the financial analysis of the Division's Fund Financial Statements below.

FINANCIAL ANALYSIS OF THE DIVISION'S MAJOR FUND

At June 30, 2006, the Division reported fund balances of $232 million. Of this total amount, $197 million, 85.08%, constitutes unreserved fund balance, which is available for appropriation for the general purposes of the funds. The remainder of fund balance is reserved and is not available for new spending because it is dedicated for various commitments, such as inventories.

State Road Fund

The State Road Fund is the Division's General Fund. At the end of the 2006 fiscal year, unreserved fund balance of the General Fund was $197 million and reserved fund balance was $35 million. The total General Fund balance increased $14 million during the year primarily due to increased revenue.

State Road (General) Fund and Budgetary Highlights

The Division is dependent on revenues generated from the purchase and use of motor fuel, motor vehicle fees, privilege tax on consumer purchases of motor vehicles, and federal funding generated from motor fuel purchases. Revenues are affected by state and national economic conditions, world events affecting availability and pricing of motor fuel, and fuel consumption rates for motor vehicles. Although average fuel consumption rates for motor vehicles have remained fairly constant over the past several years, any future changes in consumption rates would have a significant impact on revenue collections unless there is a corresponding change to the tax rates or structure. For five of the previous six years, tax and fee revenue collections increased over the previous year. Tax and fee revenue collections increased by approximately $2.4 million in 2006: they increased $27.4 million during the previous year. The following table summarizes tax and fee collections over the past two years (amounts in thousands):

	2006	2005	Change	%Change
Motor fuel excise and wholesale fuel	$ 330,538	$ 320,891	$ 9,647	3.01%
Motor vehicle registration	87,534	86,466	1,068	1.24%
Privilege tax	170,484	178,763	(8,279)	(4.63%)
	$ 588,556	$ 586,120	$ 2,436	.42%

On January 1, 2005, the gasoline and special fuels excise tax was repealed, and the motor fuel excise tax was imposed on motor fuel. The motor fuel excise tax is the combination of a flat 20.5 cents per invoiced gallon rate and a variable sales and use tax rate that is calculated yearly. In September 2005, the Governor of West Virginia issued an executive order to freeze the variable rate at its January 1, 2004 level of 6.5 cents per invoiced gallon. That executive order is in effect through December 31, 2006.

Automobile privilege tax collections were positively impacted from 2002 through 2005 by low interest rates and significant incentives offered by automobile manufacturers. The automobile privilege taxes declined 8.3 million in 2006, however a decline was expected.

The Division's federal revenue for budgetary purposes for fiscal year 2006 was $393 million, to be used primarily for design, right-of-way and construction of Corridor D, Corridor H, WV 9, US Route 35 and other major corridors including King Coal Highway, WV 121, and WV 10 and all other federal highways. As previously discussed the recognition of revenue under these grants occurs when expenditures occur on specific projects that have qualified for federal participation. The budgeted amounts for federal revenue and expenditures are based on projects that have been approved and estimates of the timing of each phase of the project. Since the timing of such expenditures are dependent on variables such as the weather, the existence of differing site conditions that require plan modification, or delays caused by environmental issues or the results of public meetings, expenditures often do not occur as planned. Federal revenue recognized in the Statement of Activities in each of the last two years is summarized below (amounts in thousands):

	2006	2005	Change	%Change
Federal reimbursement - budgeted funds	$ 423,979	$ 428,424	$ (4,445)	(1.04%)
Federal reimbursement - emergency funds	5,604	12,155	(6,551)	(53.90%)
Total federal aid	$ 429,583	$ 440,579	$ (10,996)	(2.50%)

Although it is anticipated that revenues will increase slightly in the next fiscal year, the Division's revenue increases are not projected to keep pace with increases in costs related to retirement, health insurance, increased debt service and other increases that are non-discretionary in nature. As a result, the Division will be required to reduce expenditures on programs that are discretionary and expenditures in these areas will be managed to ensure that the Division maintains a positive fund balance. The fiscal 2007 budget reflects a budgeted decrease in fund balance of approximately $17 million. Management is taking all necessary steps to ensure that the fund balance of the Division is maintained at levels that are adequate to ensure the soundness of the Division and is confident that adequate discretionary items exist to permit the Division to continue to operate in a fiscally sound manner. Under the newly enacted SAFETEA-LU, the Division expects to annually receive an average of $403 million in federal funding. In order to capture the extra federal aid available, the Division will need an additional $15 million annually in state matching funds, which will raise the total needed annually from $86 million to $101 million.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

As of June 30, 2006, the Division had invested $7 billion, net of accumulated depreciation, in a range of capital assets (see note 7 for additional details). Depreciation charges for the fiscal year totaled $268 million.

The $260 million increase in capital assets, net of depreciation, reflects the nature of the State's road system. While the Division continues to expand the state road system, these expansions are focused primarily on upgrading existing roadways and completion of Appalachian Highway Corridors. While these are significant construction projects, the additions are offset by $249 million in depreciation of the infrastructure. The Division expended $528 million dollars during the year ended June 30, 2006 for additions to capital assets. Of this amount, $499 million was related to the acquisition of right of way and construction of roads and bridges. Construction costs for completed projects in the amount of $228 million were reclassified from construction in process to roads and bridges. Major construction expenditures during the year included continued construction related to Corridor H in Hardy County, Corridor D in Wood County, upgrade of WV 10 in Logan County, widening of I-64, upgrade of WV Route 9 in the Eastern Panhandle, upgrade of US Route 35 in Putnam County, upgrade of US Route 52 in Mingo County, upgrade of WV 121 in Raleigh County and continued environmental studies on various projects in process.

Long-term Debt

The Division has been authorized to issue bonds by constitutional amendments and all bonds are general obligation bonds of the State of West Virginia. All bonds authorized under prior constitutional amendments have been issued. At June 30, 2006, the Division had $448 million in outstanding bonds. The amount outstanding decreased by $20 million (4.26%) due to net principal payments.

The following is a summary of the amounts outstanding, including insured status and bond ratings:

Issue	Status of insurance	Bond Rating		Amount (in thousands)	
Safe Roads 98A - All Bonds maturing on or before June 1, 2023	Insured by FGIC	Fitch:	AAA		
		Moody's:	Aaa		
		S&P:	AAA	$	56,755
Safe Roads 99A - All Bonds maturing on or before June 1, 2017	Not Insured	Fitch:	AA-		
		Moody's:	Aa3		
		S&P:	AA-		6,560
Safe Roads 01A - Bonds maturing between June 1, 2006 to 2013	Insured by FSA	Fitch:	AAA		
		Moody's:	Aaa		
		S&P:	AAA		67,120
Safe Roads 05A - Bonds maturing on or before June 1, 2025.	Not Insured	Fitch:	AA-		
		Moody's:	Aa3		
		S&P:	AA-		2,045
Safe Roads 05A - Bonds maturing on or before June 1, 2025.	Insured by FSA	Fitch:	AAA		
		Moody's:	Aaa		
		S&P:	AAA		315,515
				$	447,995

The Division of Highways is expected to issue revenue bonds in the amount of $78 million in October 2006. It is anticipated that another estimated $95 million will be issued during January 2007. These bonds will be revenue bonds and the debt service payments will be funded through federal aid revenue.

More detailed information regarding capital asset and long-term debt activity is included in the notes 7 and 9, respectively to the financial statements.

REQUESTS FOR INFORMATION

This financial report is designed to provide an overview of the finances of the Division 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 Department of Transportation, Division of Highways at 1900 Kanawha Boulevard, East, Building 5, Room 220, Charleston, West Virginia 25305.

BASIC FINANCIAL STATEMENTS

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION, DIVISION OF HIGHWAYS
STATEMENT OF NET ASSETS
JUNE 30, 2006
(amounts expressed in thousands)

	Governmental Activities
ASSETS	
Current assets	
Cash and cash equivalents	$ 112,040
Accounts receivable, net	91,554
Taxes receivable	64,159
Due from other State of West Virginia agencies	3,691
Inventories	34,592
Total current assets	306,036
Non-current assets	
Capital assets, net of accumulated depreciation	
Land - non-infrastructure	15,403
Land improvements	4,483
Land Improvements - work in progress	437
Buildings	66,637
Buildings - work in progress	1,270
Furniture and fixtures	361
Rolling stock	60,903
Scientific equipment	636
Shop equipment	86
Roads	3,583,095
Bridges	1,224,855
Land - infrastructure	806,875
Construction in progress	1,188,306
Total capital assets	6,953,347
Other non-current assets	2,435
Total assets	7,261,818
LIABILITIES	
Current liabilities	
Accounts payable	45,382
Retainages payable	10,110
Accrued payroll and related liabilities	16,359
Due to other State of West Virginia agencies	2,357
Accrued interest payable	1,852
Current maturities of long term obligations	39,276
Total current liabilities	115,336
Non-current liabilities	
Claims and judgements	9,050
Compensated absences	57,629
General obligation bonds	457,857
Total non-current liabilities	524,536
Total liabilities	639,872
NET ASSETS	
Invested in capital assets, net of related debt	6,475,338
Unrestricted	138,096
Restricted	8,512
Total net assets	$ 6,621,946

The Accompanying Notes Are An Integral Part Of These Financial Statements

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION, DIVISION OF HIGHWAYS
STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2006
(amounts expressed in thousands)

Functions/Programs	Expenses	Program Revenues: Charges for Services	Program Revenues: Capital Grants and Contributions	Net Revenue (Expenses) and Changes in Net Assets
Government activities				
Road maintenance				
Expressway, trunkline & feeder & SLS	$ 236,326	$ -	$ -	$ (236,326)
Contract paving & secondary roads	48,345	-	-	(48,345)
Small bridge repair & replacement	14,135	-	-	(14,135)
Litter control program	1,744	-	-	(1,744)
Depreciation	15,925	-	-	(15,925)
Other road operations				
Interstate highways	4,479	-	53,359	48,880
Appalachian highways	4,434	-	104,228	99,794
Other federal aid programs	92,941	-	271,996	179,055
Non federal aid improvements	10,257	-	-	(10,257)
Industrial access roads	5,475	-	3,016	(2,459)
Depreciation	249,288	-	-	(249,288)
General and administration				
Support and administrative operations	43,609	4,290	-	(39,319)
Claims	3,394	-	-	(3,394)
Costs associated with DMV	34,346	87,534	-	53,188
Interest on long-term debt	21,283	-	-	(21,283)
Unallocated depreciation	3,030	-	-	(3,030)
	$ 789,011	$ 91,824	$ 432,599	(264,588)

General revenues	
Taxes:	
Gasoline and motor carrier	330,538
Automobile privilege	170,484
Investment and interest income	4,701
Miscellaneous revenues	53,255
Total general revenues	558,978
Change in net assets	294,390
Net assets, beginning	6,327,556
Net assets, ending	$ 6,621,946

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION, DIVISION OF HIGHWAYS
BALANCE SHEET - GOVERNMENTAL FUND
JUNE 30, 2006
(amounts expressed in thousands)

		State Road (General)
ASSETS		
Assets		
Cash and cash equivalents	$	112,040
Receivables		91,554
Taxes receivable		64,159
Due from other State of West Virginia agencies		3,691
Inventories		34,592
Total assets	$	306,036
LIABILITIES AND FUND BALANCES		
Liabilities		
Accounts payable	$	45,382
Retainages payable		10,110
Accrued payroll and related liabilities		16,359
Due to other State of West Virginia agencies		2,357
Total liabilities		74,208
Fund balances		
Reserved for inventories		34,592
Unreserved, undesignated		197,236
Total fund balances		231,828
Total liabilities and fund balances	$	306,036

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION, DIVISION OF HIGHWAYS
RECONCILIATION OF THE BALANCE SHEET - GOVERNMENTAL FUND TO THE STATEMENT OF NET ASSETS
JUNE 30, 2006
(amounts expressed in thousands)

Total fund balances - governmental funds		$ 231,828
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. These assets consist of:		
Land - non infrastructure	$ 15,403	
Land improvements- non infrastructure	4,483	
Land improvements- work in progress	437	
Buildings	66,637	
Buildings - work in progress	1,270	
Furniture and Fixtures	361	
Rolling Stock and Shop Equipment	60,903	
Scientific Equipment	636	
Shop Equipment	86	
Roads	3,583,095	
Bridges	1,224,855	
Infrastructure Land	806,875	
Work in progress	1,188,306	6,953,347
Bonds issued by the Division have associated costs that are paid from current available financial resources in the funds. However, these costs are deferred on the statement of net assets.		2,435
Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:		
Accrued interest payable	(1,852)	
Claims and judgments	(9,194)	
Compensated absences	(76,609)	
General obligation bonds	(478,009)	(565,664)
Net assets of governmental activities		$ 6,621,946

The Accompanying Notes Are An Integral Part Of These Financial Statements

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION, DIVISION OF HIGHWAYS
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE - GOVERNMENTAL FUND
YEAR ENDED JUNE 30, 2006

(amounts expressed in thousands)

	State Road (General)
Revenues	
Taxes	
Gasoline and motor carrier	$ 330,538
Automobile privilege	170,484
Industrial access roads	3,016
License, fees and permits	
Motor vehicle registrations and licenses	87,534
Special fees and permits	4,290
Federal aid	
Interstate highways	53,359
Appalachian highways	104,228
Other federal aid programs	271,996
Investment and interest income, net of arbitrage rebate	4,701
Miscellaneous revenues	53,255
	1,083,401
Expenditures	
Current	
Road maintenance	
Expressway, trunkline and feeder, state and local services	238,425
Contract paving and secondary roads	48,345
Small bridge repair and replacement	22,099
Litter control program	1,744
Support and administrative operations	75,050
Division of Motor Vehicles operations	34,346
Claims	397
Capital outlay and other road operations	
Road construction and other road operations	
Interstate highways	69,406
Appalachian highways	156,141
Other federal aid programs	354,562
Nonfederal aid construction and road operations	20,825
Industrial access roads	5,475
Debt service	
Principal	19,920
Interest	23,098
	1,069,833
Excess (deficiency) of revenues over expenditures	13,568
Fund balances, beginning of year	218,260
Fund balances, end of year	$ 231,828

The Accompanying Notes Are An Integral Part Of These Financial Statements

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION,
DIVISION OF HIGHWAYS
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE - GOVERNMENTAL FUND TO THE STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2006
(amount expressed in thousands)

Net change in fund balances - total governmental funds	$	13,568
Amounts reported for governmental activities in the statement of activities are different because:		
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays of $528,879, exceeded depreciation of ($268,243) in the current period.		260,636
Governmental funds report the proceeds from the sale of capital assets, primarily equipment, as revenue. In the statement of activities revenue is only recognized to the extent that amounts received are in excess of the net book value of the assets sold. The net book value of assets disposed of during the year was $319.		(319)
Repayment of bond principal is an expenditure to governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.		19,920
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds. This is the amount by which the decrease in compensated absences of $1,769, accretion of bond premiums of $2,072 an increase in interest payable of $71 exceeded the increase in claims of ($2,997) and amortization of bond issuance costs of ($330).		585
Change in net assets of governmental activities	$	294,390

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION, DIVISION OF HIGHWAYS
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
(BUDGETARY BASIS) - STATE ROAD FUND
YEAR ENDED JUNE 30, 2006
(amounts expressed in thousands)

	Original Budget	Budget Amendments	Final Budget	Actual Amounts	Variance with Final Budget - Positive (Negative)
Revenues					
Taxes					
Gasoline and motor carrier	$ 318,000	$ -	$ 318,000	$ 320,757	$ 2,757
Automobile privilege	182,665	-	182,665	171,479	(11,186)
Motor vehicle registrations and licenses	85,160	-	85,160	86,976	1,816
Revenue Transfer to Industrial Access Roads	(3,000)	-	(3,000)	(3,005)	(5)
Federal aid	458,818	32,682	491,500	392,821	(98,679)
Miscellaneous revenues	11,479	-	11,479	11,860	381
	1,053,122	32,682	1,085,804	980,888	(104,916)
Expenditures					
Road construction and other road operations					
Interstate highways	80,000	-	80,000	70,871	9,129
Appalachian highways	170,000	(10,000)	160,000	144,972	15,028
Other federal aid programs	300,700	50,000	350,700	347,864	2,836
Nonfederal aid construction	25,000	-	25,000	18,617	6,383
Road maintenance					
Maintenance	249,700	-	249,700	241,257	8,443
Contract paving and secondary roads	50,000	-	50,000	48,273	1,727
Small bridge repair and replacement	30,000	-	30,000	23,035	6,965
Litter control program	1,755	-	1,755	1,755	-
Support and administrative operations					
General operations	44,500	-	44,500	34,260	10,240
Equipment revolving	15,000	7,000	22,000	21,169	831
Inventory revolving	2,000	-	2,000	(4,437)	6,437
Debt service	50,000	(6,900)	43,100	42,364	736
PSC Weight Enforcement	4,566	68	4,634	4,075	559
Division of Motor Vehicles operations	36,900	527	37,427	35,669	1,758
Waste tire	3,426	-	3,426	1,865	1,561
Claims - DOH and DMV	205	199	404	404	-
	1,063,752	40,894	1,104,646	1,032,013	72,633
Excess (deficiency) of revenues over expenditures	(10,630)	(8,212)	(18,842)	(51,125)	(32,283)
Fund balance, beginning of year	134,567	-	134,567	134,567	-
Fund balance, end of year	$ 123,937	$ (8,212)	$ 115,725	$ 83,442	$ (32,283)

The Accompanying Notes Are An Integral
Part Of These Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION - The accompanying financial statements of the West Virginia Department of Transportation, Division of Highways (the "Division") have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

REPORTING ENTITY - The Division is an operating unit of the West Virginia Department of Transportation and represents separate funds of the State of West Virginia (the "State") that are not included in the State's general fund. The Division is a legally separate entity defined by the State constitution, and has statutory responsibility for the construction, reconstruction, maintenance, and improvement of all State roads. The Division is governed by a commissioner who is appointed by the Governor, but does not have a governing board separate from the State Legislature. The Division is considered a component unit of the State and its financial statements are blended with the financial statements of the primary government in the State's comprehensive annual financial report.

The financial statements of the Division are intended to present the financial position, and the results of operations of only that portion of the financial reporting entity of the West Virginia Department of Transportation and the State of West Virginia, that is attributable to the transactions of the Division. They do not purport to, and do not, present fairly the financial position of the West Virginia Department of Transportation or the State of West Virginia as of June 30, 2006 and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Management has considered all potential component units to be included in the Division's reporting entity by applying the criteria set forth in accounting principles generally accepted in the United States of America. These criteria include consideration of organizations for which the Division is financially accountable, or organizations for which the nature and significance of their relationship with the Division are such that exclusion would cause the Division's financial statements to be misleading or incomplete. Since no organizations meet these criteria, the Division has no component units.

The Division of Motor Vehicles is an operating division of the West Virginia Department of Transportation, which collects certain revenues for expenditure by the Division. The expenditures related to the collection of these revenues are recorded in the State Road Fund of the Division.

The Public Service Commission collects revenues from coal companies that are operating trucks with excessive weights. These revenues are deposited into the Coal Resource fund, which is controlled by the Division.

GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS - The government-wide financial statements (the statement of net assets and the statement of activities) report information of all of the activities of the primary government and its component units, if any. For the most part, the effect of interfund activity has been removed from these government-wide statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from the legally separate component units for which the primary government is financially accountable.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The statement of activities demonstrates the degree to which the direct expenses of a given function, segment or component unit are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function, segment, or component unit. Program revenues include charges to customers who purchase, use or directly benefit from goods or services provided by a given function, segment, or component unit. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function, segment, or component unit. Taxes and other items not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally are reported as general revenues rather than as program revenues. The Division does not allocate general government (indirect) expenses to other functions.

Net assets are restricted when constraints placed on them are either externally imposed or are imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net assets. The government-wide statement of net assets reports $8,512 restricted assets, of which all is restricted by enabling legislation.

When both restricted and unrestricted resources are available for use, generally it is the Division's policy to use restricted resources first, then unrestricted resources, as they are needed. Separate financial statements are provided for governmental funds, proprietary funds, fiduciary funds and similar component units, and major component units, if applicable. However, the fiduciary funds are not included in the government-wide statements. Major individual governmental funds and major individual enterprise funds, if applicable, are reported as separate columns in the fund financial statements.

MEASUREMENT FOCUS, BASIS OF ACCOUNTING AND FINANCIAL STATEMENT PRESENTATION -

GOVERNMENT-WIDE FINANCIAL STATEMENTS - The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

GOVERNMENTAL FUND FINANCIAL STATEMENTS - The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Division considers revenues to be available if they are collected within 45 days of the end of the current fiscal year. Principal revenues subject to accrual include gasoline and wholesale fuel taxes, automobile privilege taxes, federal reimbursements and other reimbursements for use of materials and services.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting for the governmental fund financial statements include:

- Employees' vested annual leave is recorded as expenditures when utilized. The amount of accumulated annual leave unpaid at June 30, 2006, has been reported only in the government-wide financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- Division employees earn sick leave benefits, which accumulate, but do not vest. When separated from employment with the Division, an employee's sick leave benefits are considered ended and no reimbursement is provided. However, an employee may convert, at the time of retirement, any unused accumulated sick leave to pay a portion of the employee's postemployment health care insurance premium or to increase service credits for retirement purposes. The liability for accumulated sick leave for employees has been recorded only in the government-wide financial statements.

- The Division pays 100% of the health insurance premium for retirees who elected to participate in the health insurance plans prior to July 1, 1988 and 50% of the premium for retirees who elected to participate prior to July 1, 2001. The liability for accumulated post-employment health insurance has been reported only in the government-wide financial statements.

- Principal and interest on general long-term debt are recorded as fund liabilities when due or when amounts have been accumulated in the debt service fund for transfer to the fiscal agent or for payment to be made early in the following year.

- Claims and judgments are recorded only when payment is due.

FUND ACCOUNTING - The Division uses funds to report its financial position and the results of its operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

A fund is a separate accounting entity with a self-balancing set of accounts. The following summarizes the major governmental funds that are presented in the accompanying financial statements:

- State Road (General) Fund - This fund serves as the Division's general fund and is used to account for all financial resources, except those required to be accounted for in another fund. The State Road Fund is funded primarily by dedicated highway user taxes and fees and matching federal highway funds.

INTERFUND ACTIVITY - As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are payments-in-lieu of taxes and other charges from the government's various functions. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned. The Division processes certain routine payments, such as payroll through the State Road Fund and allocates those costs to the other governmental funds based on individual projects charged. The interfund balances at June 30, 2006 are a result of these routine payments and transfers.

BUDGETING AND BUDGETARY CONTROL - The Division's expenditures are subject to the legislative budget process of the State, with annual budgets adopted utilizing the cash basis of accounting. The cash basis is modified at year-end to allow for payment of invoices up to 45 days after year-end for goods or services received prior to year-end. Appropriated budgeted expenditures, which lapse 45 days after the end of the fiscal year, are incorporated into the Division's overall financial plan, which includes revenue estimates developed by the Division and the State's executive branch. Expenditures are budgeted using natural categories of activity including specific categories of construction, maintenance, and operations, as well as special items. Any revisions that alter overall budgeted expenditures for an expenditure category must be approved by the State Legislature.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Division's State Road (General) Fund which includes the State Road Fund and A. James Manchin Fund has a legislatively approved budget. However, the coal resource fund, industrial access fund and certain monies reported within the State Road Fund for accounting principles generally accepted in the United States of America purposes, are not considered appropriated funds in accordance with the Division's budgetary reporting policy. Accordingly, these funds have not been reported in the Division's Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual (Budgetary Basis) - State Road Fund. A reconciliation of the excess of revenues over expenditures and other financing uses for the year ended June 30, 2006, on the budgetary basis to the GAAP basis for the State Road fund follows:

Excess of expenditures over revenues - budgetary basis	$ (51,125)
Basis of accounting differences (budgetary to GAAP)	67,083
Unbudgeted funds	(2,390)
Excess of revenues over expenditures - GAAP basis	$ 13,568

CASH AND CASH EQUIVALENTS - Cash and cash equivalents are 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). Interest income from these investments is prorated to the Division at rates specified by the BTI based on the balance of the Division's deposits maintained in relation to the total deposits of all state agencies participating in the pool. Deposits are available with overnight notice to the BTI.

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 BTI for investment in accordance with the West Virginia Code, policies set by the BTI, and provisions of bond indentures and trust agreements when applicable. The West Virginia Legislature, effective July 8, 2005, established the BTI to manage the short-term operating funds of the State. Prior to this date, the West Virginia Investment Management Board (the "IMB") was responsible for investment of both the short-term and long-term funds. The Legislature declared this transfer to ensure direct governmental oversight of state general and special revenue funds. The IMB continues to manage the retirement funds, the employment security funds, and other assets with longer time horizons.

INVENTORIES - Inventories are stated at weighted average cost generally using the "consumption method" whereby expenditures are recognized in the period in which inventory usage, as opposed to purchase, occurs. The portion of fund balance relating to inventories is reported as "Reserve for inventories" in the Government Fund Financial Statements.

CAPITAL ASSETS - Capital assets, which include buildings, non-infrastructure land, furniture and fixtures, rolling stock, scientific equipment, shop equipment and infrastructure assets (which are normally immovable and of value only to the Division, such as roads, bridges, and similar items), are reported in the statement of net assets in the government-wide financial statements. Capital assets are defined by the Division as follows:

- Non-infrastructure assets with a useful life of at least three years and:

  - A cost of five thousand dollars or more for machinery, equipment, rolling stock, furniture and fixtures; or

  - An acquisition cost of twenty-five thousand dollars or more for buildings at the date of acquisition; and

- Infrastructure assets with a cost in excess of one million dollars.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Purchased and constructed capital assets are valued at historical cost or estimated historical cost. Donated capital assets are recorded at their fair market value at the date of donation.

The estimates of historical costs of buildings and other improvements were based on values that were compiled in 1983. Building and non-infrastructure land have been recorded at cost since 1983. Infrastructure constructed from July 1, 1980 to July 1, 2001 has been recorded at estimated historical cost. The estimated historical cost for years 1980-2001 was based on capital outlay expenditures reported by the West Virginia Department of Transportation in the annual reports for those years, less an amount estimated for the historical cost of the acquisition of land for right-of-way. The Division has not capitalized any infrastructure expenditures for assets constructed prior to July 1, 1980, as permitted by GASB 34. The costs of normal maintenance and repairs that do not add to the asset's value or materially extend an asset's useful life are not capitalized. Interest incurred during construction of capital facilities is not capitalized.

Capital assets utilized in the governmental funds are recorded as expenditures in the governmental fund financial statements. Depreciation expense is recorded in the government-wide financial statements.

Capital assets are depreciated on the straight-line method over the assets' estimated useful lives. There is no depreciation recorded for land and construction in progress. Generally, estimated useful lives are as follows:

- Machinery and equipment: 5 - 20 years
- Buildings: 40 years
- Furniture and fixtures: 3 - 20 years
- Rolling stock: 1 - 20 years
- Scientific equipment: 2 - 25 years
- Infrastructure: roads - 30 years
- Infrastructure: bridges - 50 years

ACCOUNTS AND TAXES RECEIVABLE - Accounts receivable in all funds report amounts that have arisen in the ordinary course of business and are stated net of allowances for uncollectible amounts. Governmental fund type receivables consist primarily of amounts due from the Federal government. Interest and investment revenue receivable in all funds consist of revenues due on each investment. Taxes receivable in governmental funds represent taxes subject to accrual, primarily gasoline and wholesale fuel taxes and automobile privilege taxes, which are collected within forty-five days after year end. The uncollectible amounts are based on collection experience and a review of the status of existing receivables.

OTHER ASSETS - Other assets represent payments that reflect costs applicable to future accounting periods and are recorded as other assets in both government-wide and fund financial statements.

CLAIMS - Claims awarded against the Division in the West Virginia State Court of Claims must be approved and funded by legislative action. Expenditures in the fund financial statements for such claims are recognized to the extent that claims awarded are approved and funded by the Legislature. A liability for unfunded claims is recorded in the government-wide financial statements when management and the Division's legal section determine that it is probable that a loss has occurred and the loss can be reasonably estimated. Such claims are segregated as either tort or contract actions and estimates of loss are based on an analysis of the individual claims and historical experience.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

COMPENSATED ABSENCES - Division employees generally earn vacation and sick leave on a monthly basis. Vacation, up to specific limits, is fully vested when earned, and sick leave, while not vesting to the employee prior to retirement, can be carried over to subsequent periods. Any unused vacation and sick leave accumulated at employee retirement vests to the employee and may be provided in the form of post-retirement payment of all or a portion of the employee's health insurance premiums, or as service credits for retirement purposes. Expenditures for compensated absences are recognized as incurred in the governmental fund financial statements. The government-wide financial statements present the cost of accumulated compensated absences as a liability.

POSTEMPLOYMENT BENEFITS - The Division pays 100% of the health insurance premium for retirees who elected to participate in the health insurance plans prior to July 1, 1988 and 50% of the premium for retirees who elected to participate between that date and July 1, 2001. Employees who were eligible and elected to participate in the Division's health insurance plan at July 1, 1988 and 2001, and who had continuous participation in the Plan since those dates, are eligible for the postemployment benefits. Employees hired subsequent to July 1, 2001 are not eligible for these benefits. Expenditures for postemployment health insurance premiums are recognized as incurred in the governmental fund financial statements. The government-wide financial statements present the cost of accumulated post-employment health insurance as a liability.

RETIREMENT BENEFITS - The Division's employees are covered by the West Virginia Public Employees Retirement System (PERS), a multi-employer cost-sharing defined benefit pension plan. PERS covers substantially all employees of the Division, with employer contributions prescribed by the State Legislature as a percentage of covered payroll.

PREMIUMS, DISCOUNTS AND ISSUANCE COSTS - In the government-wide financial statements long-term debt and other long-term obligations are presented in the columns for governmental activities. Where material, bond and note premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the debt. Bonds and notes payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges in other assets and are amortized over the term of the related debt**.** In the governmental fund financial statements, governmental funds recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuance are reported as other financing sources while discounts are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

RECENT STATEMENTS ISSUED BY THE GASB - The following statements were adopted by the Division during the fiscal year ended June 30, 2006:

- Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries* - this statement requires the Division 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.

- Statement No. 46, *Net Assets Restricted by Enabling Legislation* (an amendment of GASB Statement No. 34) - this statement provides guidance clarifying the meaning of the phrase "legally enforceable" as it applies restrictions imposed on net asset use by enabling legislation.

(amounts expressed in thousands)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- Statement No. 47, *Accounting for Termination Benefits* - this statement provides standards for the measurement, recognition and display of voluntary termination benefit expenditures, assets, and liabilities, including applicable note disclosures.

These statements did not have a significant effect on the operations of the Division, and are not expected to in future years.

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. Effective July 1, 2007, the Division is required to participate in this multiple employer cost sharing plan sponsored by the State of West Virginia. Details regarding this plan can be obtained by contacting Public Employees Insurance Agency, State Capitol Complex, Building 5, Room 1001, 1900 Kanawha Boulevard, East, Charleston, West Virginia, 25305-0710 or http://www.wvpeia.com. No liability related to this plan exists for the Division at June 30, 2006. The impact on the Division's financial statements in subsequent years has not yet been determined, but such amount may be significant.

NOTE 2 - 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	$ 13,553	$ 13,553
Cash on deposit with State Treasurer invested in BTI cash liquidity pool	98,023	98,023
Cash in transit	464	464
	$ 112,040	$ 112,040

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

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.

(amounts expressed in thousands)

NOTE 2 - CASH AND CASH EQUIVALENTS (Continued)

Credit Risk

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

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

	Credit Rating *			
Security Type	Moody's	S&P	Carrying Value	Percent of Pool Assets
Commercial paper	P1	A-1	$ 943,057	54.14%
Corporate bonds and notes	Aaa	AAA	61,992	3.56
	Aa	AA	55,063	3.16
	Aa	A	12,000	0.69
			129,055	7.41
U.S. agency bonds	Aaa	AAA	43,663	2.51
U.S. Treasury bills	Aaa	AAA	306,279	17.58
Certificates of deposit	P1	A-1	99,000	5.68
	NR	NR	23,800	1.37
			122,800	7.05
U.S. agency discount notes	P1	A-1	93,851	5.39
Money market funds	Aaa	AAA	758	0.04
Repurchase agreements (underlying securities):				
U.S. Treasury notes	Aaa	AAA	73,000	4.19
U.S. agency notes	Aaa	AAA	29,339	1.69
			102,339	5.88
			$ 1,741,802	100.00%

* NR = Not Rated

The Division's ownership represents 5.62% of these amounts held by BTI.

Interest Rate Risk

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

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

(amounts expressed in thousands)

NOTE 2 - CASH AND CASH EQUIVALENTS (Continued)

Security Type	Carrying Value	WAM (Days)
Repurchase agreements	$ 102,339	3
U.S. Treasury bills	306,279	32
Commercial paper	943,057	25
Certificates of deposit	122,800	105
U.S. agency discount notes	93,851	89
Corporate notes	129,055	77
U.S. agency bonds/notes	43,663	208
Money market fund	758	1
	$ 1,741,802	42

Other Investment Risks

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

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

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the BTI will not be able to recover the value of investment or collateral securities that are in the possession of an outside party.

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.

NOTE 3 - ACCOUNTS RECEIVABLE

Accounts receivable at June 30, 2006 consisted of the following:

Federal aid billed and not paid	$ 39,268
Federal aid earned but not billed	42,019
Total federal aid receivable	81,287
Other receivables	11,047
Combined total receivables	92,334
Less: allowance for uncollectibles	(780)
Net accounts receivable	$ 91,554

Accounts receivable representing federal aid earned but not billed relate principally to the Federal Highway Administration's (FHWA) participating share of expenditures on highway projects.

(amounts expressed in thousands)

NOTE 4 - TAXES RECEIVABLE

Taxes receivable at June 30, 2006 consisted of the following:

Automobile privilege taxes	$ 26,276
Motor fuel excise taxes	34,714
Registration fees	3,169
	$ 64,159

NOTE 5 - DUE FROM/TO OTHER STATE OF WEST VIRGINIA AGENCIES

Amounts due from other State of West Virginia agencies at June 30, 2006 consisted of the following:

The Department of Motor Vehicles	$ 3,395
The Department of Administration	195
Other agencies	101
	$ 3,691

Amounts due to other State of West Virginia agencies at June 30, 2006 consisted of the following:

Public Employees Insurance Agency	$ 1,223
Public Employee's Retirement	1,026
Department of Administration	39
Other agencies	69
	$ 2,357

NOTE 6 - INVENTORIES

Inventories at June 30, 2006 consisted of the following:

Materials and supplies	$ 22,737
Equipment repair parts	9,312
Gas and lubrication supplies	2,543
	$ 34,592

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION,
DIVISION OF HIGHWAYS
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2006
(amounts expressed in thousands)

NOTE 7 - CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2006, was as follows:

	Balance July 1, 2005	Increases	Decreases	Balance June 30, 2006
Capital assets not being depreciated:				
Land - non infrastructure	$ 15,312	$ 546	$ 455	$ 15,403
Land - infrastructure	771,447	35,428	-	806,875
Construction-in-progress - buildings	4,936	4,388	8,054	1,270
Construction-in-progress – land improvements	288	803	654	437
Construction-in-progress - roads	672,701	286,242	159,659	799,284
Construction-in-progress - bridges	280,014	232,816	123,808	389,022
Total capital assets not being depreciated	1,744,698	560,223	292,630	2,012,291
Capital assets being depreciated:				
Buildings	91,034	7,637	110	98,561
Furniture and fixtures	3,719	129	101	3,747
Land improvements - non infrastructure	5,442	1,038	-	6,480
Rolling stock	182,306	24,496	7,265	199,537
Shop equipment	3,040	-	-	3,040
Scientific equipment	2,224	116	32	2,308
Infrastructure - roads	6,488,317	135,906	-	6,624,223
Infrastructure - bridges	1,426,753	91,963	-	1,518,716
Total capital assets being depreciated	8,202,835	261,285	7,508	8,456,612
Less accumulated depreciation:				
Buildings	29,481	2,547	104	31,924
Furniture and fixtures	3,276	211	101	3,386
Land improvements - non infrastructure	1,725	272	-	1,997
Rolling stock	129,778	15,814	6,958	138,634
Shop equipment	2,931	23	-	2,954
Scientific equipment	1,611	88	27	1,672
Infrastructure - roads	2,821,829	219,299	-	3,041,128
Infrastructure - bridges	263,872	29,989	-	293,861
Total accumulated depreciation	3,254,503	268,243	7,190	3,515,556
Total capital assets being depreciated, net	4,948,332	(6,958)	318	4,941,056
Governmental activities capital assets, net	$ 6,693,030	$ 553,265	$ 292,948	$ 6,953,347

Current year depreciation totaling $265,213 was allocated as separate line items in the statement of activities under the major functions of the Division of Maintenance and Improvements. The remaining $3,030 unallocated depreciation expense is included as a separate line item in the statement of activities. Infrastructure depreciation is primarily related to construction type activities; depreciation of shop and rolling stock assets is primarily related to maintenance type activities; and depreciation of buildings and improvements and furniture and fixtures support all of the various activities of the Division.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION,
DIVISION OF HIGHWAYS
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2006
(amounts expressed in thousands)

NOTE 7 - CAPITAL ASSETS (Continued)

A summary of depreciation on each capital asset type follows:

Asset Type	Depreciation
Buildings and improvements	$ 2,547
Furniture and fixtures	211
Land improvements	272
Total unallocated	3,030
Rolling stock	15,814
Shop equipment	23
Scientific equipment	88
Total road maintenance	15,925
Infrastructure - roads	219,299
Infrastructure - bridges	29,989
Total other road operations	249,288
Total depreciation expense	$ 268,243

NOTE 8 - RETAINAGES PAYABLE

The Division has entered into an arrangement with the BTI whereby amounts retained from payments to contractors may, at the option of the contractor, be deposited in an interest bearing account in the contractor's name. Retainage payments are made to the contractor when contracts are satisfactorily completed. The funds on deposit in these accounts are not reported as assets of the Division. At June 30, 2006, retainages payable on contracts had been reduced by these amounts on deposit in such accounts to approximately $1,107.

NOTE 9 - LONG-TERM OBLIGATIONS

Long-term obligations at June 30, 2006, and changes for the fiscal year then ended are as follows:

	Issue Date	Interest Rates	Maturity Through	Beginning Balance	Additions	Reductions	Ending Balance
General obligation bonds payable from tax revenue:							
Better highway bonds	1973	5.625%-6.10%	02/01/2006	$ 1,480	$ -	$ 1,480	$ -
Safe road bonds	1998	4.30%-5.25%	06/01/2023	63,935	-	7,180	56,755
Safe road bonds	1999	4.30%-5.75%	06/01/2017	8,550	-	1,990	6,560
Safe road bonds	2001	3.50%-5.50%	06/01/2013	76,390	-	9,270	67,120
Safe road bonds	2005	3.00%-5.00%	06/01/2025	317,560	-	-	317,560
Total general obligation bonds				467,915	-	19,920	447,995
Bond premium				32,086	-	2,072	30,014
Total general obligation bonds payable net of premium				500,001	-	21,992	478,009
Claims and judgments				6,197	3,394	397	9,194
Compensated absences				78,378	1,462	3,231	76,609
Total long-term obligations				$ 584,576	$ 4,856	$ 25,620	$ 563,812

(amounts expressed in thousands)

NOTE 9 - LONG-TERM OBLIGATIONS (Continued)

General obligation bond issues are authorized by constitutional amendments and are general obligations of the State of West Virginia. Legislation implementing the amendments require that debt service on the bonds be paid from the State Road Fund and, to the extent that there are insufficient funds therein, from a levy of an annual state tax. All bonds authorized under prior constitutional amendments have been issued and include amounts outstanding above.

Debt service expenditures for debt service funds included interest of $23,098 for the year ended June 30, 2006. Total debt service costs, exclusive of coupon redemption costs, for each of the next five years and thereafter, on general obligation bonds payable and liquidated through debt service funds, are as follows:

	2007	2008	2009	2010	2011	2012-2016	2017-2021	2022-2025	Total
General obligation bonds payable from tax revenue:									
Safe road bonds	$ 40,380	$ 49,993	$ 49,996	$ 49,995	$ 49,993	$ 199,549	$ 117,577	$ 94,062	$ 651,545
Total general obligation bonds	40,380	49,993	49,996	49,995	49,993	199,549	117,577	94,062	651,545
Less: interest	22,230	21,338	19,911	18,405	16,828	61,128	33,142	10,568	203,550
Total principal	18,150	28,655	30,085	31,590	33,165	138,421	84,435	83,494	447,995
Bond premium	2,002	1,941	1,886	1,633	1,586	7,521	7,469	5,976	30,014
Total principal and bond premium	$ 20,152	$ 30,596	$ 31,971	$ 33,223	$ 34,751	$ 145,942	$ 91,904	$ 89,470	$ 478,009

The portion of long-term and short-term compensated absences, claims payable, and general obligation bonds are as follows:

	Compensated Absences	Claims and Judgments	General Obligation Bonds and Premium	Total
Short-term liability	$ 18,980	$ 144	$ 20,152	$ 39,276
Long-term liability	57,629	9,050	457,857	524,536
	$ 76,609	$ 9,194	$ 478,009	$ 563,812

During the year ended June 30, 1972, the State was authorized by constitutional amendment to issue $500,000 of general obligation bonds to fund highway and road construction projects known as Better Highway Bonds. The last bonds from this issue were repaid during the year ended June 30, 2006. During the year ended June 30, 1997, the State was authorized by constitutional amendment to issue $550,000 of general obligation bonds to fund highway and road construction projects know as Safe Road Bonds. These bonds will be repaid from revenues of the State Road Fund. Safe Road Bonds of $220,000 were issued during July 1998; $110,000 were issued during July 1999; $110,000 were issued during July 2000; and an additional $110,000 were issued during July 2001.

In 2005, the State refinanced part of the above mentioned bonds in the amount of $321,405. These bonds will be repaid from revenues of the State Road Fund through the year 2025.

(amounts expressed in thousands)

NOTE 9 - LONG-TERM OBLIGATIONS (Continued)

In 2005, the State refinanced $321,405 in general obligation bonds to advance-refund $319,860 of outstanding 1998, 1999 and 2000 Series bonds. The net proceeds of $351,405 (after payment of $1,606 in underwriting fees, insurance, and other issuance costs) were used to purchase U.S. Government State and Local Government Series securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the refinanced portions of the 1998, 1999, and 2000 Series bonds. As a result, the refinanced portion of the 1998 and 1999 Series bonds along with all 2000 Series bonds are considered to be defeased and the liability for those bonds has been removed from the government-wide statement of net assets. The reacquisition price exceeded the net carrying amount of the old debt by $1,545. This amount is being netted against the new debt and amortized over the remaining useful life of the refunded debt. This advance refunding was undertaken to reduce total debt service payments over the next 20 years by $19,689 and resulted in an economic gain of $18,821.

The following summarizes the estimated claims liability for the current year and that of the preceding two years.

	Year Ended June 30, 2006	Year Ended June 30, 2005	Year Ended June 30, 2004
Estimated claims liability, July 1	$ 6,197	$ 8,700	$ 6,961
Additions for claims incurred during the year	3,094	1,200	3,346
Changes in estimates for claims of prior periods	300	(3,287)	(845)
Payments on claims	(397)	(416)	(762)
Estimated claims liability, June 30	$ 9,194	$ 6,197	$ 8,700

At June 30, 2006, approximately $20,847 of tort claims and $6,775 of construction claims, including non-incremental claims, were pending against the Division in the West Virginia State Court of Claims. With respect to these claims, the Division has an estimated obligation of $9,194, recorded in the government-wide Statement of Net Assets, based on management's evaluation of the nature of such claims and consideration of historical loss experience for the respective types of action. Such claims will be recognized primarily as expenditures of the State Road Fund if, and when, they are approved for payment by the Legislature in accordance with legal statutes. Also included in claims are claims that have been settled in the court of claims and approved for payment through legislative action. These amounts total approximately $144. During the normal course of operations, the Division may become subject to other litigation. No provision has been made in the financial statements for liabilities, if any, from such litigation.

The Division's obligation for accrued vacation leave time includes leave time and related costs expected to be paid to employees in the future and are determined using wage levels in effect at the date the obligation is calculated. Also included in this amount is the Division's unfunded obligation of approximately $7,614 arising in connection with legislation to fund portions of employee postemployment health insurance costs for retired employees. These liabilities are generally liquidated by the State Road Fund.

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 the West Virginia Public Employees Retirement System. These liabilities are generally liquidated by the State Road Fund. Expenditures during the year ended June 30, 2006 for health care premiums for 490 retirees were approximately $1,794.

NOTE 10 - RELATED PARTY TRANSACTIONS WITH THE STATE OF WEST VIRGINIA

The Division enters into certain transactions with various agencies of the State of West Virginia. The following summarizes the nature and terms of the most significant transactions:

- The Division leases from the Department of Administration substantially all of State Office Building No. 5 and a portion of State Office Building No. 3 which are owned by the State Building Commission. The Division may be released from its obligation only at the option of the lessor. The Division is obligated under these operating leases, which expire December 31, 2006 for rental payments of approximately $2.0 million annually. Management expects the leases to be renewed upon expiration.

- The Division's employees participate in various benefit plans offered by the State of West Virginia. Employer contributions to these plans are mandatory. During the year ended June 30, 2006 the Division incurred payroll related expenditures of approximately $31,882 for employee health insurance benefits provided through the West Virginia Public Employees Insurance Agency and approximately $16,559 in employer matching contributions to the State Public Retirement System.

- The Division was insured under the West Virginia Workers' Compensation Division until January 1, 2006. In January 2006 the state privatized Workers' Compensation. Workers' Compensation coverage is currently provided solely from BrickStreet Insurance Company, a private mutual insurance company established in conjunction with the privatization process. During the year ended June 30, 2006 the Division paid approximately $4,732 to West Virginia Workers' Compensation Division for coverage through December 31, 2005, and approximately $5,286 to BrickStreet Insurance Company for coverage from January 1 through June 30, 2006.

- The Division made payments to the Department of Military Affairs and Public Safety, Division of Public Safety for various services performed. These expenditures, which were authorized by the Legislature, amounted to approximately $5,481 during the year ended June 30, 2006.

- The Division made payments to the Public Service Commission for weight enforcement duties. These expenditures, which were authorized by the Legislature, amounted to approximately $4,075 during the year ended June 30, 2006.

NOTE 11 - COMMITMENTS AND CONTINGENCIES

The amount of unexpended balances of highway design and construction contracts entered into by the Division with various contractors approximated $652,552 at June 30, 2006.

The Division participates in several federal programs which are subject to audit by the federal awarding agency. Any disallowed claims, including amounts already collected, may constitute a liability of the applicable funds. The amount, if any, of expenditures that may be disallowed by the federal awarding agency cannot be determined at this time. The Division expects such amounts, if any, to be immaterial to the financial position of the Division. The Division records these disallowed audit adjustments for questioned costs in the period the audit is finalized.

NOTE 12 - RETIREMENT PLAN

PLAN DESCRIPTION - The Division 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 benefit provisions to the PERS Board of Trustees. Employees 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 Division's contribution of 10.5% which is established by PERS. The Division's contributions to PERS for the years ended June 30, 2006, 2005, and 2004 were $16,559, $17,450, and $17,721, respectively, equal to the required contributions for each year.

NOTE 13 - RISK MANAGEMENT

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

BRIM is a public entity risk pool that provides coverage for general, property, medical malpractice, and automobile liability. PEIA is also a public entity risk pool and provides coverage for employee and dependent health, life and prescription drug insurance. The West Virginia Workers' Compensation Commission, an insurance enterprise fund (prior to January 1, 2006), and BrickStreet Insurance, a private mutual insurance company, (after December 31, 2005) provide coverage for work related accidents. The Division retains the risk of loss on certain tort and contractor claims in excess of the amount insured or covered by BRIM's insurance carrier. Other than the amounts disclosed in Note 9, amounts of settlements have not exceeded insurance coverage in the past three years. The Division has evaluated this potential risk of loss as discussed in Note 9.

Through its participation in the PEIA, the Division has obtained health coverage for its employees. In exchange for payment of premiums to PEIA, the Division has transferred its risks related to health coverage. PEIA issues publicly available financial reports that include financial statements and required supplementary information, these reports may be obtained by writing to PEIA.

NOTE 14 - SUBSEQUENT EVENTS

The Division of Highways is expected to issue revenue bonds in the amount of $78 million in October 2006. It is anticipated that another estimated $95 million will be issued during January 2007. These bonds will be revenue bonds and the debt service payments will be funded through federal aid revenue.

COMPLIANCE AND INTERNAL CONTROL REPORT

Suttle & Stalnaker
CERTIFIED PUBLIC ACCOUNTANTS

Business Advisors and Consultants

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Joint Committee on Government and Finance
West Virginia Legislature

We have audited the financial statements of the governmental activities and each major fund of the West Virginia Department of Transportation, Division of Highways as of and for the year ended June 30, 2006, which collectively comprise the West Virginia Department of Transportation, Division of Highways basic financial statements and have issued our report thereon dated October 13, 2006. 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 West Virginia Department of Transportation, Division of Highways' 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. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the West Virginia Department of Transportation, Division Highways' ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings as items 2006-1 through 2006-5.

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the West Virginia Department of Transportation, Division of Highways' 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and responses as items 2006-2 through 2006-5.

We noted other matters involving the internal control over financial reporting that we have reported to management of the Division in a separate letter dated October 13, 2006.

This report is intended for the information of the audit committee, management of the West Virginia Department of Transportation, Division of Highways and the Joint Committee on Government and Finance.

Suttle & Stalnaker, PLLC

October 13, 2006

2006-1 Information Systems Controls

Criteria: The management of the Division is responsible for establishing and maintaining adequate information systems internal controls. Furthermore, an integral part of an entity's internal control structure is the effective segregation of duties, which involves assigning responsibilities for authorizing transactions, recording transactions and maintaining custody of assets to different individuals, thus reducing the risk of errors or fraud occurring and not being detected.

Condition: The Division operates a wide variety of computer applications, many of which affect federal and state programs' data. During our review of the information systems controls we noted the following:

- Through the West Virginia Information System & Communication Department of the State of West Virginia (IS&C), the Division did have a vulnerability test conducted on all access points from the IS&C systems to the firewall at the Division's system access point. However, the vulnerability test performed did not include a test of the internal network or the wireless networks utilized by the Division. By completing this review, the Division will have assurance that network devices and server platforms are protected from current and emerging threats and vulnerabilities. Furthermore, the Division has not had a code review on all online/e-commerce applications utilized by the Division. Also, there are no policies and procedures in place for conducting periodic vulnerability testing and intrusion testing of the various computer systems maintained by the Division. (Partially noted in prior year)

- Programmers in the Division's Information Services Department have access to production programs in the REMIS system and the Project Record System (PRS). This access grants the Division's Information Services Department personnel the same rights as a business user of the application, which allows them access to data and transaction authority. (Also, partially noted in the prior year)

- The Division's Information Services Department is not notified immediately upon the termination of employees. Lack of notification to the Information Services Department in a timely basis increases the risk of unauthorized access to the information systems and data. Furthermore, the Division maintains several user accounts which are not for specific employees of the Division.

- The Division of Motor Vehicles (DMV) Cash Register System stores user account passwords in clear unencrypted text. Storing passwords in clear, unencrypted text increases the risk that a user account's password could be compromised by another user. (Also, noted in the prior year)

Context: Information systems controls potentially can affect all federal and state programs and are critical to the daily operations of the Division.

Cause: Policies and procedures have not been adequately updated and information system controls may have not been monitored by the Division.

2006-1 Information Systems Controls (Continued)

Effect: Unauthorized use and/or access to critical information systems may occur and not be detected.

Recommendation: We recommend the following:

- The Division should complete a vulnerability assessment of the internal network environment including the related wireless networks. In addition, we recommend that the Division complete a code review on all online/e-commerce applications. Both of these reviews could be conducted under a statewide contract that is currently in place with IS&C. Furthermore, we recommend that the Division develop policies and procedures for conducting periodic vulnerability and intrusion testing of the various computer systems maintained by the Division.

- The Division should remove programmer access from production applications and develop policies and procedures regarding programmer access. If this access is necessary, mitigating controls such as monitoring of programmer access and activities within the production application should be performed and documented.

- The Division should establish policies and procedures to ensure that the Information Services Department is notified immediately of all employee terminations. The Division should also identify and document user accounts not utilized by employees but need within the servers, such as application and system accounts. User accounts deemed as unnecessary should be disabled or removed.

- The Division should contact the vendor of the DMV Cash Register System and request that passwords be encrypted.

Management Response: ***Agree.*** *We recognize and agree with the need for a vulnerability assessment of the internal network. Since last year's audit, we have implemented Enterasys Policy Manager on the DOT computer network. Installation of this product, while not a vulnerability assessment, does provide us with greater control of user access through the implementation of "access policies".*

Concerning a vulnerability assessment, we planned to consult with the Office of Technology about using the statewide contract for this service, determine the costs and present a proposal to the DOT Business Manager for review and approval consideration. However, the State Chief Technology Officer's (CTO) plans to consolidate all state agency networks and support personnel into one agency, Office of Technology, have moved forward. After consolidation, DOT would not be responsible for network operations including vulnerability assessments, intrusion detection and the policies and procedures for these functions. Negotiations continue with the Office of Technology for an agreeable Memorandum of Understanding. The MOU may be signed by 1/1/2007.

2006-1 Information Systems Controls (Continued)

Management Response: (Continued)

The CTO presented a draft Memorandum of Understanding (MOU) for consolidation to the Secretary of Transportation in August 2006 (see attached). The MOU specifies the scope of information security services that will be provided in section 2.2.1. Upon receipt of the MOU, negotiations ensued and once signed; the CTO's plans will be implemented. Once the network is consolidated, DOT will assist the CTO to ensure a secure network is provided.

As stated in prior years, we do not consider the wireless networks referenced to be vulnerable. Wireless use within the DOT network is restricted to only one wireless bridge connecting two point-to-point accesses. These wireless accesses are controlled by MAC addresses only. The DOT network offers no wireless access points or hot spot connections that a hacker could exploit. Again, we will work with the CTO to confirm and ensure that this connection remains secure.

We continue to disagree as to the need to do a code review of all online/ecommerce applications. We still have only one minor e-commerce application (NASCAR plates). This application was rewritten after the previous problem and there have been no known problems since then. Before investing in a code review by the statewide contract vendor, we would strongly consider abandoning this application. Last year there were only 29 transactions. Therefore, we would not be able to justify the expense of a code review service for a system with so few transactions generating so little revenue.

***Agree**. As stated before, Change Management Control is the issue here with the fundamental control being separation of duties that would require splitting our staff and responsibilities into development groups and production groups. We acknowledge this in principle, but maintain that we have an insufficient number of personnel to support this level of work separation.*

We maintain control through supervisor monitoring and end product review prior to implementation. Also, we solicit review and approval by the manager responsible for the specific system for significant programs and changes. Program revisions are only put into production by section supervisors after these review steps are satisfied. Regardless of the level of access afforded our programmers; they are unable to commit DOT funds.

Previously, we agreed to review assigned duties and responsibilities of personnel to determine if functions can be further separated. Also, we agreed to document the processes and controls. We continue our efforts in this area.

***Agree.** We have responded to this recommendation in the past stating that we revoke or remove user access of terminated employees as early as is reasonable. To address the need for immediate notification of all employee terminations, the Director of DOT Human Resources Division issued a memo on October 19, 2006. Since then, both contact persons of Information Services Division have received such notifications and removed the employee's network and systems access. Also, we will incorporate this requirement in the DOT Administrative Procedures. Additionally, employees from certain areas such as Human Resources, Information Services or Finance that have higher risk are certainly prioritized and monitored.*

2006-1	Information Systems Controls (Continued)
Management Response: (Continued)	*Finally, we will identify and document user accounts needed within servers and disable or delete unnecessary accounts. The Division also puts added emphasis on employees that are terminated from areas such as Human Resources, Personnel or Finance.*
	Agree. *DMV's application vendor completed this revision and it is operating live at the Winfield Regional Office. The Director of DMV's Information Services was contacted on November 3, 2006 and he confirmed that these program changes required some adjustments, but they have been operating successfully for a week at the Winfield Regional Office. Statewide implementation of this revision is now planned for November 12, 2006.*

2006-2 Procurement of Architectural and Engineering Services

Criteria: Chapter 5A, Article 8, Section 9 of the West Virginia Code states in part that: "The head of each agency shall make and maintain records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency's activities." Section 157-1-7.3n of the Code of State Rules states in part that: "A written expression of interest made by the consultant indicating his desire to perform a particular project, task or service. This shall include, as a minimum, a current qualification questionnaire, location of where work would be performed, cost accounting information statement…" Section 157-1-7.16 states: "Record Keeping. Unless otherwise noted, all documentation under this procedure will be retained on file at the Division of Highways and would be available for review by the FHWA." Section 154-1-7.4j states "The Selection Committee will review the short list and schedule interviews with each firm. Discussions will be held regarding anticipated concepts and proposed methods of approach to the assignment including those items noted in the qualification and technical analysis, provided that if interviews were conducted concerning qualifications and capabilities prior to or during the selection process, then the committee may in its discretion forego further interviews and discussions." Further section 154-1- 7.4.k states "After scheduled interviews with the short listed consultants, the highest qualified is selected. The remaining consultants will be ranked in order of preference for future use if negotiations fail with the highest rated consultant."

In addition, Section 157-1-7.3bb of the Code of State Rules requires the selection committee for the procurement of architectural and engineering services to consist of the Secretary of Transportation, the Commissioner of Highways, the State Highway Engineer and the next lower level of management below the State Highway Engineer under whose direction the work will be performed.

Condition: We noted the following during our review of documentation related to the procurement of architectural and engineering services:

- For several of the projects reviewed, the reasons for why a vendor was selected and the interviews of consultants were not documented. (Noted in prior year) Specifically, we noted this problem in the following files: S304-40-0.80, S317-98-4.06, T640-64-43.80, T628-BLU/EF-6, T635-470-0.04, S320-77-103.43, S318-77-144, and S335-70-0.02.

Context: Total expenditures for architectural and engineering services were $46.3 million for the year ended June 30, 2006.

Cause: The Division was unable to locate some of the documentation, and policies and procedures of the Division do not clearly specify the documentation which should be maintained.

Effect: The Division was unable to provide supporting documentation related to compliance with the West Virginia State Code.

2006-2 Procurement of Architectural and Engineering Services (Continued)

Recommendation: We recommend that the Division strengthen their policies and procedures regarding required documentation for the procurement of architectural and engineering services and/or seek clarification from the State of West Virginia Legislature regarding the applicable documentation and the related requirements of the West Virginia State Code. We are aware that the Division has developed revised procedures which they believe will address this issue.

Management Response: ***Agree:*** *The West Virginia Division of Highways in conjunction with the Federal Highway Administration has revised Procurement Procedures for Engineering Services. These revisions strengthened our processes and procedures, and are based on the Brooks Act. These procedures provide evaluation factors for preparing the short list. These revisions provide documentation as to how a consultant is selected and provides documentation on interviews that are conducted prior to the final selection being made. The Division of Highways feels the new procedures will address the various issues that auditors have reported.*

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION,
DIVISION OF HIGHWAYS
SCHEDULE OF FINDINGS AND RESPONSES
YEAR ENDED JUNE 30, 2006

2006-3 Evaluation of Consultant's Work

Criteria: Chapter 5A, Article 8, Section 9 of the West Virginia Code states in part that: "The head of each agency shall make and maintain records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency's activities." Further, Section 157-1-7.10 of the code of State Rules states that: "Upon completion or performance termination of the consultant's work, the responsible Division will prepare a report recording its evaluation of the consultant's efforts. A copy shall be sent to the consultant for review and comment and any written comments received shall be attached to the final report. All consultants with active contracts shall be evaluated in March of each year on each active project. On contracts where the final product has been accepted by the Division but the final invoices have not been paid, the consultant will not need to be evaluated…"

Condition: We noted the following during our review of the Division's evaluation of consultants' work:

We found 3 instances of 28 where no interim evaluations were located in file, but a final evaluation was located. The project numbers are S322-32-9.04, S352-250-8.66 00, and S344-9-3.71 00.

We also found 21 instances of 28 where no evaluations were located in the file. The project numbers are T620-P25-0.07, X354-D-0.00 02, U212-220-12.65, X341-125-0.01, S320-61-27.69 00, T615-30-0.17 00, X216-10/10-0.00, U234-19-11.72 02, X354-D-4.73 02, S330-65/5-1.47 00, S306-64-6.28 00, X354-D/2.18 04, S620-64/77-3, U316-220-8.50 00, S323-10-8.99 00, S339-72-1.85 00, X354-D-0.00 02, T631-79-149.39, U319-17-0.43, S320-61-13.10, and S314-127-1.40.

Context: Total expenditures for architectural and engineering services were $46.3 million for the year ended June 30, 2006.

Cause: The Division indicated that evaluations are performed at the preliminary field review, final field review, and final grade review, and that these evaluations may be retained by the project manager in the project files. As of the date of fieldwork, these evaluations had not been provided.

Effect: The Division was unable to provide supporting documentation related to compliance with the West Virginia State Code.

Recommendation: We recommend that the Division strengthen their policies and procedures regarding required documentation for the evaluation of consultants.

Management Response: ***Agree:*** *The finding that consultant evaluations have not been completed as required in the procedures is being addressed. We believe the major issue is that the procedures need to be revised to allow a more appropriate number of evaluations which will then allow them to be more effectively used. Engineering Division has established an internal committee that is currently working on recommendations for these revised procedures. The committee will present their recommendations to WVDOH Management in January 2007. These recommendations will then be discussed with the Consulting Industry and FHWA before final implementation. The target date for completion is April 2007.*

2006-4 Authorization of Overtime Pay

Criteria: The management of the Division is responsible for establishing and maintaining adequate controls related to the approval and authorization of overtime pay for employees of the Division.

Condition: We reviewed overtime paid during the fiscal year ended June 30, 2006 and noted the following:

- The Division does not have adequate policies and procedures for the administration of overtime.
- The Division has not updated the existing policies and procedures and related payroll classifications regarding the new U.S. Department of Labor Standards.
- The Division may not be in full compliance with the provisions set forth by the Department of Labor (DOL) concerning the overtime increment pay.

Context: On April 22, 2005, the Cabinet Secretary issued a memo stating that all non-emergency overtime would need approval from his office. Total overtime expense for fiscal year 2006, 2005 and 2004 was approximately $8,505,000, $14,002,000 and $15,366,000, respectively, a $5,496,000 and $1,364,000 reduction. For a six month period from January to June of each year, the totals were $4,792,000 for 2006, $6,814,000 for 2005 and $8,772,000 for 2004, a $2,022,000 and $1,958,000 reduction, respectively. However, the Division had not analyzed the decrease to determine how much of the decrease was due to the revised process and how much was due to factors such as fewer snow storms, floods, etc.

Cause: Adequate policies and procedures and internal controls may not exist for the approval of overtime compensation.

Effect: Amounts claimed as overtime compensation may be excessive for the tasks performed.

Recommendation: We recommend that the Division continue to review and monitor their policies and procedures for approval and authorization for overtime pay to determine if changes are needed. Furthermore, we recommend that management continue to review overtime paid to determine the appropriateness of the amount charged and the effectiveness of the hours worked. In addition, we recommend that the Division work with the West Virginia Division of Personnel and review their policies and procedures for determining which employees are eligible for overtime and ensure policies and procedures are in compliance with the new Federal overtime laws and regulations. In addition, management should monitor overtime for individuals within the retirement window to ensure that compensation for retirement calculation purposes is not inappropriately inflated. Further, management should work to seek resolution of the overtime increment pay.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION,
DIVISION OF HIGHWAYS
SCHEDULE OF FINDINGS AND RESPONSES
YEAR ENDED JUNE 30, 2006

2006-4 Authorization of Overtime Pay (Continued)

Management Response:

Agree: *The Division of Highways has existing policies for administrating overtime, though the Division is modifying those policies so a better monitoring function can be performed.*

Agree: *The Division will be changing the method of overtime compensation for approximately 200-500 employees effective January 1, 2007. Again, the Division must maintain an efficient and safe highway system. Though we may be changing the method of compensation we did not eliminate compensation as that may not be in the best interest of the traveling public.*

Agree: *As stated in the previous reply, the Division's first concern is the traveling public. Therefore, managerial decision was made about the overtime compensation and that decision was made to serve the traveling public and was not made to pay the minimum amount DOL requires.*

2006-5	Land and Leases
Criteria:	Section 157-2-8 of the West Virginia Code sets forth various requirements regarding land and lease issues. West Virginia Code sections 17-2A-19, 5A-8-9, and 12-2-2 also address various criteria to be followed by the State regarding land and lease issues.
Condition:	We noted several issues relating to land and leases, including the following: • There was not a comprehensive detail of additions and disposals related to land and land improvements for the year provided by the Right of Way Division. Further although the Division has a comprehensive detail list of all land and land improvements, it does not have a process in place to ensure that the listing is reconciled to the general ledger balances. • Leased property was sometimes occupied by the lessee prior to payment or to the execution of the lease agreement. • Lease documents were not filed properly. • There is no system to readily track leases or other property maintained by the Division.
Context:	The total land and land improvements on the financial statement is approximately $20.3 million as of June 30, 2006.
Cause:	Management of the Division has extended authority to the districts and has not maintained controls of the record keeping within the division or at the district locations.
Effect:	The lack of controls and poor record keeping could result in errors, irregularities or abuses that are not detected.
Recommendation:	We recommend that the Division develop policies and procedure to establish sound record keeping and internal controls to address the issues noted above.
Management Response:	***Agree:*** *The Division is continuing the development of a computerized tracking system for property acquisitions. In the interim, Districts are now required to file quarterly reports to allow central office to track acquisitions, sales and leases.* *The Division's new procedure of requiring the first month's rental payment at the time of execution of the lease is working well and eliminates the lessee occupation of the property prior to rental payment.* *A diligent attempt is made to correctly file all documents. However, clerical errors do occur but are not indicative to a deficiency in the existing procedures.*