

WEST VIRGINIA STATE RAIL AUTHORITY
A COMPONENT UNIT OF THE STATE OF WEST VIRGINIA
AND THE WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
FINANCIAL STATEMENTS WITH ADDITIONAL INFORMATION
YEARS ENDED JUNE 30, 2004 AND 2003
AND
INDEPENDENT AUDITORS' REPORT

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	3
MANAGEMENT'S DISCUSSION AND ANALYSIS	5 - 12
FINANCIAL STATEMENTS	
Statements of Net Assets	13
Statements of Revenues, Expenses, and Changes in Fund Net Assets	14
Statements of Cash Flows	15
Notes to the Financial Statements	16
ADDITIONAL INFORMATION	
Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed In Accordance with <i>Government Auditing Standards</i>	25
Schedule of Findings	27

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying basic financial statements of the West Virginia State Rail Authority (the Authority), a component unit of the West Virginia Department of Transportation and the State of West Virginia, as of and for the years ended June 30, 2004 and 2003, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated August 27, 2004, on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 5 through 12 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.

Seattle & Stalraker, PLLC

August 27, 2004

This section of the West Virginia State Rail Authority's (Authority) financial report presents a discussion and analysis of the Authority's financial performance for the fiscal year ended June 30, 2004 compared to the year ended June 30, 2003, and for the year ended June 30, 2003 compared to the year ended June 30, 2002. Please read it in conjunction with the Authority's basic financial statements which follow this section.

FINANCIAL HIGHLIGHTS

- The Authority's net assets increased \$1,701,107 between 2004 and 2003 and \$1,590,559 between 2003 and 2002. This was primarily due to continued appropriations from the Legislature of the State of West Virginia for capital improvements and an increase in freight revenue.
- The Authority's total operating expenses were \$3,508,176 in the fiscal year ended June 30, 2004 compared to \$3,370,877 in the fiscal year ended June 30, 2003 and \$3,352,533 in the fiscal year ended June 30, 2002. This was an increase of \$137,299 from 2003 to 2004 and \$18,344 from 2002 to 2003.
- The total non-operating revenues (expenses) were (\$358,820) in the fiscal year ended June 30, 2004 compared to non-operating revenues (expenses) of (\$387,923) in the fiscal year ended June 30, 2003 and non-operating revenues (expenses) of (\$804,596) in the fiscal year ended June 30, 2002. The decrease in total non-operating revenues (expenses) can be attributed to decreases in interest expense and losses on disposition of assets.
- The Authority completed approximately \$1,600,000 and \$2,800,000 in capital improvements on the South Branch Valley Railroad (SBVR) during the fiscal years ended June 30, 2004 and 2003. Improvements in 2004 included replacing 6.6 miles of light weight rail with heavier continuous welded rail and reconfiguring the track in the Moorefield and Petersburg yards for safer operations and more efficient storage areas. Improvements in 2003 included replacing 25,300 defective crossties, replacing 4.6 miles of light weight rail with heavier continuous welded rail, replacing areas of light jointed rail with heavier jointed rail, and replacing three railroad crossings.
- Two passenger cars were purchased and restored for use on the SBVR during 2004, and three six-axle SD locomotives were purchased for the SBVR during 2003.
- Two acres of property were purchased at the Duffields train station to expand the commuter parking at the Maryland Rail Commuter train (MARC) facility at a cost of \$45,000 during the year ended June 30, 2004.
- Three thousand crossties were replaced on the West Virginia Central Railroad at a total cost of over \$250,000 during 2004, and four thousand five hundred were replaced at a cost of over \$300,000 during 2003.

OVERVIEW OF BASIC FINANCIAL STATEMENTS

The basic financial statements include the statements of net assets; statements of revenues, expenses, and changes in net assets; statements of cash flows; and notes to the financial statements. The notes to the financial statements provide more detailed data concerning the financial condition of the Authority.

FINANCIAL ANALYSIS OF THE AUTHORITY AS A WHOLE

The Authority's budget for the fiscal year ended June 30, 2004 consisted of funds received from the State of West Virginia General Fund, funds from the Governor's Contingency Fund, fund reimbursements from the Federal Emergency Management Agency (FEMA) Public Assistance Program, revenues earned from operating the SBVR, revenues received from the operator of the WVCR per the specifications of the operating agreement, and other miscellaneous revenues received from leases and licenses on its railroad right-of-ways.

The Authority's net assets increased from \$29,586,676 at June 30, 2002 to \$31,177,235 at June 30, 2003 to \$32,878,342 at June 30, 2004. The following tables summarize the financial position and changes in financial position for the years ended June 30, 2004, 2003, and 2002.

Table 1 - Statements of Net Assets

	<u>2004</u>	<u>2003</u>	<u>2002</u>	2004-2003 Increase (Decrease)	2004-2003 Percentage Increase (Decrease)
Current assets					
Cash and cash equivalents	\$ 1,105,161	\$ 1,026,072	\$ 944,054	\$ 79,089	7.7%
Trade receivables	95,432	94,957	41,255	475	.5%
Inventories	64,668	75,284	91,065	(10,616)	-14.1%
Due from other governmental entities	494,265	440,292	1,233,736	53,973	12.3%
Other current assets	<u>13,454</u>	<u>13,000</u>	<u>11,683</u>	<u>454</u>	3.5%
Total current assets	<u>1,772,980</u>	<u>1,649,605</u>	<u>2,321,793</u>	<u>123,375</u>	7.5%
Non current assets					
Capital assets	43,701,421	41,993,347	39,492,077	1,708,074	4.1%
Accumulated depreciation	<u>(10,208,458)</u>	<u>(9,343,547)</u>	<u>(8,969,435)</u>	<u>(864,911)</u>	9.3%
Total non-current assets	<u>33,492,963</u>	<u>32,649,800</u>	<u>30,522,642</u>	<u>843,163</u>	2.6%
Total assets	<u>35,265,943</u>	<u>34,299,405</u>	<u>32,844,435</u>	<u>966,538</u>	2.8%
Current liabilities	1,038,562	1,407,785	1,199,169	(369,223)	-26.2%
Long-term debt	1,223,338	1,585,004	1,921,670	(361,666)	-22.8%
Other non-current liabilities	<u>125,701</u>	<u>129,381</u>	<u>136,920</u>	<u>(3,680)</u>	-2.8%
Total liabilities	<u>2,387,601</u>	<u>3,122,170</u>	<u>3,257,759</u>	<u>(734,569)</u>	-23.5%
Net assets					
Invested in capital assets not debt related	31,907,959	30,728,130	28,284,306	1,179,829	3.8%
Unrestricted	<u>970,383</u>	<u>449,105</u>	<u>1,302,370</u>	<u>521,278</u>	116.1%
Total net assets	<u>\$ 32,878,342</u>	<u>\$ 31,177,235</u>	<u>\$ 29,586,676</u>	<u>\$ 1,701,107</u>	5.5%

WEST VIRGINIA STATE RAIL AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS

7

Table 2 - Statements of Revenues

	2004	2003	2002	2004-2003 Increase (Decrease)	2004-2003 Percentage Increase (Decrease)
Operating revenues					
Freight	\$ 1,772,761	\$ 1,717,117	\$ 1,538,689	\$ 55,644	3.2%
Miscellaneous	<u>150,322</u>	<u>180,723</u>	<u>162,265</u>	<u>(30,401)</u>	-16.8%
Total operating revenues	<u>1,923,083</u>	<u>1,897,840</u>	<u>1,700,954</u>	<u>25,243</u>	1.3%
Depreciation expense	1,137,009	1,098,127	1,298,641	38,882	3.5%
Other operating expenses	<u>2,371,167</u>	<u>2,272,750</u>	<u>2,053,892</u>	<u>98,417</u>	4.3%
Total operating expenses	<u>3,508,176</u>	<u>3,370,877</u>	<u>3,352,533</u>	<u>137,299</u>	4.1%
Operating income (loss)	<u>(1,585,093)</u>	<u>(1,473,037)</u>	<u>(1,651,579)</u>	<u>(112,056)</u>	-7.6%
Nonoperating revenues (expenses)					
Interest income	7,656	11,061	13,563	(3,405)	-30.8%
Interest expense	(111,420)	(135,520)	(154,083)	24,100	-17.8%
Federal assistance	76,412	90,625	287,046	(14,213)	-15.7%
Gain (loss) on disposition of assets	(331,468)	(354,089)	(962,884)	22,621	-6.4%
Other	<u>-</u>	<u>-</u>	<u>11,762</u>	<u>-</u>	
Total nonoperating revenues (expenses)	<u>(358,820)</u>	<u>(387,923)</u>	<u>(804,596)</u>	<u>29,103</u>	7.5%
Income (loss) before other revenues, expenses, gains or losses	(1,943,913)	(1,860,960)	(2,456,175)	(82,953)	-4.5%
Forgiveness of debt	<u>259,570</u>	<u>-</u>	<u>-</u>	<u>259,570</u>	100.0%
Income (loss) before transfers	(1,684,343)	(1,860,960)	(2,456,175)	176,617	9.5%
Transfers in	<u>3,385,450</u>	<u>3,451,519</u>	<u>3,995,081</u>	<u>(66,069)</u>	-1.9%
Change in net assets	1,701,107	1,590,559	1,538,906	110,548	7.0%
Total net assets - beginning	<u>31,177,235</u>	<u>29,586,676</u>	<u>28,047,770</u>	<u>1,590,559</u>	5.4%
Total net assets - ending	<u>\$32,878,342</u>	<u>\$31,177,235</u>	<u>\$29,586,676</u>	<u>\$ 1,701,107</u>	5.5%

The Authority received \$3,400,000 from the general fund appropriations from the State of West Virginia during the fiscal year ended June 30, 2004. This money was used for the capital improvement projects on the SBVR, numerous maintenance projects on the WVCB, wages/benefits and office expenses for the operations of the Authority, and upkeep of the MARC commuter train stations in the eastern panhandle. The decrease in liabilities was attributable mainly to a decrease in long-term debt. Furthermore, net assets increased primarily due to the numerous capital projects that were completed during the fiscal years ended June 30, 2004 and 2003.

During the year ended June 30, 2004, the Authority earned approximately \$1,800,000 from the operations of the SBVR and approximately \$150,000 from miscellaneous operating revenues. These revenues were used to pay the operating expenses of the SBVR. When compared to the previous year, these revenues increased 1.3% in the fiscal year ended June 30, 2004 and 11% in the fiscal year ended June 30, 2003.

The Authority also received \$75,000 during the year ended June 30, 2004 from the Governor's Contingency Fund. This was used to begin rehabilitation on the unopened section of the WVCR.

The Authority received \$76,412 during the year ended June 30, 2004 from FEMA for reimbursement of flood expenses on the South Branch Valley Railroad and the Deckers Creek portion of the Caperton Trail.

Operating expenses increased \$137,299 during the year ended June 30, 2004 compared to the fiscal year ended June 30, 2003 and \$18,344 during the year ended June 30, 2003 compared to the fiscal year ended June 30, 2002. The significant growth in operating expenses during the year ended June 30, 2004 came primarily from increases in car-hire and diesel fuel expenses and higher Board of Risk and Insurance Management insurance rates. Operating revenues increased \$25,243 in the fiscal year ended June 30, 2004 compared to the year ended June 30, 2003. This resulted in an overall increase in operating loss of \$112,056 for the year ended June 30, 2004.

Non-operating expenses decreased during the year ended June 30, 2004 by \$29,103 compared to the fiscal year ended June 30, 2003. Non-operating expenses decreased by \$416,673 during the fiscal year ended June 30, 2003 compared to the fiscal year ended June 30, 2002. This was attributable mainly to an increase in other revenues.

Chart 1 - Funding Breakdown - Year Ended June 30, 2004

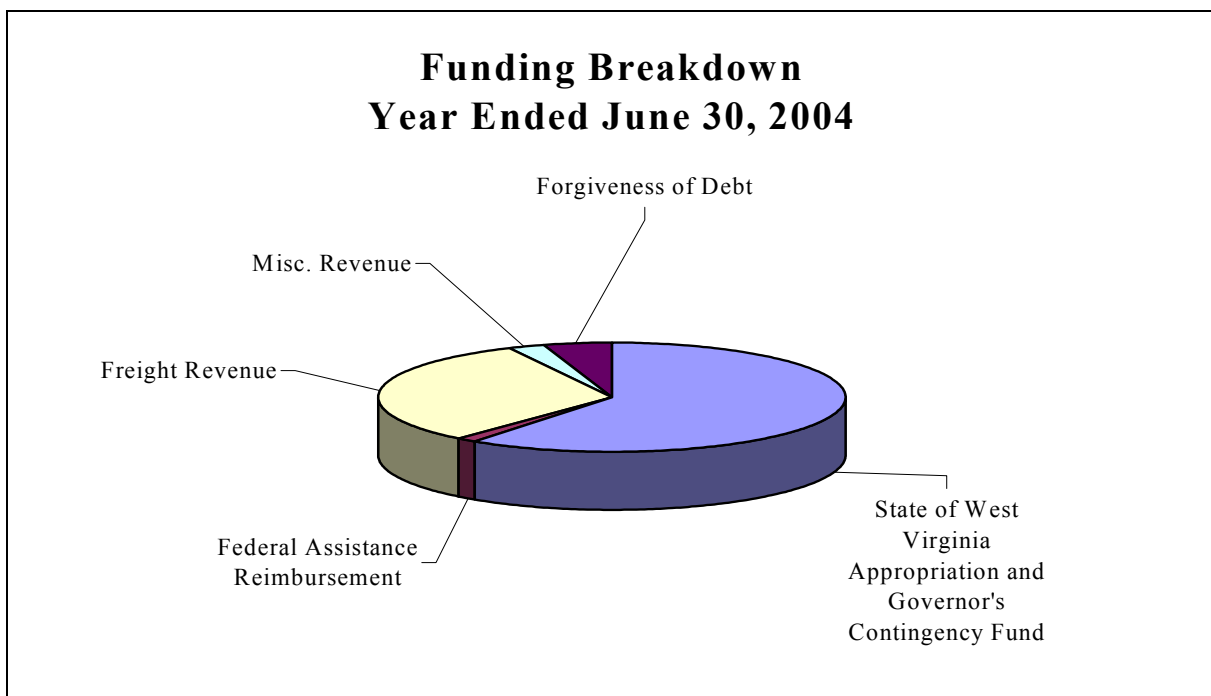
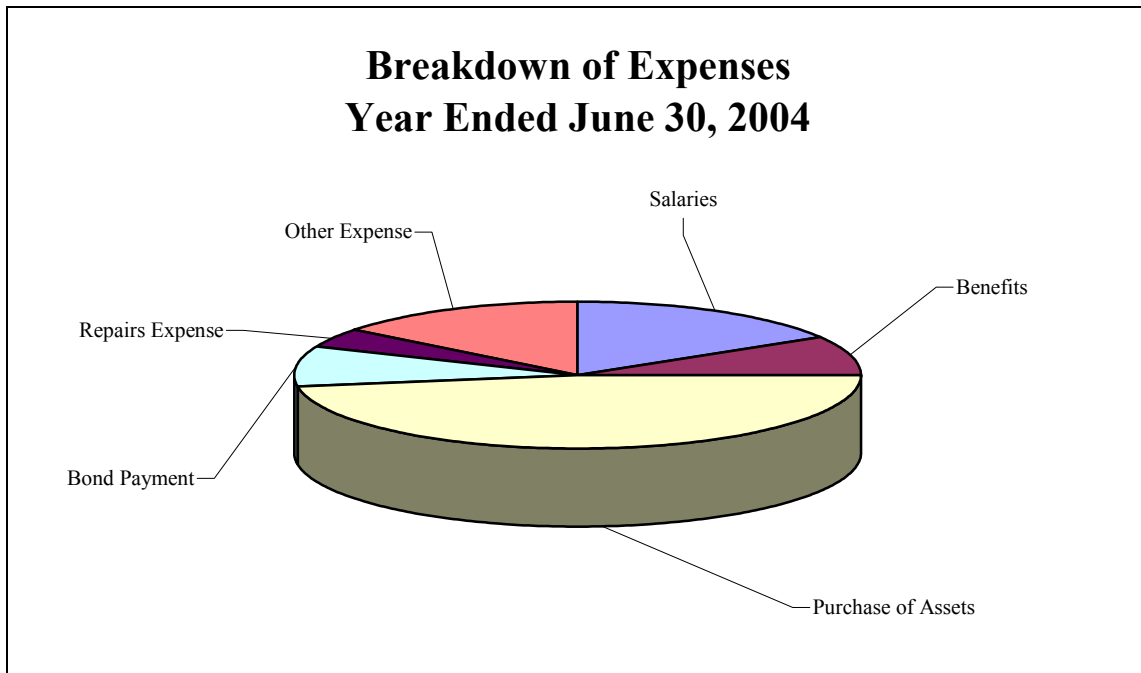


Chart 2 - Expenses Breakdown - Year Ended June 30, 2004



CAPITAL ASSET AND DEBT ADMINISTRATION

CAPITAL ASSETS

At June 30, 2004, the Authority had invested \$43,701,421 in a broad range of capital assets (see table below). This amount represents an increase of \$1,708,074 or 4.1% over the previous year.

Table 3 - Capital Assets

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>
Land	\$ 4,790,588	\$ 45,000	\$ -	\$ 4,835,588
Rail properties	36,014,532	2,294,288	683,216	37,625,604
Transportation and other equipment	731,765	52,002	-	783,767
Office building and equipment	<u>456,462</u>		<u>-</u>	<u>456,462</u>
Total	<u>\$ 41,993,347</u>	<u>\$ 2,391,290</u>	<u>\$ 683,216</u>	<u>\$ 43,701,421</u>

Major capital additions for the year ended June 30, 2003 were in the rail properties category for the replacement of defective cross-ties, replacement of lightweight rail with heavier continuous welded rail, replacement of light jointed rail with heavier jointed rail and the replacement of three railroad crossings.

Major capital asset additions for the year ended June 30, 2004 were in the rail properties category with a few additions to transportation equipment and land, and are further described below.

- A total of \$2,294,288 was added to the rail properties category and \$683,216 was deleted from rail properties, \$45,000 was added to the land category and \$52,002 was added to transportation equipment. Total related accumulated depreciation on deleted properties was approximately \$272,098.
- 6.6 miles of continuous welded rail was installed at a cost of \$1,211,312.
- Track realignment in the Petersburg yard and track upgrade work in the Moorefield yard were performed at a cost of \$363,813.
- Hot Start Systems were installed on three six-axle SD locomotives at a cost of \$24,525.
- Two passenger cars were purchased and restored for use on the SBVR at a cost of \$295,235.
- Power assemblies were installed on three locomotives at a cost of \$81,360.
- A new set of combos was installed on a locomotive at a cost of \$31,164.
- 3,000 defective crossties were replaced and the line surfaced on the WVCR at a cost of \$252,000.
- Two new transportation vehicles were purchased at a total cost of \$41,315
- A new lifting magnet was purchased for maintenance of way use at a cost of \$10,690.
- Two acres of land were purchased at Duffields train depot at a cost of \$45,000.

LONG TERM DEBT

With the 1992 expansion of the Wampler-Longacre feedmill in Hardy County, the traffic on the SBVR doubled. The increase in traffic required the SBVR to replace over 11 miles of rail, resurface 42 miles of track, build a 40-car siding at the Wampler feedmill in Moorefield, rebuild two grade crossings, and replace one bridge. To afford all of these improvements, the Authority sold \$4,000,000 of Commercial Development Revenue Bonds. The debt schedule on these bonds runs through July 2007. During the years ended June 30, 2004 and 2003, \$453,820 and \$454,220 of debt service expenditures were paid from the revenues received from the operation of the SBVR. The following table shows the remaining debt service expenditures, all of which will be paid from the freight revenue.

Table 4 - Debt Schedule

Year ending June 30	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
	\$456,420	\$456,925	\$455,285	\$456,450

The rehabilitation of the SBVR is planned to be completed in June of 2007. This will result in much lower requests for funding from the State of West Virginia. In addition, the final bond debt payment will be in July of 2007. This will enhance the cash flow by approximately \$450,000 a year, which will be used toward the operation of the SBVR.

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

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The SBVR's track structure has improved greatly over the past five years. By establishing a long term capital improvement program and sticking to the basic plan, the Authority has been able to increase the weight allowance from Green Spring to Moorefield to 286,000 pounds per railcar. Track also has been made safer, resulting in fewer derailments. Due to the improvement of the track structure, operating speeds on the SBVR have increased. This has allowed the rail line to successfully move a 65-car unit train from Green Spring to the Pilgrim's Pride feed mill, have the car unloaded, and return it to CSX Transportation (CSXT) within 36 hours. This process, which was negotiated with CSXT and Pilgrim's Pride, brings the SBVR more revenue per car and allows the customer to receive better shipping rates from CSXT. This is a win-win situation for all parties, and since Pilgrim's Pride is the largest employer in the valley, it is a plus for the local economy. The SBVR is integral to the economic success of the area so it is important that the Authority continues to upgrade its infrastructure and not allow the track to deteriorate as it had in the past. The SBVR capital improvements planned for the fiscal year ending June 30, 2005 include tie replacement, bridge replacement and repair, adding ballast, and surfacing.

The Authority's fiscal year 2005 budget includes \$3,367,221 from the State of West Virginia and \$2,017,185 from freight revenue. This funding will be used to continue the long-term rehabilitation projects started on the SBVR in fiscal year 2000 and maintain the WVCR. The capital improvement projects planned on the WVCR for the fiscal year ending June 30, 2005 include tie replacement and culvert replacement. This railroad has completed five years of operations and continues to be a strong economic factor in the areas that it serves. The ridership on the tourist excursions on the WCVR grew from 19,709 in fiscal 2002 to 29,212 in fiscal 2003 to 32,732 in fiscal 2004.

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

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide the Authority's taxpayers, customers, investors, and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. If you have questions about this report or need additional information, contact the Authority at 120 Water Plant Drive, Moorefield, West Virginia, 26836.

WEST VIRGINIA STATE RAIL AUTHORITY
STATEMENTS OF NET ASSETS
JUNE 30, 2004 AND 2003

ASSETS	<u>2004</u>	<u>2003</u>
Current assets		
Cash and cash equivalents	\$ 572,432	\$ 508,343
Restricted cash and cash equivalents	532,729	517,729
Total cash and cash equivalents	<u>1,105,161</u>	<u>1,026,072</u>
Trade receivables	95,432	94,957
Inventories	64,668	75,284
Due from other governmental entities	494,265	440,292
Other current assets	<u>13,454</u>	<u>13,000</u>
Total current assets	<u>1,772,980</u>	<u>1,649,605</u>
Noncurrent assets		
Capital assets	43,701,421	41,993,347
Accumulated depreciation	<u>(10,208,458)</u>	<u>(9,343,547)</u>
Total noncurrent assets	<u>33,492,963</u>	<u>32,649,800</u>
Total assets	<u>35,265,943</u>	<u>34,299,405</u>
LIABILITIES		
Current liabilities		
Accounts payable	363,973	444,588
Accrued expenses	117,133	130,089
Compensated absences	56,877	65,426
Due to other governmental entities	138,913	431,016
Current maturities of long-term debt	<u>361,666</u>	<u>336,666</u>
Total current liabilities	<u>1,038,562</u>	<u>1,407,785</u>
Noncurrent liabilities		
Long-term debt	1,223,338	1,585,004
Compensated absences	<u>125,701</u>	<u>129,381</u>
Total noncurrent liabilities	<u>1,349,039</u>	<u>1,714,385</u>
Total liabilities	<u>2,387,601</u>	<u>3,122,170</u>
NET ASSETS		
Invested in capital assets, net of related debt	31,907,959	30,728,130
Unrestricted	<u>970,383</u>	<u>449,105</u>
Total net assets	<u>\$ 32,878,342</u>	<u>\$ 31,177,235</u>

The Accompanying Notes Are An Integral
Part Of These Financial Statements

WEST VIRGINIA STATE RAIL AUTHORITY
 STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
 YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
Operating revenues		
Freight	\$ 1,772,761	\$ 1,717,117
Miscellaneous	150,322	180,723
Total operating revenues	1,923,083	1,897,840
Depreciation Expense	1,137,009	1,098,127
Other operating expenses	2,371,167	2,272,750
Total operating expenses	3,508,176	3,370,877
Operating income (loss)	(1,585,093)	(1,473,037)
Nonoperating revenues (expenses)		
Interest income	7,656	11,061
Interest expense	(111,420)	(135,520)
Federal assistance	76,412	90,625
Gain (loss) on disposition of assets	(331,468)	(354,089)
Total nonoperating revenues (expenses)	(358,820)	(387,923)
Income (loss) before other revenues, expenses, gains or losses	(1,943,913)	(1,860,960)
Forgiveness of debt	259,570	-
Income (loss) before transfers	(1,684,343)	(1,860,960)
Transfers in	3,385,450	3,451,519
Change in net assets	1,701,107	1,590,559
Total net assets - beginning	31,177,235	29,586,676
Total net assets - ending	\$ 32,878,342	\$ 31,177,235

The Accompanying Notes Are An Integral
 Part Of These Financial Statements

WEST VIRGINIA STATE RAIL AUTHORITY
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2004 AND 2003

15

	2004	2003
Cash flows from operating activities		
Cash received from customers and government	\$ 1,922,607	\$ 1,843,771
Cash paid to employees	(805,419)	(720,905)
Cash paid to suppliers and government	(1,710,585)	(1,318,741)
Net cash provided (used) by operating activities	(593,397)	(195,875)
Cash flows from noncapital financing activities		
Cash received from State of West Virginia operating assistance	3,411,128	4,244,963
Net cash provided (used) by noncapital financing activities	3,411,128	4,244,963
Cash flows from capital and related financing activities		
Federal assistance cash receipts	76,412	90,625
Cash purchases of capital assets	(2,391,290)	(3,633,236)
Interest paid on long term debt	(111,420)	(135,520)
Principal paid on long term debt	(320,000)	(300,000)
Net cash provided (used) by capital and related financing activities	(2,746,298)	(3,978,131)
Cash flows from investing activities		
Receipts of interest	7,656	11,061
Net cash provided (used) by investing activities	7,656	11,061
Increase (decrease) in cash and cash equivalents	79,089	82,018
Cash and cash equivalents, beginning of year, including restricted cash	1,026,072	944,054
Cash and cash equivalents, end of year, including restricted cash	\$ 1,105,161	\$ 1,026,072
Reconciliation of operating income to net cash provided (used) by operating activities		
Operating loss	\$ (1,585,093)	\$ (1,473,037)
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	1,137,009	1,098,127
Amortization	(16,666)	(16,666)
Changes in operating assets and liabilities		
(Increase) decrease in trade receivables	(476)	(53,702)
(Increase) decrease in inventories	10,616	15,781
(Increase) decrease in other current assets	(454)	(1,317)
Increase (decrease) in operating accounts payable	(80,615)	218,387
Increase (decrease) in accrued expenses	(12,956)	12,139
Increase (decrease) in deferred revenue	-	(367)
Increase (decrease) in compensated absences	(12,229)	(4,642)
Increase (decrease) in due to other governmental entities	(32,533)	9,422
Net cash provided (used) by operating activities	\$ (593,397)	\$ (195,875)
Noncash transactions		
Forgiveness of debt	\$ 259,570	\$ -

The Accompanying Notes Are An Integral
Part Of These Financial Statements

NOTE 1 - DESCRIPTION OF ORGANIZATION AND FINANCIAL REPORTING ENTITY

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

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

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

CASH AND CASH EQUIVALENTS - Cash and cash equivalents include short-term investments with original maturities of 90 days or less. Cash and cash equivalents principally consist of amounts on deposit in the State Treasurer's Office (STO) that are pooled funds managed by the West Virginia Investment Management Board (IMB). In addition, the Authority makes interest-earning deposits in certain investment pools maintained by IMB that are available to the Authority with overnight notice. Interest income from these investments is prorated to the Authority at rates specified by IMB based on the balance of the Authority's deposits maintained in relation to the total deposits of all state agencies participating in the pool. Because these deposits are held in the IMB investment pools, no other disclosures related to safekeeping, credit or market risk are required. However, market risk exists as the value of the investment pools' underlying investment assets may decline because of an increase in interest rates or a decline in stock prices. The carrying value of the deposits reflected in the financial statements approximates fair value and approximates the value of the shares in the external investment pool.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

RESTRICTED CASH AND CASH EQUIVALENTS - Restricted cash and cash equivalents of \$532,729 and \$517,729, at June 30, 2004 and 2003 respectively, are invested in a U.S. Government securities money market mutual fund reported at fair value. The carrying amounts of these deposits do not differ materially from the bank balance of these deposits at June 30. These deposits are subject to the terms of a loan agreement and bond covenants, which restrict the deposits to resources accumulated for debt service payments.

The Authority's balances invested in money market mutual funds are not subject to categorization under the provisions of Statement No. 3 of the Governmental Accounting Standards Board.

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

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

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

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

INVESTMENT IN CAPITAL ASSETS, NET OF RELATED DEBT - This component of net assets consists primarily of capital assets, including restricted capital assets (if any), net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

RESTRICTED NET ASSETS - Restricted net assets are assets whose use or availability has been restricted and the restrictions limit the Authority's ability to use the resources to pay current liabilities. When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first, then unrestricted resources as needed. For the years ended June 30, 2004 and 2003, there were no restricted net assets.

WEST VIRGINIA STATE RAIL AUTHORITY
 NOTES TO THE FINANCIAL STATEMENTS
 YEARS ENDED JUNE 30, 2004 AND 2003

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

NOTE 3 - CAPITAL ASSETS

Capital assets balances and the activity for the years ended June 30, 2003, and 2004 are summarized below:

	June 30,2003			June 30,2004
	<u>Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u>
Capital assets				
Land	\$ 4,790,588	\$ 45,000	\$ -	\$ 4,835,588
Rail properties	36,014,532	2,294,288	683,216	37,625,604
Transportation and other equipment	731,765	52,002	-	783,767
Office building and equipment	<u>456,462</u>	<u>-</u>	<u>-</u>	<u>456,462</u>
Total capital assets	<u>\$ 41,993,347</u>	<u>\$ 2,391,290</u>	<u>\$ 683,216</u>	<u>\$ 43,701,421</u>
Accumulated depreciation				
Rail properties	\$ 8,598,448	\$ 1,076,556	\$ 272,098	\$ 9,402,906
Transportation and other equipment	466,835	47,092	-	513,927
Office building and equipment	<u>278,264</u>	<u>13,361</u>	<u>-</u>	<u>291,625</u>
Total accumulated depreciation	<u>\$ 9,343,547</u>	<u>\$ 1,137,009</u>	<u>\$ 272,098</u>	<u>\$ 10,208,458</u>
	June 30,2002			June 30,2003
	<u>Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u>
Capital assets				
Land	\$ 4,790,588	\$ -	\$ -	\$ 4,790,588
Rail properties	33,302,310	3,610,994	898,772	36,014,532
Transportation and other equipment	899,432	-	167,667	731,765
Office building and equipment	<u>499,747</u>	<u>-</u>	<u>43,285</u>	<u>456,462</u>
Total capital assets	<u>\$ 39,492,077</u>	<u>\$ 3,610,994</u>	<u>\$ 1,109,724</u>	<u>\$ 41,993,347</u>
Accumulated depreciation				
Rail properties	\$ 8,083,640	\$ 1,027,877	\$ 513,069	\$ 8,598,448
Transportation and other equipment	579,658	54,845	167,668	466,835
Office building and equipment	<u>306,137</u>	<u>15,405</u>	<u>43,278</u>	<u>278,264</u>
Total accumulated depreciation	<u>\$ 8,969,435</u>	<u>\$ 1,098,127</u>	<u>\$ 724,015</u>	<u>\$ 9,343,547</u>

WEST VIRGINIA STATE RAIL AUTHORITY
 NOTES TO THE FINANCIAL STATEMENTS
 YEARS ENDED JUNE 30, 2004 AND 2003

NOTE 4 - LONG-TERM DEBT

Long-term debt consists of notes payable to the County Commissions of Hardy County and Hampshire County, West Virginia, payable in monthly installments ranging from \$37,852 to \$37,748, including interest ranging from 6.7% to 7.4%, with the final payment due July 2007. In July 1998, in consideration of a one-time payment in the amount of \$150,000, the Authority agreed to surrender its right to redeem the notes in accordance with the original trust indenture. This payment is recorded as a premium on the notes payable and is being amortized over the life of the notes, offsetting the related interest expense, using the straight-line method. At June 30, 2004 and 2003, the Authority's premium on notes payable was \$50,004 and \$66,670, respectively, and amortization expense related to the premium was \$16,666 per year. The notes are secured by gross operating receipts of the Authority, excluding any transfers from the State of West Virginia.

Total notes payable at June 30, 2003		\$	1,921,670
Less principle retirement			(320,000)
Less amortization of premium			<u>(16,666)</u>
Total notes payable at June 30, 2004			1,585,004
Less current portion			<u>(361,666)</u>
Long-term notes payable		\$	<u><u>1,223,338</u></u>

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

Year ending <u>June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 345,000	\$ 111,420	\$ 456,420
2006	370,000	86,925	456,925
2007	395,000	60,285	455,285
2008	<u>425,000</u>	<u>31,450</u>	<u>456,450</u>
	1,535,000	290,080	1,825,080
Premium	50,004	-	50,004
Amortization of premium	<u>-</u>	<u>(50,004)</u>	<u>(50,004)</u>
	<u>\$ 1,585,004</u>	<u>\$ 240,076</u>	<u>\$ 1,825,080</u>

NOTE 5 - DUE TO/FROM OTHER GOVERNMENTAL ENTITIES

At June 30, 2004 and 2003, the Authority had amounts due to the Department of Transportation, Division of Highways of \$138,913 and \$431,016, respectively. During the year ended June 30, 2004, the West Virginia Department of Transportation, Division of Highways forgave \$259,570 of disputed debt that the Authority had previously recognized as expense and due to other governments. At June 30, 2004 and 2003, the Authority had amounts due from the State of West Virginia of \$494,265 and \$440,292, respectively.

NOTE 6 - SIGNIFICANT CUSTOMERS AND FUNDING SOURCES

During the years ended June 30, 2004 and 2003, approximately 93% and 94%, respectively, of the Authority's freight traffic was attributable to a single customer. In addition, during the years ended June 30, 2004 and 2003, the Authority received transfers of \$3,385,450 and \$3,451,519, respectively, in appropriated funds from the State of West Virginia. A significant decrease in this assistance would have a significant effect on the operations of the Authority.

NOTE 7 - RISK MANAGEMENT

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

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

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

NOTE 8 - RETIREMENT PLAN

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

FUNDING POLICY - The PERS funding policy has been established by action of the State Legislature. State statute requires that plan participants contribute 4.5% of compensation. The current combined contribution rate is 15% of annual covered payroll, including the Authority's contribution of 10.5% which is established by PERS. The Authority's contributions to PERS for the years ending June 30, 2004, 2003 and 2002 were \$79,495, \$69,627 and \$66,516, respectively, equal to the required contributions for each year.

NOTE 9 - POST EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

Upon retirement, an employee may apply unused sick leave or annual leave, or both to reduce their future insurance premiums paid to the Public Employees Insurance Agency or to obtain a greater benefit under PERS. The estimated liability for sick leave postretirement benefits approximating \$125,701, \$129,381, and \$136,920 as of June 30, 2004, 2003, and 2002, respectively, is included in noncurrent liabilities in the statements of net assets.

During the years ended June 30, 2004 and 2003, the Authority did not disburse any benefits from the liability balances discussed above to fund health insurance premiums for its retirees who had elected to use their accumulated leave time for health coverage.

ADDITIONAL INFORMATION

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

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

We have audited the financial statements of the West Virginia State Rail Authority (the Authority) as of and for the year ended June 30, 2004, and have issued our report thereon dated August 27, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

Compliance and Other Matters

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

We noted certain matters that we reported to management of the Authority in a separate letter dated August 27, 2004.

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

Suttle & Stalrock, PLLC

August 27, 2004

WEST VIRGINIA STATE RAIL AUTHORITY
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2004

None