

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

**AUDITED FINANCIAL STATEMENTS
WITH ADDITIONAL INFORMATION**

**YEAR ENDED JUNE 30, 2003
AND
INDEPENDENT AUDITORS' REPORTS**

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INDEPENDENT AUDITORS' REPORT

To the Secretary
West Virginia Department of Transportation

We have audited the accompanying financial statements of the governmental activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the West Virginia Department of Transportation, as of and for the year ended June 30, 2003, which collectively comprise the West Virginia Department of Transportation's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the West Virginia Department of Transportation's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Parkways, Economic Development and Tourism Authority, a discretely presented component unit. Those statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to amounts included for the Parkways, Economic Development and Tourism Authority is based solely on the report of the other auditors.

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

As discussed in Note 1, the financial statements of the West Virginia Department of Transportation are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the West Virginia Department of Transportation of the State of West Virginia that is attributable to the transactions of the West Virginia Department of Transportation. They do not purport to, and do not, present fairly, the financial position of the State of West Virginia as of June 30, 2003 and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the West Virginia Department of Transportation, as of June 30, 2003, and the respective changes in financial position thereof and the respective budgetary comparison for the State Road Fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 5 through 15 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 31, 2003 on our consideration of the West Virginia Department of Transportation's internal control over financial reporting and our tests of its compliance with certain provisions of law, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the West Virginia Department of Transportation's basic financial statements. The combining and individual nonmajor fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Suttie & Stalner, PLLC

October 31, 2003

MANAGEMENT'S DISCUSSION AND ANALYSIS

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION,
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2003

This section of the West Virginia Department of Transportation (Department) annual financial report presents our discussion and analysis of the Department's financial performance during the fiscal year that ended June 30, 2003. 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 Department's financial statements, which immediately follow this section.

During the current year it was determined that an undercapitalization of infrastructure assets had occurred in the initial implementation of the provisions of GASB Statement 34 *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. Certain projects that met the capitalization criteria were excluded from Work in Progress and other projects that were completed were not properly capitalized into infrastructure. This undercapitalization of infrastructure assets affected only the government-wide financial statements. There was no impact on the fund or budgetary comparison financial statements for the year ended June 30, 2002. Applicable prior year amounts included in this section reflect the restated amounts. In addition, it was determined that certain amounts previously recorded for rail properties had been disposed of over a period of years due to capital improvement projects undertaken by the Department. The effect of the removal of these assets from the records of the Department's financial statements impact only the amounts reported for the State Rail Authority, a discretely presented component unit.

FINANCIAL HIGHLIGHTS - PRIMARY GOVERNMENT

Net Assets - The Department's total combined net assets related to its governmental activities increased by \$217 million, 3.86%, between fiscal year 2002 and 2003.

Changes in Net Assets - During the year the Division's expenses were \$217 million less than the \$1,010 million generated in revenues for governmental activities. This is a decline compared to the prior year, when expenses were \$226 million less than revenues.

Revenues and Expenses - Total revenues decreased by \$40 million or 3.80%. Total expenses decreased \$32 million or 3.82%. There were no significant changes in the programs carried out by the Department during the year.

Governmental Funds - Fund Balances - As of the close of fiscal year 2003, the Department's governmental funds reported combined total fund equity of \$214 million, a decrease of \$43 million in comparison to the prior year. Of this total amount, \$154 million represents the "unreserved fund balances" with substantially all being in the general fund. This is approximately 14.64 % of the total governmental fund expenditures for the year.

Long-term Debt - The Department's total long-term debt obligations, net of bond premiums, decreased by \$22 million (4.08%) during the current fiscal year. There were no new bond offerings during the year and principal payments reduced outstanding debt.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The basic financial statements include the following:

- Management's Discussion and Analysis (MD&A), this section
- Basic financial Statements which include:
 - Two kinds of financial statements that present different views of the Department - the Government-Wide Financial Statements and the Fund Financial Statements.
 - The Notes to the Financial Statements that explain some of the information in the financial statements and provide more detail.

Government-wide Statements

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

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION,
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2003

Fund Financial Statements

The fund financial statements focus on the individual parts of the Department, excluding discretely presented component units, reporting the Department'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 Department 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.

Refer to Note 1 to the financial statements for more detailed information on the elements of the financial statements. The following Table summarizes the major features of the basic financial statements:

Major Features of the Basic Financial Statements

	Government-wide Financial Statements	Fund Financial Statements
Scope	Entire Department	Activities of the Department excluding discretely presented component units
Required financial statements	<ul style="list-style-type: none"> • Statement of net assets • Statement of activities 	<ul style="list-style-type: none"> • Balance sheet • Statement of revenues, expenditures, and changes in fund balances
Accounting basis and measurement focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus
Type of asset/liability information	All assets and liabilities, both financial and capital, and short-term and long-term	Only assets expected to be used up and liabilities that come due during the year or soon thereafter; no capital assets or long-term debt included
Type of inflow/outflow information	All revenues and expenses during the year, regardless of when cash is received or paid	<ul style="list-style-type: none"> • Revenues for which cash is received during or soon after the end of the year • Expenditures when goods or services have been received and payment is due during the year or soon thereafter.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION,
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2003

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 Department's net assets as of June 30, 2003 and 2002 (amounts in thousands).

Net Assets as of June 30

	<u>2003</u>	<u>2002</u>	<u>% Change</u>
Total current assets	\$ 301,618	\$ 381,013	(20.83%)
Capital assets, net of accumulated depreciation	6,246,206	6,000,421	4.10%
Other non-current assets	<u>6,610</u>	<u>5,645</u>	17.09%
Total assets	<u>6,554,434</u>	<u>6,387,079</u>	2.62%
Current liabilities	131,212	165,757	(20.84%)
Long term liabilities	<u>567,237</u>	<u>582,746</u>	(2.66%)
Total liabilities	<u>698,449</u>	<u>748,503</u>	(6.69%)
Invested in capital assets, net of related debt	5,756,415	5,540,273	3.90%
Unrestricted	<u>99,570</u>	<u>98,303</u>	1.29%
Total net assets	<u>\$ 5,855,985</u>	<u>\$ 5,638,576</u>	3.86%

The largest component (98.30%) of the Department'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 Department 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, unrestricted net assets, may be used at the Department's discretion.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION,
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2003

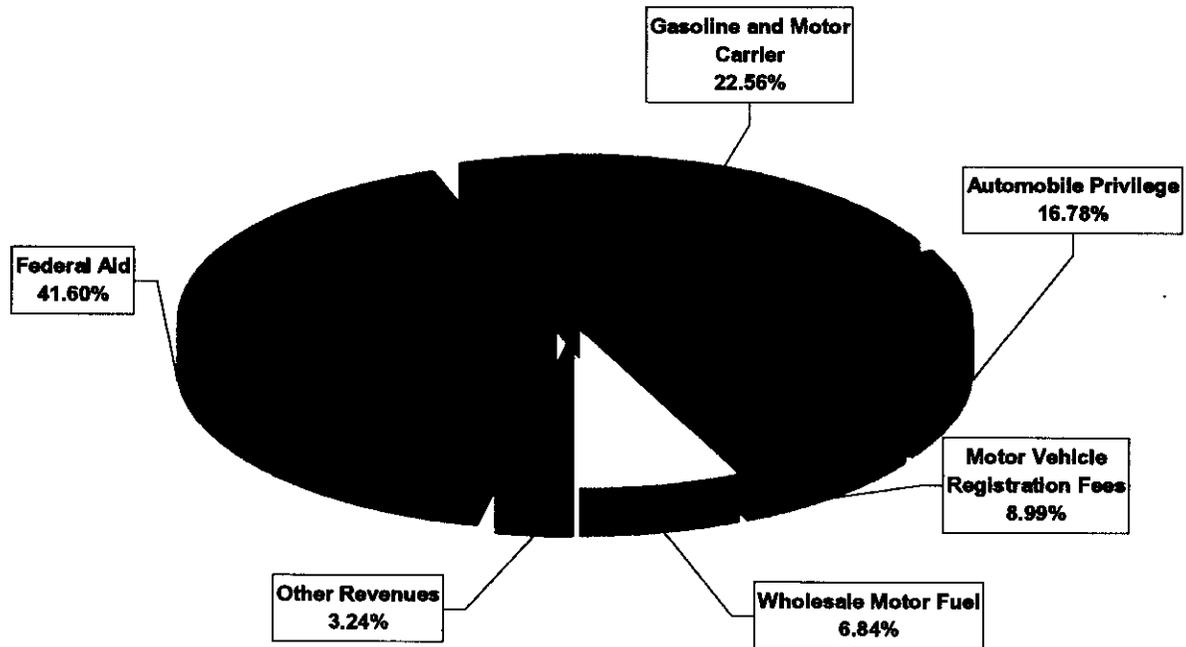
Condensed Statement of Activities

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

	<u>2003</u>	<u>2002</u>	<u>% Change</u>
Revenues			
Taxes	\$ 466,771	\$ 481,920	(3.14%)
Licenses, fees and permits	90,802	90,942	(.15%)
Investment and interest income	3,666	8,173	(55.14%)
Payments from primary government	3,527	2,965	18.95%
Miscellaneous revenues	<u>19,155</u>	<u>15,330</u>	24.95%
Total general revenues	<u>583,921</u>	<u>599,330</u>	(2.57%)
Federal aid	421,894	446,151	(5.43%)
Charges for service	<u>3,965</u>	<u>4,173</u>	(4.98%)
Total program revenues	<u>425,859</u>	<u>450,324</u>	(5.43%)
Total revenues	<u>1,009,780</u>	<u>1,049,654</u>	(3.80%)
Expenses			
Road maintenance	315,921	313,378	.81%
Other road operations	329,531	380,281	(13.35%)
General and administration	117,336	99,718	17.67%
Interest on long-term debt	27,434	28,168	(2.61%)
Unallocated depreciation	<u>2,149</u>	<u>2,327</u>	(7.65%)
Total expenses	<u>792,371</u>	<u>823,872</u>	(3.82%)
Change in net assets	217,409	225,782	(3.71%)
Net assets, beginning	<u>5,638,576</u>	<u>5,412,794</u>	4.17%
Net assets, ending	<u>\$ 5,855,985</u>	<u>\$ 5,638,576</u>	3.86%

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION,
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2003

Over time, increases and decreases in net assets measure whether the Department's financial position is improving or deteriorating. During the fiscal year, the net assets of the governmental activities increased by \$217 million or 3.86% percent. The following chart depicts the revenues of the Department for the fiscal year.



Total revenues decreased by approximately \$40 million. Total tax revenues decreased by approximately \$17 million with the majority of the decrease (\$11 million) due to a decline in automobile privilege tax. Federal aid revenue decreased by approximately \$22 million. The following summarizes revenues for the years ended June 30, 2003 and June 30, 2002 (amounts in thousands):

	2003	2002	Increase (decrease)	% Increase (decrease)
Gasoline and motor carrier road tax	\$ 227,793	\$ 229,650	\$ (1,857)	(.81%)
Wholesale motor fuel	69,049	71,314	(2,265)	(3.18%)
Aviation fuel	498	484	14	2.89%
Industrial access roads	1,891	3,914	(2,023)	(51.69%)
Automobile privilege	169,431	180,472	(11,041)	(6.12%)
Motor vehicle registration fees	90,802	90,942	(140)	(.15%)
Special fees and permits	3,965	4,173	(208)	(4.98%)
Federal aid	420,003	442,237	(22,234)	(5.02%)
Investment and interest income	3,666	8,173	(4,507)	(55.14%)
Payments from primary government	3,527	2,965	562	18.95%
Miscellaneous revenues	19,155	15,330	3,825	24.95%
	<u>\$ 1,009,780</u>	<u>\$ 1,049,654</u>	<u>\$ (39,874)</u>	<u>(3.80%)</u>

The Department's primary sources of revenue for funding of ongoing administration of the Department, general maintenance and construction of the State Road System and for providing resources to match available Federal funds is derived from fuel taxes, automobile privilege tax, motor vehicle registration and license fees.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION,
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2003

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. Operating divisions are allocated amounts for routine maintenance in the Department's annual plan. The State had a relatively severe winter during the year ended June 30, 2003 and incurred approximately \$27 million in costs in excess of those incurred in the prior year. This increase was offset to a large degree by cost containment measures implemented during the 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 Department's Fund Financial Statements below.

Discretely Presented Component Units:

The State Rail Authority's operating revenues are not sufficient to provide adequate cash flows to meet regular operating needs. During the year ended June 30, 2003 the cash flows from operations were \$(196) thousand compared to \$(391) thousand in the prior year. The Authority funds capital projects and net operating deficits through general revenue appropriations from the State Legislature. Appropriations received totaled \$3.4 million a decline of \$545 thousand compared to the prior year.

The West Virginia Parkways, Economic Development and Tourism Authority (Parkways) relies on toll revenues, revenues generated through its economic development activities (primarily the Caperton Center) and the operation of travel plaza restaurants and gas stations. Total revenues from these sources remained flat during the year with a small decrease of \$.2 million or (.39%) for the fiscal year ended June 30, 2003. Operating expenses increased by \$1.6 million or 2.46% for the same period primarily due to increased maintenance costs associated with the harsh winter. The Authority experienced net losses during fiscal years ended June 30, 2003 and 2002 but generated positive cash flows from operating activities in excess of \$25 million in both years.

Further analysis of changes in the financial results of the discretely presented component units are included in separately issued financial statements of the individual component units, which can be obtained from their respective administrative offices. Addresses and other additional information about the State's component units are presented in the notes to the financial statements.

FINANCIAL ANALYSIS OF THE DEPARTMENT'S MAJOR FUNDS

As the Department completed the year, the Department reported fund balances of \$214 million. Of this total amount, \$154 million, 71.90%, constitutes unreserved fund balances, which are available for appropriation for the general purposes of the funds. The remainder of fund balances are reserved and are not available for new spending because they have already been dedicated for various commitments, such as capital outlay projects.

State Road Fund

The State Road Fund is the Department's largest Fund, and is used to account for all activities not accounted for in other funds. At the end of the 2003 fiscal year, unreserved fund balance of the fund was \$144 million and reserved fund balance was \$27 million. The total fund balance increased \$8 million during the year primarily due to cost containment measures instituted which offset the lower than anticipated tax revenues and the impact of the severe winter as discussed above in the financial analysis of the Department as a whole.

Capital Projects Fund

The Capital Projects Fund is used to account for financial resources to be used for road construction or reconstruction financed by the proceeds from the sale of Safe Road Bonds and matching federal highway funds on such projects. At June 30, 2003 the fund balance of the fund represented unexpended bond funds associated with the 2002 bond issue (discussed below). The projects to be constructed from the proceeds of these bonds have been programmed, and where applicable, the federal funds for the projects have been obligated.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION,
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2003

State Road Fund and Budgetary Highlights

The Department 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 the previous six years, tax and fee revenue collections increased over the previous year. However, tax and fee revenue collections declined by approximately \$19 million during the current year.

The following table summarizes tax and fee collection over the past three years (amounts in thousands):

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2003 vs. 2002</u>	
				<u>Change</u>	<u>%Change</u>
Gasoline and motor carrier	\$ 225,946	\$ 229,650	\$ 227,793	\$ (1,857)	(.81%)
Sales tax on fuel - wholesale	71,521	71,314	69,049	(2,265)	(3.18%)
Motor vehicle registration	78,745	87,380	85,880	(1,500)	(1.72%)
Privilege tax	155,623	180,472	169,431	(11,041)	(6.12%)
Other taxes and fees	<u>4,063</u>	<u>8,087</u>	<u>5,856</u>	<u>(2,231)</u>	<u>(27.59%)</u>
	<u>\$ 535,898</u>	<u>\$ 576,903</u>	<u>\$ 558,009</u>	<u>\$ (18,894)</u>	<u>(3.28%)</u>

Automobile privilege tax collections were positively impacted in 2002 by low interest rates and significant incentives offered by automobile manufacturers. It is possible that the automobile privilege taxes could decline significantly when these factors no longer exist and that declines in automobile privilege tax revenues could continue. Declining motor fuel collections reflect the current economic weakness and the impact of the war in Iraq that have lead to falling fuel consumption.

The Department's budget included \$397 million in federal aid revenues to be used primarily for design, right-of-way and construction of Corridor D, Corridor H, WV 9 and other major corridors including King Coal Highway, Coalfields Expressway, WV 2, WV 10, and WV 35. As previously discussed the recognition of revenue under these grants occurs when expenditures occur on specific projects that have qualified for federal participation. 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. The budgeted amounts for federal aid revenue and expenditures are based on projects that have been approved and estimates of the timing of each phase of the project. Federal Aid revenue in each of the last three years is summarized below (amounts in thousands):

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>Change</u>	<u>%Change</u>
Federal reimbursement - budgeted funds	\$ 374,138	\$ 371,548	\$ 380,079	\$ 8,531	2.30%
Federal reimbursement - bond funds	<u>35,802</u>	<u>47,139</u>	<u>23,129</u>	<u>(24,010)</u>	<u>(50.93%)</u>
Total federal aid	<u>\$ 409,940</u>	<u>\$ 418,687</u>	<u>\$ 403,208</u>	<u>\$ (15,479)</u>	<u>(3.70%)</u>

The State of West Virginia had a severe winter during 2003. As a result, expenditures for snow and ice removal were in excess of the amounts initially budgeted. With total cost of approximately \$45 million, the winter of 2002-2003 was almost exactly double West Virginia's five-year average of \$23 million for snow removal and ice control and half again as much as the previous record expenditure of \$31 million.

As a result of the above items, the original budget was amended. The most significant changes were:

- Decrease anticipated federal aid expenditures and the related revenues by approximately \$67 million
- Increase in maintenance expenditures by approximately \$42 million

There were no over expenditures by the Department in appropriated funds. In addition, there were no over expenditures in specific budget line items.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION,
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2003

Although it is anticipated that revenues will increase slightly in the next fiscal year, the Department'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 Department will be required to reduce expenditures on programs that are discretionary and expenditures in these areas will be managed to ensure that the Department maintains a positive fund balance. The fiscal 2004 budget reflects a budgeted increase in fund balance of approximately \$53 million. A portion of this increase is based on projected increase in tax collections as a result of implementation of new legislation that moves the point of fuel tax collection from the distribution to the rack. Management is taking all necessary steps to ensure that the fund balance of the Department is maintained at levels that are adequate to ensure the soundness of the Department and is confident that adequate discretionary items exist to permit them to continue to operate in a fiscally sound manner. However, the level of funding available and the increases in non-discretionary spending may impact the Department's ability to achieve all operational objectives.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

Primary Government:

As of June 30, 2003, the Department had invested \$6.2 billion, net of accumulated depreciation, in a range of capital assets (see note 8 for additional details). Depreciation charges for the fiscal year totaled \$244 million.

The \$246 million increase in capital assets, net of depreciation, reflects the nature of the State's road system. While the Department 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 \$244 million in depreciation. The Department expended \$516 million dollars during the year ended June 30, 2003 for additions to capital assets, including infrastructure. Of this amount, \$491 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 \$356 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 Randolph and Hardy Counties, Corridor D in Wood County, upgrade of WV 10 in Logan County, upgrade of WV 2 in Brooke County, widening of I-64, and continued environmental studies on various projects in process.

Discretely Presented Component Units:

As of June 30, 2003, the discretely presented component units had invested \$603 million, net of accumulated depreciation, in capital assets which primarily consisted of Rail Property, Toll Road infrastructure and the Caperton Center. Depreciation charges for the fiscal year totaled \$29 million. Capital assets declined by approximately 1.92% as \$13.5 million in capital improvements were offset by the current years depreciation.

Long-term Debt

Primary Government:

The Department 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, 2003 the Department had \$518 million in outstanding bonds. The amount outstanding decreased by \$22 million (4.08%) due to principal payments of \$22 million.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION,
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2003

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

Issue	Status of insurance	Bond Rating	Amount (in thousands)
Better Highways 73 - All Bonds maturing on or before February 1, 2006	Not insured	Fitch: Moody's: S&P:	AA- Aa3 AA- \$ 10,815
Safe Roads 98A - All Bonds maturing on or before June 1, 2023	Insured by FGIC	Fitch: Moody's: S&P:	AAA Aaa AAA 199,750
Safe Roads 99A - All Bonds maturing on or before June 1, 2017	Not Insured	Fitch: Moody's: S&P:	AA- Aa3 AA- 103,270
Safe Roads 00A - All Bonds maturing on or before June 1, 2020	Insured by FGIC	Fitch: Moody's: S&P:	AAA Aaa AAA 32,290
Safe Roads 00A - Term Bond maturing on June 1, 2025	Insured by MBIA	Fitch: Moody's: S&P:	AAA Aaa AAA 77,710
Safe Roads 01A - Bonds maturing between June 1, 2005 to 2013	Insured by FSA	Fitch: Moody's: S&P:	AAA Aaa AAA 93,465
Safe Roads 01A - Bonds maturing in 2004	Not insured	Fitch: Moody's: S&P:	AA- Aa3 AA- 200
			<u>\$ 517,500</u>

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

Discretely Presented Component Units:

The State Rail Authority continued to amortize its outstanding debt and no additional activity occurred related to the Authority's indebtedness.

The amount of Parkways' outstanding debt is approximately \$4 million less at June 30, 2003 than it was in 2002. Parkways refinanced approximately \$64 million in bonds during 2003 to take advantage of the low interest rate environment that existed during the year. Parkways has entered into various derivative financial instruments, interest rate swap agreements and forward swap agreements, to enable them to issue variable rate debt instruments and mitigate risk associated with changes in interest rates.

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

BASIC FINANCIAL STATEMENTS

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
STATEMENT OF NET ASSETS
JUNE 30, 2003
(amounts expressed in thousands)

17

	Primary Government	Component Units	
	Governmental Activities	Parkways, Economic Development and Tourism Authority	State Rail Authority
ASSETS			
Current assets			
Cash and cash equivalents	\$ 144,582	\$ 7,077	\$ 1,026
Short term investments	-	13,826	-
Accounts receivable	56,319	1,705	95
Taxes receivable	68,668	-	-
Accrued interest receivable	-	309	-
Due from other State of West Virginia agencies	775	-	440
Inventories	28,724	2,511	75
Other assets	2,550	197	13
Total current assets	301,618	25,625	1,649
Non-current assets			
Capital assets, net of accumulated depreciation			
Land - non-infrastructure	14,948	-	4,791
Land improvements	3,836	-	-
Buildings	39,848	63,186	-
Buildings - construction in progress	8,105	-	-
Furniture and fixtures	565	-	178
Rolling stock	48,488	805	265
Scientific equipment	613	-	-
Shop equipment	224	-	-
Roads	3,787,146	-	-
Bridges	974,763	-	-
Land - infrastructure	647,247	53,247	-
Toll road	-	453,606	-
Rail property	-	-	27,416
Work in progress	720,423	-	-
Total capital assets	6,246,206	570,844	32,650
Non-current investments	-	23,228	-
Non-current taxes receivable	3,411	-	-
Other non-current assets	3,199	-	-
Total assets	6,554,434	619,697	34,299
LIABILITIES			
Current liabilities			
Accounts payable	44,423	4,183	444
Retainages payable	13,017	-	-
Accrued payroll and related liabilities	18,548	1,979	196
Due to other State of West Virginia agencies	4,192	207	431
Due to other States IRP	2,729	-	-
Accrued interest payable	2,241	746	-
Deferred revenue	331	-	-
Current maturities of long term obligations	45,731	2,961	337
Total current liabilities	131,212	10,076	1,408
Non-current liabilities			
Claims and judgements	6,400	-	-
Compensated absences	63,626	2,921	129
Long-term debt obligations	497,211	111,846	1,585
Total non-current liabilities	567,237	114,767	1,714
Total liabilities	698,449	124,843	3,122
NET ASSETS			
Invested in capital assets, net of related debt	5,756,415	456,037	30,728
Restricted	-	33,942	-
Unrestricted	99,570	4,875	449
Total net assets	\$ 5,855,985	\$ 494,854	\$ 31,177

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2003
(amounts expressed in thousands)

Functions/Programs	Primary Government			Component Units
	Expenses	Charges for Services	Capital Grants and Contributions	Net Revenue (Expenses) and Changes in Net Assets
Primary Government:				
Government activities				
Road maintenance				
Expressway, trunkline & feeder & SLS	\$ 237,026	\$ -	\$ -	\$ (237,026)
Contract paving & secondary roads	43,417	-	-	(43,417)
Small bridge repair & replacement	21,580	-	-	(21,580)
Litter control program	1,492	-	-	(1,492)
Depreciation	12,406	-	-	(12,406)
Other road operations				
Interstate highways	3,152	-	44,372	41,220
Appalachian highways	-	-	168,789	168,789
Other federal aid programs	83,240	-	206,842	123,602
Non federal aid improvements	12,688	-	-	(12,688)
Industrial access roads	523	-	1,891	1,368
Depreciation	229,928	-	-	(229,928)
General and administration				
Support and administrative operations	80,681	3,965	-	(76,716)
Claims	2,461	-	-	(2,461)
Costs associated with DMV	34,194	-	-	(34,194)
Interest on long-term debt	27,434	-	-	(27,434)
Unallocated depreciation	2,149	-	-	(2,149)
Total primary government	\$ 792,371	\$ 3,965	\$ 421,894	\$ (366,512)
Component units:				
Parkways, Economic Development and Tourism Authority	\$ 72,656	\$ 62,712	\$ -	\$ -
State Rail Authority	3,506	1,988	-	(9,944)
Total component units	\$ 76,162	\$ 64,700	\$ -	\$ (11,462)
General revenues				
Taxes:				
Gasoline and motor carrier			\$ 227,793	\$ -
Wholesale motor fuel			69,049	-
Aviation fuel			498	-
Automobile privilege			169,431	-
Motor vehicle registration fees			90,802	-
Investment and interest income			3,666	11
Gain (loss) on sale of capital assets			-	(354)
Payments from primary governments			3,527	3,452
Miscellaneous revenues			19,155	-
Total general revenues			583,921	3,109
Change in net assets			217,409	(8,353)
Net assets, beginning (as restated)			5,638,576	534,384
Net assets, ending			\$ 5,855,985	\$ 526,031

The Accompanying Notes Are An Integral
Part Of These Financial Statements

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
BALANCE SHEET - GOVERNMENTAL FUNDS
JUNE 30, 2003
(amounts expressed in thousands)

	State Road Fund (Special Revenue)	Capital Projects	Other Governmental Funds	Total Governmental Funds
ASSETS				
Assets				
Cash and cash equivalents	\$ 94,514	\$ 34,562	\$ 15,506	\$ 144,582
Receivables	54,754	953	612	56,319
Taxes receivable	64,180	-	123	64,303
Due from other State of West Virginia agencies	732	-	43	775
Due from other funds	2,959	178	-	3,137
Inventories	27,461	-	1,263	28,724
Other assets	2,026	-	524	2,550
Total assets	\$ 246,626	\$ 35,693	\$ 18,071	\$ 300,390
LIABILITIES AND FUND BALANCES				
Liabilities				
Accounts payable	\$ 41,319	\$ 2,627	\$ 477	\$ 44,423
Retainages payable	11,298	1,636	83	13,017
Accrued payroll and related liabilities	18,398	-	150	18,548
Due to other State of West Virginia agencies	4,044	-	148	4,192
Due to other states	-	-	2,729	2,729
Deferred revenue	-	-	331	331
Due to other funds	178	-	2,959	3,137
Total liabilities	75,237	4,263	6,877	86,377
Fund balances				
Reserved for capital projects	-	31,430	-	31,430
Reserved for inventories	27,461	-	1,263	28,724
Unreserved, undesignated reported in special revenue fund	143,928	-	9,931	153,859
Total fund balances	171,389	31,430	11,194	214,013
Total liabilities and fund balances	\$ 246,626	\$ 35,693	\$ 18,071	\$ 300,390

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
 RECONCILIATION OF THE BALANCE SHEET - GOVERNMENTAL FUNDS
 TO THE STATEMENT OF NET ASSETS
 JUNE 30, 2003
 (amounts expressed in thousands)

Total fund balances - governmental funds \$ 214,013

Amounts reported for governmental activities in the statement of net assets are different because:

Certain receivables will be collected after year end but are not available soon enough to pay for the current period's expenditures and therefore are deferred in the funds. 7,776

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	\$	14,948	
Land improvements- non infrastructure		3,836	
Buildings		39,848	
Buildings - construction in progress		8,105	
Furniture and Fixtures		565	
Rolling Stock		48,488	
Scientific Equipment		613	
Shop Equipment		224	
Roads		3,787,146	
Bridges		974,763	
Infrastructure Land		647,247	
Work in process		<u>720,423</u>	6,246,206

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 3,199

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		(2,241)	
Claims and judgments		(6,961)	
Compensated absences		(85,051)	
Long-term debt obligations		<u>(520,956)</u>	<u>(615,209)</u>

Net assets of governmental activities \$ 5,855,985

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS
YEAR ENDED JUNE 30, 2003

(amounts expressed in thousands)

	State Road Fund (Special Revenue)	Capital Projects	Other Governmental Funds	Total Governmental Funds
Revenues				
Taxes				
Gasoline and motor carrier	\$ 227,793	\$ -	\$ -	\$ 227,793
Wholesale motor fuel	69,049	-	-	69,049
Aviation fuel	-	-	497	497
Automobile privilege	169,431	-	-	169,431
Industrial access	1,891	-	-	1,891
License, fees and permits				
Motor vehicle registrations and licenses	85,880	-	3,087	88,967
Special fees and permits	3,965	-	-	3,965
Federal aid	403,208	4,456	12,339	420,003
Investment and interest income, net of arbitrage rebate	1,101	2,554	11	3,666
Payments from primary government	-	-	3,527	3,527
Miscellaneous revenues	18,846	-	362	19,208
	<u>981,164</u>	<u>7,010</u>	<u>19,823</u>	<u>1,007,997</u>
Expenditures				
Current				
Road maintenance				
Expressway, trunkline and feeder, state and	238,591	-	-	238,591
Contract paving and secondary roads	43,417	-	-	43,417
Small bridge repair and replacement	28,749	-	-	28,749
Litter control program	1,492	-	-	1,492
Support and administrative operations	57,655	-	18,752	76,407
Division of Motor Vehicles operations	34,194	-	-	34,194
Claims	595	-	-	595
Capital outlay and other road operations				
Road construction				
Interstate highways	54,404	329	-	54,733
Appalachian highways	194,507	-	-	194,507
Other federal aid programs	256,844	5,637	-	262,481
Nonfederal aid improvements	12,361	53,297	-	65,658
Industrial access road	523	-	-	523
Debt service	50,019	-	-	50,019
	<u>973,351</u>	<u>59,263</u>	<u>18,752</u>	<u>1,051,366</u>
Excess (deficiency) of revenues over expenditures	7,813	(52,253)	1,071	(43,369)
Fund balances, beginning of year	<u>163,576</u>	<u>83,683</u>	<u>10,123</u>	<u>257,382</u>
Fund balances, end of year	<u>\$ 171,389</u>	<u>\$ 31,430</u>	<u>\$ 11,194</u>	<u>\$ 214,013</u>

The Accompanying Notes Are An Integral
Part Of These Financial Statements

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
 RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
 IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
 YEAR ENDED JUNE 30, 2003
 (amounts expressed in thousands)

Net change in fund balances - total governmental funds	\$	(43,369)
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 \$511,474 exceeded depreciation of (\$244,480) in the current period.		266,994
In the statement of activities only the loss on the sale of assets is reported, whereas in the governmental funds, the proceeds from the sale increase financial resources. Thus, the change in the net assets differs from the change in fund balance by the undepreciated cost of the assets sold.		(21,210)
Repayment of bond principal is an expenditure to governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.		22,040
Revenues that were recognized in a prior year in the statement of activities but did not provide current financial resources until the current year.		1,813
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 increase in compensated absences of (\$7,539), accrued claims of (\$1,865), and amortization of bond issuance costs of (\$375) exceeded accretion of bond premiums of \$835 and decrease in interest payable of \$85.		<u>(8,859)</u>
Change in net assets of governmental activities	\$	<u>217,409</u>

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
(BUDGETARY BASIS) - STATE ROAD FUND
YEAR ENDED JUNE 30, 2003

(amounts expressed in thousands)

	Original Budget	Budget Amendments	Final Budget	Actual Amounts	Variance with Final Budget - Positive (Negative)
Revenues					
Taxes					
Gasoline and motor carrier	\$ 226,960	\$ -	\$ 226,960	\$ 220,463	\$ (6,497)
Wholesale motor fuel	72,100	-	72,100	67,576	(4,524)
Automobile privilege	160,868	12,000	172,868	170,478	(2,390)
Motor vehicle registrations and licenses	79,490	-	79,490	85,836	6,346
Federal aid	511,204	(66,910)	444,294	396,631	(47,663)
Miscellaneous revenues	9,000	(3,350)	5,650	8,049	2,399
	<u>1,059,622</u>	<u>(58,260)</u>	<u>1,001,362</u>	<u>949,033</u>	<u>(52,329)</u>
Expenditures					
Road construction					
Interstate highways	70,000	(10,000)	60,000	55,198	4,802
Appalachian highways	225,000	(17,000)	208,000	199,670	8,330
Other federal aid programs	325,700	(41,000)	284,700	234,569	50,131
Nonfederal aid construction	20,000	2,000	22,000	14,463	7,537
Road maintenance					
Maintenance	243,700	41,500	285,200	247,250	37,950
Contract paving and secondary roads	45,000	3,500	48,500	45,390	3,110
Small bridge repair and replacement	34,000	(3,000)	31,000	29,066	1,934
Litter control program	1,490	-	1,490	1,490	-
Support and administrative operations					
General operations	43,768	-	43,768	37,019	6,749
Equipment revolving	15,000	-	15,000	14,119	881
Inventory revolving	2,000	-	2,000	(1,959)	3,959
Debt service	50,000	-	50,000	49,798	202
Division of Motor Vehicles operations	38,219	-	38,219	34,194	4,025
Waste tire	3,625	-	3,625	2,004	1,621
Claims	595	-	595	595	-
	<u>1,118,097</u>	<u>(24,000)</u>	<u>1,094,097</u>	<u>962,866</u>	<u>131,231</u>
Excess (deficiency) of revenues over expenditures	(58,475)	(34,260)	(92,735)	(13,833)	78,902
Fund balance, beginning of year	<u>105,992</u>	<u>-</u>	<u>105,992</u>	<u>105,992</u>	<u>-</u>
Fund balance, end of year	<u>\$ 47,517</u>	<u>\$ (34,260)</u>	<u>\$ 13,257</u>	<u>\$ 92,159</u>	<u>\$ 78,902</u>

The Accompanying Notes Are An Integral
Part Of These Financial Statements

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION - The accompanying financial statements of the West Virginia Department of Transportation, (the Department) 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 Department was created as a department within the executive branch of the State of West Virginia (the "State") government by an Act of the West Virginia Legislature, effective July 1, 1989. The Department is headed by the Secretary of Transportation, who is appointed by the Governor with the approval of the Senate. The Department administers the entities statutorily assigned to it.

The Governor appoints the commissioners and authority members of the entities included in the Department. The entities are considered to be component units of the State. The financial statements of the Parkways, Economic Development and Tourism Authority and the State Rail Authority are discretely presented in the comprehensive annual financial report of the State, while the financial statements of the other entities are blended with the financial data of the State.

The financial statements of the Department are intended to present the financial position, and the results of operations of only that portion of the financial reporting entity of the State of West Virginia that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of West Virginia as of June 30, 2003 and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

These financial statements include the component units of the State that are administered by the Department. Following are descriptions of entities included in these financial statements:

DIVISION OF HIGHWAYS - The Division of Highways (the Division) is an operating unit of the West Virginia Department of Transportation and represents separate funds of the State of West Virginia 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 Legislature.

DIVISION OF MOTOR VEHICLES - The Division of Motor Vehicles is an operating division of the West Virginia Department of Transportation which collects registration fees, license fees, and automobile privilege taxes for expenditure by the Division of Highways, as well as other motor vehicle fees. The expenditures related to the collection of registration fees, license fees, and automobile privilege taxes are recorded in the State Road Fund within the Division of Highways.

DIVISION OF PUBLIC TRANSIT - The Division of Public Transit is under the supervision of the Secretary of Transportation. The West Virginia Department of Transportation, through the Division of Public Transit, is designated as the agency of the State responsible for administering all federal and state programs relating to public transportation. The Division of Public Transit assists in the development of improved public transportation facilities, services, equipment, techniques and methods, with the cooperation of transportation carriers, both public and private.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

AERONAUTICS COMMISSION - The West Virginia Aeronautics Commission has general supervision and control over all airports used for commercial purposes, all state and municipal airports, all air schools, and all phases of aeronautics within the State. The Commission consists of five members, four appointed by the Governor with the consent of the Senate, and the fifth member is the Secretary of Transportation.

PUBLIC PORT AUTHORITY - The West Virginia Public Port Authority is under the supervision of the Secretary of Transportation. The Authority assesses specific transportation needs and considers feasibility studies for the purpose of determining the best site locations for transportation centers, terminals, ports and harbors, and foreign trade zones. The authority consists of eleven members, including the Secretary of Transportation, who serves as the chairman, and ten individuals who are appointed by the Governor with the advice and consent of the Senate.

COMPONENT UNITS - Management has considered all potential component units to be included in the Department'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 Department is financially accountable, or organizations for which the nature and significance of their relationship with the Department are such that exclusion would cause the Department's financial statements to be misleading or incomplete. In conformity with accounting principles generally accepted in the United States of America, the financial statements of component units have been included in the financial reporting entity as discretely presented component units.

DISCRETELY PRESENTED COMPONENT UNITS - The component units' columns in the combined financial statements include the financial data of the Department's two component units. These units are reported in separate columns to emphasize that they are legally separate from the Department. Separately issued independent audit reports for each of the discretely presented component units may be obtained from West Virginia Department of Transportation, Division of Highways, Finance Section, Building 5, Room A-220, 1900 Kanawha Boulevard, East, Charleston, WV 25305-0430 or from the respective component units at the addresses presented below.

STATE RAIL AUTHORITY - The State Rail Authority (Railroad) is responsible for state-wide rail planning and the operation of the South Branch Valley Railroad (SBVRR) and West Virginia Central Railroad (WVCRR). It can issue bonds and receives federal and state grants to supplement the cost of operations of the SBVRR. The board consists of seven members, six members appointed by the Governor and the seventh member is the Secretary of Transportation. Address: 120 Water Plant Drive, Moorefield, West Virginia 26836

PARKWAYS, ECONOMIC DEVELOPMENT AND TOURISM AUTHORITY - The responsibilities of the West Virginia Parkways, Economic Development and Tourism Authority (Parkways) include the operation and maintenance of the West Virginia Turnpike, and economic development and tourism for areas within 75 air miles of the turnpike. Parkways can also issue bonds and set rates for using the turnpike. The Secretary of Transportation serves as its chairman and six members are appointed by the Governor. Address: 3310 Piedmont Road, Charleston, West Virginia 25311.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 non-fiduciary 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.

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 Department 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.

When both restricted and unrestricted resources are available for use, generally it is the Department'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, 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 Department considers revenues to be available if they are collected within 60 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.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 an expenditure when utilized. The amount of accumulated annual leave unpaid at June 30, 2003, has been reported only in the government-wide financial statements.
- Department employees earn sick leave benefits, which accumulate, but do not vest. When separated from employment with the Department, 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 post employment 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 Department 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 on or after that date. The liability for accumulated post-retirement 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 Department 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 (Special Revenue) Fund** - This fund is used to account for specific revenues that are legally restricted to expenditures for particular purposes. The State Road Fund is funded primarily by dedicated highway user taxes and fees and matching federal highway funds.
- **Capital Projects Fund** - This fund accounts for financial resources to be used for road construction or reconstruction financed by proceeds from the sale of the Safe Road Bonds and matching federal highway funds.

The Department reports the following proprietary funds which are presented as discretely presented component units:

- **State Rail Authority (Proprietary) Fund** - This fund accounts for the activities of the Railroad, a discretely presented component unit of the Department. The Railroad is responsible for state-wide rail planning and the operation of the SBVRR and WVCRR.
- **Parkway, Economic Development and Tourism Authority (Proprietary) Fund** - This fund accounts for the activities of Parkways, a discretely presented component unit of the Department. Parkways is responsible for operation and maintenance of the West Virginia Turnpike, and economic development and tourism for areas within 75 air miles of the turnpike.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The government has elected not to follow subsequent private-sector guidance.

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.

BUDGETING AND BUDGETARY CONTROL - Except for Parkways, the Department'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 31 days after year-end for goods or services received prior to year-end. Appropriated budgeted expenditures, which lapse 31 days after the end of the fiscal year, are incorporated into the Department's overall financial plan, which includes revenue estimates developed by the Department 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 for special items. Any revisions that alter budgeted expenditures for the expenditure categories for each division as a whole must be approved by the State Legislature.

The Department's State Road Fund (Special Revenue Fund) has a legislatively approved budget. In addition, with the exception of the debt service fund, all divisions included in the financial statements as other governmental funds, have an annual appropriated budget of expenditures. However, the capital projects fund, debt service fund, and certain monies reported within the State Road Fund for GAAP purposes, are not considered appropriated funds in accordance with the Department's budgetary reporting policy. Accordingly, these funds have not been reported in the Department's Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual (Budgetary Basis) - State Road Fund. A reconciliation of the excess (deficiency) of revenues over expenditures for the year ended June 30, 2003, on the budgetary basis to the GAAP basis for the State Road Fund follows:

Excess (deficiency) of revenues over expenditures - budgetary basis	\$	(13,833)
Basis of accounting differences (budgetary to GAAP)		21,783
Unbudgeted funds		<u>(137)</u>
 Excess of revenues over expenditures - GAAP basis.	 \$	 <u>7,813</u>

CASH AND CASH EQUIVALENTS - Cash and cash equivalents are short-term investments with original maturities of 90 days or less. Except for Parkways, 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 Department makes interest-earning deposits in certain investment pools maintained by the IMB that are available to the Department with overnight notice. Interest income from these investments is prorated to the Department at rates specified by the IMB based on the balance of the Department'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.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 1 - 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.

Parkways maintains unrestricted and restricted cash deposits with financial institutions. Such deposits are either fully insured or collateralized by State or United States Government Securities.

INVESTMENTS - Investments are reported at fair value and realized and unrealized gains and losses are reported in the statement of activities as a component of investment income.

INVENTORIES - Except for Parkways, the Department's 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. Parkways' inventories are valued at the lower of cost (first-in, first-out method) or market.

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 Department, such as roads, bridges, toll roads, rail properties 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.

Purchased and constructed capital assets are valued at historical cost or estimated historical cost. Donated fixed 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 Department 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 Department 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.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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: 30-40 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
- Toll Road Infrastructure: 10-50 years
- Rail property: 3-35 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. They are comprised primarily of amounts on deposit with West Virginia Workers' Compensation Fund.

CLAIMS - Claims awarded against the Department 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 Department's legal section determines 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.

COMPENSATED ABSENCES - Department 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 vacation, sick leave, and post retirement health insurance premiums are recognized as incurred in the governmental fund financial statements. The government-wide financial statements present the cost of accumulated vacation leave, sick leave and post-retirement health insurance as a liability.

POST EMPLOYMENT BENEFITS - The Department 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 post retirement benefits. Expenditures for post retirement health insurance premiums are recognized as incurred in the governmental fund financial statements. The government-wide financial statements present the cost of accumulated post-retirement health insurance as a liability.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

RETIREMENT BENEFITS - The Department'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 Department, with employer contributions prescribed by PERS 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.

OPERATING REVENUES AND EXPENSES - Proprietary funds distinguish operating revenues and expenses from nonoperating items. Balances classified as operating revenues and expenses are those which comprise the Department's ongoing operations. Principal operating revenues are charges to customers for use of the services. 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 - The Department displays net assets in the following three components, if applicable:

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 Department's ability to use the resources to pay current liabilities. When both restricted and unrestricted resources are available for use, it is the Department's policy to use restricted resources first, then unrestricted resources as needed.

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.

ARBITRAGE REBATE LIABILITY - The capital project fund accounts for arbitrage rebate payable, if any, as a liability of the fund. The change in the obligation is recorded as an adjustment to current year interest revenue.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 2 - CASH, CASH EQUIVALENTS, AND INVESTMENTS

Primary Government - Cash and cash equivalents for the primary government 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) and cash on hand.

The cash and cash equivalents of the primary government were comprised of the following at June 30, 2003:

	<u>Governmental Activities</u>
Investments with IMB	\$ 115,116
Cash with Treasurer's office	25,804
Cash on hand	3,463
Deposits with financial Institutions	-
Cash in transit	<u>199</u>
	<u>\$ 144,582</u>

Discretely Presented Component Units:

State Rail Authority - The State Rail Authority maintains deposits with the STO that are pooled funds managed by the IMB. State Rail Authority also maintains certain restricted cash deposits which are subject to the terms of a loan agreement and bond covenants. These restricted funds are invested in a U.S. Government securities money market mutual fund. The carrying amount of these deposits do not differ materially from the bank balance at June 30 and are not subject to categorization under the provisions of Statement No. 3 of the Governmental Accounting Standards Board. The total amount of deposits with the STO and invested in mutual funds at June 30, 2003 is as follows:

IMB investment pools	\$ 508
Investment in U.S. Government securities money market mutual fund	<u>518</u>
	<u>\$ 1,026</u>

Parkways - Parkways maintains unrestricted and restricted cash deposits with financial institutions. The carrying amount of these cash deposits were \$312 with bank balances of \$652. The bank balances were covered by \$200 of federal depository insurance (Category 1) with the remaining amounts collateralized with securities held by the pledging financial institutions' agents in Parkways' name (Category 2).

The Parkways Trust Indentures dated October 15, 1989, February 15, 1993, December 1, 1994 and November 1, 1996, December 1, 2001, and February 1, 2002 (the Trust Indentures), created in connection with the issuance of revenue bonds (the Bonds), pledge substantially all of Parkways' operating revenues and all monies, and impose certain restrictions on the deposit and investment of such funds as described below. The Trust Indentures require that cash deposits, including certificates of deposits, be either insured or fully collateralized by a pledge of securities held by an agent of the pledging financial institution in Parkways' name. The Trust Indentures and the agreements with the Bonds' insurer permit investments in obligations of, or guaranteed by, the United States of America, its agencies and instrumentalities (United States Government Obligations); obligations of any state of the United States of America which meet certain ratings; commercial paper and other obligations which meet certain ratings; certain money market funds; investment agreements with certain financial institutions; and repurchase agreements with banks or primary government dealers meeting certain ratings or collateralized with obligations of, or guaranteed by, the United States of America.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 2 - CASH, CASH EQUIVALENTS, AND INVESTMENTS (Continued)

The investments that are represented by specific identifiable investment securities are classified as to credit risk by the three categories described below:

Category 1 - Insured or registered, or securities held by Parkways or its agent in Parkways' name.

Category 2 - Uninsured and unregistered, investments for which the securities are held by the counterparty's trust department or agent in Parkways' name.

Category 3 - Uninsured and unregistered, investments for which the securities are held by the counterparty in Parkways' name, or by the counterparty's trust department or agent, but not in Parkways' name.

The Parkway's investments, including cash equivalents of \$6,765, by type and category of risk are as follows:

	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Cost</u>
<u>Category 1:</u>			
U.S. Treasury Bonds and Notes	\$ 1,131	\$ 1,131	\$ 1,127
U.S. Government Agency Securities	19,929	19,929	18,558
State Government Bonds	651	651	598
Corporate bonds and notes	1,945	1,945	1,905
	<u>23,656</u>	<u>23,656</u>	<u>22,188</u>
<u>Category 3:</u>			
Repurchase agreements	<u>6,765</u>	<u>6,765</u>	<u>6,765</u>
<u>Investments not subject to categorization:</u>			
Investment in money market mutual fund	<u>11,210</u>	<u>11,210</u>	<u>11,210</u>
Total investments	<u>\$ 41,631</u>	<u>\$ 41,631</u>	<u>\$ 40,163</u>

The money market mutual fund invests in high quality short-term U.S. denominated money market instruments such as government securities, obligations of banks, commercial paper and other short-term obligations and are not subject to categorization for credit and safekeeping risk. The fund maintains a dollar-weighted average maturity of 90 days or less.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 2 - CASH, CASH EQUIVALENTS, AND INVESTMENTS (Continued)

Parkways cost of cash deposits, investment securities, and related accrued interest receivable is allocated among the following restricted accounts created under the various Trust Indentures or by the adoption of a Parkways resolution at June 30, 2003:

Restricted assets:	
Assets restricted by Trust Indenture:	
Series 1989, 1993, 2002 and 2003 reserves	\$ 11,208
Series 1989 and 1993 debt service	857
Renewal and replacement	2,442
Operating and maintenance	3,877
Series 2001 debt service	109
Series 2001 construction	513
Series 2002 debt service	795
Series 2003 debt service	857
Insurance liability	891
Economic development and tourism	<u>3,607</u>
	25,156
Reserve revenue, restricted by tri-party agreement	13,779
Highway/bridge contingency, restricted by tri-party agreement	1,000
Unredeemed coupons	<u>228</u>
Total restricted assets	<u>\$ 40,163</u>

The assets restricted by the 1989, 1993, 2002 and 2003 Trust Indentures must be used for construction, turnpike maintenance and operation, and debt service. The Trust Indentures require that the balance in the 1989, 1993, 2002 and 2003 reserve account equal maximum annual debt service for all bonds. The balance in the 1989, 1993, 2002 and 2003 debt service accounts are required by the Trust Indentures to have a balance equal to accrued debt service for the current year plus one twelfth of the debt service which will accrue in the next succeeding fiscal year. The Trust Indentures also require that a reserve be established for renewal and replacement that equals the consulting engineer's recommendations for the year. The operations and maintenance account is required by the Trust Indentures to maintain a balance equal to one-eighth of budgeted operating expenses for the fiscal year. The Series 1994 Trust Indenture, as amended by a supplemental Trust Indenture dated November 1, 1996, requires that approximately \$320 of bond proceeds be deposited in the debt service reserve account equal to the maximum annual debt service on the Series 1994 bonds. The 1994 and 1996 Trust Indentures also require the establishment of bond funds, comprised of the principal and interest debt service accounts, which must be maintained at a balance at least equal to one-sixth of the interest payable and one-twelfth of the principal due on June 1, 2001, related to the Series 1994 and 1996 Bonds. The Series 1994 and 1996 were defeased during the year ended June 30, 2003 by the issuance of the Series 2001A bonds.

The insurance liability account is a self-insured fund that covers Parkways against risk of loss from natural disaster, among other items, and is designated as Parkways' percentage of contribution in the event of a disaster.

The economic development and tourism account is designated to be used for economic development and tourism projects by Parkways. All revenues derived from these projects, including recovery of principal, are pledged as security for the Series 2001A and 2001B Bonds.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 2 - CASH, CASH EQUIVALENTS, AND INVESTMENTS (Continued)

The contingency highway and bridge reserve account, established by Parkways and restricted by the tri-party agreement, was established in February 2002 in the event that Parkways needed additional cash or liquidity for highway and bridge projects for any reason (for example, without limitation, due to unanticipated traffic reductions resulting in toll revenue reductions, unanticipated cost overruns on one or more projects, the need to begin or complete project before originally planned, terrorist events, or failure to achieve all anticipated savings from the issuance of the Series 2002 and 2003 refunding bonds). This reserve is not a requirement by the bondholders and will not be used to pay debt service on any bonds of Parkways, but it will be used at the Board of Director's discretion for costs of highway and/or bridge projects in emergency situations.

The reserve revenue account, restricted by the tri-party agreement dated December 1988 among the West Virginia Department of Transportation, the Federal Highway Administration, and Parkways, can only be used for maintenance and operation of the Turnpike and for debt service.

The unredeemed coupons account has been designated by Parkways to fund redemption of interest coupons that have matured but are not yet redeemed for bonds issued under previous bond indentures.

NOTE 3 - ACCOUNTS RECEIVABLE

Accounts receivable at June 30, 2003 consisted of the following:

	<u>Primary Government</u>	<u>Component Units</u>
Federal aid billed and not paid	\$ 4,038	\$ -
Federal aid earned but not billed	<u>44,759</u>	<u>-</u>
Total federal aid receivable	48,797	-
Other receivables	<u>9,822</u>	<u>1,850</u>
Combined total receivables	58,619	1,850
Less: allowance for uncollectibles	<u>2,300</u>	<u>50</u>
 Net accounts receivable	 <u>\$ 56,319</u>	 <u>\$ 1,800</u>

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.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 4 - TAXES RECEIVABLE

Taxes receivable at June 30, 2003 consisted of the following:

Automobile privilege taxes	\$ 38,270
Gasoline and motor fuel taxes	33,686
Aviation fuel	<u>123</u>
	72,079
Less: Long-term portion	<u>3,411</u>
Current taxes receivable	<u>\$ 68,668</u>

Taxes receivable include privilege taxes that are being collected on vehicles with ongoing leases. Of the total privilege tax accrued at year end \$3,411 is not expected to be collected within one year and is classified as a long term receivable.

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

Amounts due from other State of West Virginia agencies at June 30, 2003 consisted of the following:

	<u>Primary Government</u>	<u>Component Units</u>
The Department of Administration	\$ 113	\$ -
West Virginia University	51	-
Office of Emergency Services	64	-
The Governor's Office	237	-
West Virginia State Police	58	-
West Virginia Building Commission	40	-
Other agencies	<u>212</u>	<u>440</u>
	<u>\$ 775</u>	<u>\$ 440</u>

Amounts due to other State of West Virginia agencies at June 30, 2003 consisted of the following:

	<u>Primary Government</u>	<u>Component Units</u>
Public Employees Insurance Agency	\$ 1,164	\$ -
Public Employees Retirement	1,141	-
Bureau of Employment Programs	1,644	-
The Department of Administration	30	-
Division of Corrections	47	-
Other agencies	<u>166</u>	<u>638</u>
	<u>\$ 4,192</u>	<u>\$ 638</u>

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 7 - INVENTORIES

Inventories at June 30, 2003 consisted of the following:

	<u>Primary Government</u>	<u>Component Units</u>
Materials and supplies	\$ 19,060	\$ 2,586
Equipment repair parts	8,268	-
Gas and lubrication supplies	<u>1,396</u>	<u>-</u>
	<u>\$ 28,724</u>	<u>\$ 2,586</u>

NOTE 8 - CAPITAL ASSETS

Governmental Activities:

Capital asset activity for Governmental Activities for the year ended June 30, 2003, was as follows:

	<u>Balance July 1, 2002</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2003</u>
Capital assets not being depreciated:				
Land - non infrastructure	\$ 14,585	\$ 415	\$ 52	\$ 14,948
Land - infrastructure	579,229	68,018	-	647,247
Building - construction in progress	188	10,452	2,535	8,105
Construction-in-progress - roads	530,596	271,150	277,545	524,201
Construction-in-progress - bridges	<u>122,529</u>	<u>151,757</u>	<u>78,064</u>	<u>196,222</u>
Total capital assets not being depreciated	<u>1,247,127</u>	<u>501,792</u>	<u>358,196</u>	<u>1,390,723</u>
Capital assets being depreciated:				
Buildings	63,231	2,341	785	64,787
Furniture and fixtures	9,256	181	338	9,099
Land improvements - non infrastructure	4,490	551	-	5,041
Rolling stock	204,791	12,959	46,061	171,689
Shop equipment	3,044	10	14	3,040
Scientific equipment	1,962	70	5	2,027
Infrastructure - roads	5,912,428	273,826	-	6,186,254
Infrastructure - bridges	<u>1,108,091</u>	<u>77,892</u>	<u>-</u>	<u>1,185,983</u>
Total capital assets being depreciated	<u>7,307,293</u>	<u>367,830</u>	<u>47,203</u>	<u>7,627,920</u>
Less accumulated depreciation:				
Buildings and improvements	24,046	1,620	727	24,939
Furniture and fixtures	8,576	277	319	8,534
Land improvements - non infrastructure	953	252	-	1,205
Rolling stock	136,066	12,118	24,983	123,201
Shop equipment	2,669	160	13	2,816
Scientific equipment	1,291	128	5	1,414
Infrastructure - roads	2,192,900	206,208	-	2,399,108
Infrastructure - bridges	<u>187,500</u>	<u>23,720</u>	<u>-</u>	<u>211,220</u>
Total accumulated depreciation	<u>2,554,001</u>	<u>244,483</u>	<u>26,047</u>	<u>2,772,437</u>
Total capital assets being depreciated, net	<u>4,753,292</u>	<u>123,347</u>	<u>21,156</u>	<u>4,855,483</u>
Governmental activities capital assets, net	<u>\$ 6,000,419</u>	<u>\$ 625,139</u>	<u>\$ 379,352</u>	<u>\$ 6,246,206</u>

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 8 - CAPITAL ASSETS (Continued)

Governmental Activities (Continued):

Current year depreciation totaling \$244,483 was allocated as separate line items in the statement of activities under the major functions of the Division of Maintenance and Improvements. The remaining 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 Department.

A summary of depreciation on each capital asset type follows:

<u>Asset Type</u>	<u>Depreciation</u>
Buildings and improvements	\$ 1,620
Furniture and fixtures	277
Land improvements	<u>252</u>
Total unallocated	<u>2,149</u>
Rolling stock	12,118
Shop equipment	160
Scientific equipment	<u>128</u>
Total road maintenance	<u>12,406</u>
Infrastructure - roads	206,208
Infrastructure - bridges	<u>23,720</u>
Total other road operations	<u>229,928</u>
Total depreciation expense	<u>\$ 244,483</u>

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 8 - CAPITAL ASSETS (Continued)

Discretely Presented Component Units:

Capital asset activity for discretely presented component units for the year ended June 30, 2003, was as follows:

	Balance July 1, 2001	Increases	Decreases	Balance June 30, 2003
Capital assets not being depreciated:				
Land - infrastructure	\$ 53,085	\$ 162	\$ -	\$ 53,247
Land - non infrastructure	4,791	-	-	4,791
Total capital assets not being depreciated	<u>57,876</u>	<u>162</u>	<u>-</u>	<u>58,038</u>
Capital assets being depreciated:				
Buildings	88,819	6,377	-	95,196
Furniture and fixtures	500	-	44	456
Rolling stock	7,030	46	287	6,789
Infrastructure - toll road	725,596	11,678	-	737,274
Infrastructure - rail property	33,302	3,611	899	36,014
Total capital assets being depreciated	<u>855,247</u>	<u>21,712</u>	<u>1,230</u>	<u>875,729</u>
Less accumulated depreciation:				
Buildings and improvements	28,949	3,061	-	32,010
Furniture and fixtures	306	15	43	278
Rolling stock	5,664	342	287	5,719
Infrastructure - toll road	258,751	24,917	-	283,668
Infrastructure - rail property	8,084	1,027	513	8,598
Total accumulated depreciation	<u>301,754</u>	<u>29,362</u>	<u>843</u>	<u>330,273</u>
Total capital assets being depreciated, net	<u>553,493</u>	<u>(7,650)</u>	<u>387</u>	<u>545,456</u>
Governmental activities capital assets, net	<u>\$ 611,369</u>	<u>\$ (7,488)</u>	<u>\$ 387</u>	<u>\$ 603,494</u>

Current year depreciation totaled \$29,362.

NOTE 9 - RETAINAGES PAYABLE

The Department has entered into an arrangement with the West Virginia Investment Management Board 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 Department. At June 30, 2003, retainages payable on contracts had been reduced by these amounts on deposit in such accounts by approximately \$8,220.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 10 - LONG-TERM OBLIGATIONS

Governmental Activities:

Long-term obligations at June 30, 2003, 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	\$ 18,660	\$ -	\$ 7,845	\$ 10,815
Safe road bonds	1998	4.30%-5.25%	06/01/2023	204,080	-	4,330	199,750
Safe road bonds	1999	4.30%-5.75%	06/01/2017	105,020	-	1,750	103,270
Safe road bonds	2000	5.50%-5.75%	06/01/2025	110,000	-	-	110,000
Safe road bonds	2001	3.50%-5.50%	06/01/2013	101,780	-	8,115	93,665
Total general obligation bonds				539,540	-	22,040	517,500
Bond premium				4,290	-	834	3,456
Total general obligation bonds payable net of premium				543,830	-	22,874	520,956
Claims and judgments				5,095	1,866	-	6,961
Compensated absences				77,510	7,541	-	85,051
Total long-term obligations				\$ 626,435	\$ 9,407	\$ 22,874	\$ 612,968

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 Safe 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 \$27,434 for the year ended June 30, 2003. 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:

	2004	2005	2006	2007	2008	2009-2013	2014-2018	2019-2023	2024-2026	Total
General obligation bonds payable from tax revenue:										
Better highway bonds	\$ 6,360	\$ 3,909	\$ 1,567	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 11,836
State road bonds	43,638	46,087	48,431	49,997	49,996	238,610	157,989	117,598	47,037	799,383
Total general obligation bonds	49,998	49,996	49,998	49,997	49,996	238,610	157,989	117,598	47,037	811,219
Less: interest	26,928	25,781	24,628	23,532	22,201	88,105	51,619	27,158	3,767	293,719
Total principal	23,070	24,215	25,370	26,465	27,795	150,505	106,370	90,440	43,270	517,500
Bond premium	675	563	475	400	336	882	125	-	-	3,456
Total principal and bond premium	\$ 23,745	\$ 24,778	\$ 25,845	\$ 26,865	\$ 28,131	\$ 151,387	\$ 106,495	\$ 90,440	\$ 43,270	\$ 520,956

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 10 - LONG-TERM DEBT OBLIGATIONS (Continued)

Governmental Activities (continued):

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

	<u>Compensated Absences</u>	<u>Claims and Judgments</u>	<u>General Obligation Bonds and Premium</u>	<u>Total</u>
Short-term liability	\$ 21,425	\$ 561	\$ 23,745	\$ 45,731
Long-term liability	<u>63,626</u>	<u>6,400</u>	<u>497,211</u>	<u>567,237</u>
	<u>\$ 85,051</u>	<u>\$ 6,961</u>	<u>\$ 520,956</u>	<u>\$ 612,968</u>

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. 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 known 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.

The Department's Safe Road Bonds are subject to the arbitrage rebate provisions of the Internal Revenue Code, which requires 90% of interest earnings in excess of interest expended to be paid to the Internal Revenue Service. The Department has no arbitrage rebate liability as of June 30, 2003.

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

	<u>Year Ended June 30, 2003</u>	<u>Year Ended June 30, 2002</u>	<u>Year Ended June 30, 2001</u>
Estimated claims liability, July 1	\$ 5,095	\$ 11,200	\$ 9,300
Additions for claims incurred during the year	3,246	2,787	1,585
Changes in estimates for claims of prior periods	(785)	(8,877)	415
Payments on claims	<u>(595)</u>	<u>(15)</u>	<u>(100)</u>
Estimated claims liability, June 30	<u>\$ 6,961</u>	<u>\$ 5,095</u>	<u>\$ 11,200</u>

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 10 - LONG-TERM DEBT OBLIGATIONS (Continued)

Governmental Activities (continued):

At June 30, 2003, approximately \$19,877 of tort claims and \$5,351 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 Department has an estimated obligation of \$6,400, 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 \$561. During the normal course of operations, the Department may become subject to other litigation. Accordingly, no provision has been made in the financial statements for liabilities, if any, from such litigation.

The Department'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 \$7,147 arising in connection with legislation to fund portions of employee post retirement health insurance costs for retired employees. The Division has 447 former employees currently eligible for post employment health insurance. The Division's total expenditures for post-employment health benefits for the year ended June 30, 2003 were \$2,125. These liabilities are generally liquidated by the State Road Fund and other governmental funds.

Discretely Presented Component Units:

State Rail Authority - Long-term debt of the State Rail Authority consisted of notes payable to the County Commissions of Hardy County and Hampshire County, West Virginia amounting to \$1,922 as of June 30, 2003. These notes are payable in monthly installments of approximately \$38, including interest ranging from 6.7% to 7.4%, with the final payment due July 2007.

Long-term obligations at June 30, 2003, and changes for the fiscal year then ended are as follows:

Notes payable at June 30, 2002	\$ 2,239
Less principal retirements	(300)
Less amortization of premium	<u>(17)</u>
Notes payable at June 30, 2003	1,922
Less current portion	<u>(337)</u>
	<u>\$ 1,585</u>

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 10 - LONG-TERM DEBT OBLIGATIONS (Continued)

Discretely Presented Component Units (Continued):

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

Year ending June 30	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 320	\$ 133	\$ 453
2005	345	111	456
2006	370	87	457
2007	395	60	455
2008	<u>425</u>	<u>31</u>	<u>456</u>
	1,855	422	2,277
Premium	67	-	67
Amortization of premium	<u>-</u>	<u>(67)</u>	<u>(67)</u>
	<u>\$ 1,922</u>	<u>\$ 355</u>	<u>\$ 2,277</u>

Parkways - Revenue bonds payable of Parkways consisted of the following at June 30, 2003:

Series 1993 Premium Capital Appreciation Bonds, issued \$2,121 in March 1993, at 23%, due in varying installments including accumulated appreciation, from May 2003 through May 2007	\$ 981
Series 2001 A Taxable Serial Bonds, issued \$5,695 in December 2001 at 4.75% to 7.00%, due in varying installments from June 2002 to June 2011	4,915
Series 2001 B Bonds, issued serial bonds of \$1,505 in December 2001, at 3.50% to 5.00%, due in varying installments from June 2002 through 2011	1,360
Series 2001 B term bonds, \$2,090 at 5.00% due June 2013	2,090
Series 2001 B term bonds, \$2,305 at 5.125% due June 2013	2,305
Series 2002 Serial Bonds, issued \$44,205 in February 2002 at 3.50% to 5.25%, due in varying installments from May 2002 through May 2019	40,335
Series 2003 Variable Rate Demand Revenue Refunding Bonds, \$63,900 at variable rates, due in varying installments through May 2019	<u>63,900</u>
Total revenue bonds payable	115,886
Add:	
Unamortized premium and accumulated appreciation on premium capital appreciation bonds	15,042
Less:	
Unamortized deferred loss on advance refundings	(14,127)
Unamortized discount and issuance costs	(1,994)
Current portion of revenue bonds payable	<u>(2,961)</u>
	<u>\$ 111,846</u>

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 10 - LONG-TERM DEBT OBLIGATIONS (Continued)

Discretely Presented Component Units (continued):

In 1989, Parkways issued \$46,035 of Series 1989 Serial Bonds and \$10,530 of Series 1989 Capital Appreciation Bonds dated November 7, 1989, and \$86,435 of Series 1989 Term Bonds dated October 15, 1989 (collectively the 1989 Series Bonds), under the Trust Indenture. The 1989 Series Bonds were issued to finance the cost of certain Parkway improvements, provide funds for a debt service reserve fund and bond issuance costs, and redeem \$44,543 of Turnpike Commission (predecessor to Parkways) Series 1952 and 1954 Bonds. On July 1, 1999, Parkways fully paid the Series 1989 Serial Bonds by making the final payment of \$4,160 as scheduled.

In 1993, Parkways issued \$118,781 of Revenue Refunding Bonds for the express purpose of defeasing \$111,245 of 1989 Series Bonds, all of which are no longer outstanding. The advance refunding resulted in a \$14,350 deferred loss arising from the difference between the reacquisition price and the net carrying amount of the refunded debt. Amortization of this deferral, charged annually to interest expense through 2019, approximated \$456 and \$647 in 2002 and 2001, respectively. Parkways completed the advance refunding to reduce its aggregate debt service payments by almost \$7,400 over a 26-year period (life of the refunding bonds) and obtain an economic gain (difference between the present values of the old and new debt service payments) of \$5,200.

The Revenue Refunding Bonds are comprised of coupon bonds, premium capital appreciation bonds, and the following:

- Select Auction Variable Rate Securities and Residual Interest Bonds which were issued in equal amounts with the same maturities and having variable interest rates based upon the same index. The Select Auction Variable Rate Securities and Residual Interest Bonds react to this index in an equally inverse manner and, accordingly, the blended interest rate on these securities is 5.831%.
- Yield Enhancement Securities which are variable rate securities with a maximum rate of 16% and converted to a fixed rate of 5.7% on May 15, 1998.
- Inverse Floating Rate Notes which have variable rates with maximum rates ranging from 9.5% to 12.95%. The Inverse Floating Rate Notes convert to fixed rates ranging from 4.9% to 5.8% on various dates.

Parkways has entered into interest rate swap agreements whereby it has exchanged the interest based on the variable rates on the Yield Enhancement Securities and Inverse Floating Rate Notes for interest equal to the fixed conversion rates discussed above for the same securities. The terms of the interest rate swap agreements extend to various dates in 2003, the expiration of such agreements coinciding with the date that the bonds' interest rates mandatorily convert from variable to fixed rates. Parkways is exposed to loss if one or more of the counterparties default under the terms of the interest rate swap agreements.

Interest on the Series 1993 coupon bonds, Yield Enhancement Securities, and Inverse Floating Rate Notes is payable semi-annually on May 15 and November 15 of each year. Interest on the Series 1993 Capital Appreciation Bonds is compounded on May 15 and November 15 of each year and will be payable at maturity of such bonds. Interest on the Series 1993 Select Auction Variable Rate Securities and the Series 1993 Residual Interest Bonds is payable monthly.

The Revenue Bonds under the 1989 and 1993 Trust Indentures are secured by a pledge of substantially all of Parkways' operating revenues and all monies deposited into accounts created by the Trust Indentures, with the 1989 Series Bondholders having priority over the 1993 Series Bondholders.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 10 - LONG-TERM DEBT OBLIGATIONS (Continued)

Discretely Presented Component Units (continued):

In 1994, \$3,000 of serial bonds and \$6,000 of term bonds (that were subsequently refunded by the 1996 issue) of Raleigh County, West Virginia, Commercial Development Revenue Bonds Series 1994 (the Series 1994 Bonds) were issued pursuant to a bond resolution adopted by the County Commission of Raleigh County, West Virginia (the Issuer), and a Trust Indenture, dated as of December 1, 1994 (the Indenture). The bond proceeds were lent to Parkways for the purpose of providing funds to: (i) partially finance the Caperton Center (the Project); (ii) fund a debt service reserve fund; and (iii) pay costs of issuance in connection with the Series 1994 Bonds. The Series 1994 Bonds are limited obligations of the Issuer payable solely from loan payments by Parkways pledged under the Indenture, and are also secured equally and ratably by a Trust Agreement among Parkways, the Issuer and a trustee, wherein Parkways has pledged certain non-toll revenues of Parkways including (i) net revenues of the Project; (ii) certain interest and other investment earnings; and (iii) gross revenues derived from concessionaire or other contracts with third-parties relating to operations conducted by such third parties at any of Parkways' service plazas. Toll revenues derived by Parkways in connection with the operation of the Turnpike are not pledged or otherwise available to pay debt service on the Series 1994 Bonds. Interest on the Series 1994 Bonds is payable on the first day of each December and June.

In 1996, \$5,900 of Raleigh County, West Virginia Commercial Development Revenue Bonds, Series 1996 (the Series 1996 Bonds) were issued pursuant to a bond resolution adopted by the County Commission of Raleigh County, West Virginia (the issuer) and a Trust Indenture, dated as of November 1, 1996 (the Indenture). The bond proceeds were used to advance refund the \$6,000 portion of the Series 1994 Bonds, which are no longer outstanding. The terms and conditions of the Series 1996 Bonds are similar to those of the Series 1994 Bonds noted above as toll revenues derived by Parkways in connection with the operation of the Turnpike are not pledged or otherwise available to pay debt service on the Series 1996 Bonds. Parkways completed the advance refunding to reduce its aggregate debt service payments by almost \$970 over a nine year period (life of the refunding bonds). Interest on the Series 1996 Bonds is payable on the first day of each December and June.

In 2002, \$5,695 of Raleigh County, West Virginia, Taxable Commercial Development Revenue Refunding Bonds, Series 2001A and \$5,900 of Commercial Development Revenue Bonds, Series 2001 B (the Series 2001 Bonds) were issued pursuant to a bond resolution adopted by the County Commission of Raleigh County, West Virginia (the issuer), and a Trust Indenture, dated December 1, 2001 (the Indenture). The bond proceeds of the Series 2001A were used to advance refund \$1,735 of the Series 1994 Bonds and \$4,075 of the Series 1996 Bonds, which remain outstanding. The advance refunding resulted in a \$491 deferred loss arising from the difference between the reacquisition price and the net carrying amount of the refunded debt. Amortization of this deferral, charged annually to interest expense through 2011, approximated \$27 in 2002. The Series 2001B Bonds were issued to construct and furnish an expansion of the Caperton Center. The terms and conditions of the Series 2001 Bonds are similar to those of the Series 1994 Bonds noted above as toll revenues derived by the Authority in connection with the operation of the Turnpike are not pledged or otherwise available to pay debt service on the Series 2001 Bonds. The Parkway completed the advance refunding to remove certain restrictive indenture requirements of the Series 1994 and 1996 bonds. The refunding resulted in an economic loss (difference between the present value of the old and new debt service payments) of \$583. Interest on the Series 2001 bonds is payable on the first day of each December and June.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 10 - LONG-TERM DEBT OBLIGATIONS (Continued)

Discretely Presented Component Units (continued):

Additionally in 2002, \$44,205 of Revenue Refunding Bonds were issued for the express purpose of defeasing \$36,036 of Series 1993 Bonds, all of which remain outstanding at June 30, 2003. The advance refunding resulted in a \$6,313 deferred loss arising for the difference between the reacquisition price and the net carrying amount of the refunded debt. Amortization of this deferral, charged annually to interest expense through 2019, approximated \$371 in 2003. Parkways completed the advance refunding to reduce its aggregate debt service payments by almost \$3,003 over an 18-year period (life of the refunding bonds) and obtain an economic gain (difference between the present values of the old and new debt service payments) of \$1,624.

In 2003 Parkways issued \$63,900 of Variable Rate Demand Revenue Refunding Bonds for the express purpose of refunding \$61,280 of Series 1993 Bonds. This refunding resulted in a \$7,896 deferred loss arising from the difference between the reacquisition price and the net carrying amount of the refunded debt. Amortization of this deferral, charged annually to interest expense through 2019, approximated \$247 in 2003. Parkways completed the refunding to reduce its aggregate debt service payment by \$7,270 over a 17-year period (life of the refunding bonds) and obtain an economic gain (difference between the present values of the old and new debt service payments) of \$ 4,851.

The Series 2003 bonds bear interest at the Weekly Interest Rate determined by the remarketing agent on Tuesday of each week. Parkways has entered into an interest rate swap agreement on the Series 2003 bonds as follows:

- Objective: Lower borrowing costs, when compared against fixed-rate bonds at the time of issuance. Effectively change the variable rate on the bonds to a synthetic fixed rate of 4.387%
- Terms: Matures concurrent with the Bonds on May 1, 2019 with \$63,900 notional amount matching the par of the variable rate bonds. Parkways pays a fixed rate of 4.387% and receives a variable payment at 67% of London Interbank Offered Rate (LIBOR). The bond's variable rate is based on Bond Market Association Municipal Swap Index (BMA).
- Fair Value: The swap had a negative fair value of \$9,683 as of June 30, 2003 due to declines in interest rates since its execution. Fair Value was estimated using the zero-coupon method which calculates the future net settlement payments required by the swap, assuming the current forward rates implied by the yield curve correctly anticipate future spot interest rates, and discounts those payments using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap. Because Parkways' bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase.
- Credit Risk: With the negative fair value at June 30, Parkways was not exposed to credit risk at that date. If the changing interest rates result in a positive fair value for the swap, Parkways would be exposed to credit risk. The counter party to the swap was rated AA by Fitch Rating and Standard and Poor's and Aa by Moody's Investor's Service.
- Basis Risk: If the relationship between LIBOR and BMA changes, Parkways will be exposed to basis risk, changing the synthetic rate on the bonds. If changes occur that lead to convergence of the two rates, the expected cost savings may not be realized. At June 30, 2003 the BMA rate was .98 percent and 67% of LIBOR was 1.21%.
- Termination Risk: If the swap is terminated by either party because the other party failed to perform, the bond would no longer carry a synthetic rate. Also, if at the time of termination the swap has a negative fair value, Parkways may be liable to the counterparty for a payment equal to the swap's fair value.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 10 - LONG-TERM DEBT OBLIGATIONS (Continued)

Discretely Presented Component Units (continued):

Using rates as of June 30, 2003, debt service requirements of the variable rate debt and net swap payments, assuming current interest rates remain the same for their term, were as follows. As rates vary, variable rate bond interest payments and net swap payments will vary.

Year ending June 30	Variable Rate Bonds			
	Principle	Interest	Interest Rate Swap, Net	Total
2004	\$ 200	\$ 482	\$ 2,474	\$ 3,156
2005	200	576	2,379	3,155
2006	200	574	2,427	3,201
2007	300	573	2,363	3,236
2008	3,900	569	2,335	6,804
2009-2013	23,200	2,270	9,348	34,818
2014-2018	29,200	1,120	3,982	34,302
2019	<u>6,700</u>	<u>61</u>	<u>230</u>	<u>6,991</u>
	<u>\$ 63,900</u>	<u>\$ 6,225</u>	<u>\$ 25,538</u>	<u>\$ 95,663</u>

The following schedule summarizes the revenue bonds outstanding for Parkways as of June 30, 2003:

	Beginning Balance	Additions	Reductions	Amortization	Ending Balance
Revenue Bonds:					
Series 1993	\$ 70,941	\$ -	\$ 58,656	\$ 1,098	\$ 13,383
Series 2001	10,399	-	615	425	10,209
Series 2002	37,476	-	1,615	270	36,131
Series 2003	-	<u>54,800</u>	-	<u>284</u>	<u>55,084</u>
Total Revenue Bonds	118,816	54,800	60,886	2,077	114,807
Compensated absences	<u>2,284</u>	<u>637</u>	-	-	<u>2,921</u>
Total long-term obligations	<u>\$ 121,100</u>	<u>\$ 55,437</u>	<u>\$ 60,886</u>	<u>\$ 2,077</u>	<u>\$ 117,728</u>

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 10 - LONG-TERM DEBT OBLIGATIONS (Continued)

Discretely Presented Component Units (continued):

Debt service requirements for Parkways' long-term debt are as follows:

Year Ending June 30	Revenue Bonds		
	Principal Maturities	Interest	Total
2004	\$ 2,961	\$ 13,137	\$ 16,098
2005	2,881	12,439	15,320
2006	3,047	12,282	15,329
2007	3,239	11,503	14,742
2008	6,680	5,059	11,739
2009-2013	39,930	19,941	59,871
2014-2018	46,863	9,316	56,179
2019	10,285	480	10,765
	<u>\$ 115,886</u>	<u>\$ 84,157</u>	<u>\$ 200,043</u>
Add:			
Unamortized Premium	15,042		
Less:			
Unamortized deferred loss	14,127		
Unamortized Discount and Issuance costs	1,994		
	<u>\$ 114,807</u>		

The Revenue Bonds are subject to the arbitrage rebate provisions of the Internal Revenue Code (the Code). The Code requires that 90% of excess investment earnings on the Bond proceeds be paid to the Internal Revenue Service every five years in order for bonds to maintain their tax-exempt status. The estimated arbitrage rebate payable was zero at June 30, 2003.

NOTE 11 - 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 Department 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, 2003, for rental payments of approximately \$1,796 annually. Management expects the leases to be renewed upon expiration.
- The Department'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, 2003, the Division incurred payroll related expenditures of approximately \$29,383 for employee health insurance benefits provided through the West Virginia Public Employees Insurance Agency and approximately \$19,431 in employer matching contributions to the State Public Retirement System.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 11 - RELATED PARTY TRANSACTIONS WITH THE STATE OF WEST VIRGINIA (Continued)

- The Department is insured under the West Virginia Workers' Compensation Plan. During the year ended June 30, 2003 the Division paid approximately \$9,464 for employee workers' compensation benefits, which are paid into funds administered by the West Virginia Workers' Compensation Fund.
- The Department 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 \$5,466 during the year ended June 30, 2003.

NOTE 12 - COMMITMENTS AND CONTINGENCIES

The amount of unexpended balances of highway design and construction contracts entered into by the Department with various contractors approximated \$575,892 at June 30, 2003. In addition, Parkways had contractual commitments totaling \$27,300 for various Turnpike System improvement projects, including the construction of the Caperton Center addition for which approximately \$9,300 had been expended.

The Department 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 Department expects such amounts, if any, to be immaterial to the financial position of the Department. The Department records these disallowed audit adjustments for questioned costs in the period the audit is finalized.

During the year ended June 30, 1989, the Department in-substance defeased Huntington Bridge Revenue Bonds dated January 1, 1965, by authorizing the West Virginia Municipal Bond Commission (MBC), the bond fiscal agent, to purchase U.S. government securities which will mature on dates to coincide with the remaining principal and interest payments. At June 30, 2003, \$1,905 of these bonds were outstanding and are considered defeased. Accordingly, the assets and liability for these defeased bonds have been excluded from the Department's financial statements.

NOTE 13 - RETIREMENT PLAN

PLAN DESCRIPTION - The Department 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.

West Virginia Department of Transportation
Notes to the Financial Statements
Year Ended June 30, 2003
(amounts expressed in thousands)

NOTE 13 - RETIREMENT PLAN (Continued)

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 14% of annual covered payroll, including the Department's contribution of 9.5%, which is established by PERS. The Department's contributions to PERS for the primary government and the component units for the years ended June 30, 2003, 2002 and 2001 were \$19,431, \$19,080 and \$18,720 respectively, equal to the required contributions for each year. The contribution rate for the Department will rise to 10.5% effective July 1, 2003.

NOTE 14 - RISK MANAGEMENT

The Department 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, 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 WCF provides coverage for work related accidents and is considered an insurance enterprise fund. The Department 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 10, amounts of settlements have not exceeded insurance coverage in the past three years. The Department has evaluated this potential risk of loss as discussed in Note 10.

Through its participation in the PEIA and WCF, the Department has obtained health coverage and coverage for job related injuries for its employees. In exchange for payment of premiums to PEIA and WCF, the Department has transferred its risks related to health coverage and job related injuries of employees. These entities issue publicly available financial reports that include financial statements and required supplementary information. Those reports may be obtained by writing to these specific entities.

West Virginia Department of Transportation
Notes to the Financial Statements
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NOTE 15 - RESTATEMENT OF PRIOR YEAR AMOUNTS

Governmental Activities:

During the current year it was determined that an undercapitalization of infrastructure assets had occurred in the initial implementation of the provisions of GASB Statement 34 *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. Certain projects that met the capitalization criteria were excluded from Work in Process and other projects that were completed were not properly capitalized into infrastructure. This undercapitalization of infrastructure assets had no impact on the fund or budgetary comparison financial statements for the year ended June 30, 2002. The following summarizes the impact of this undercapitalization of infrastructure assets on the government-wide financial statements:

	<u>As Previously Reported</u>	<u>Adjustment</u>	<u>Restated</u>
Total capital assets	\$5,679,425	\$320,996	\$6,000,421
Total assets	\$6,066,083	\$320,996	\$6,387,079
Net assets - investment in capital assets, net of debt	\$5,219,277	\$320,996	\$5,540,273
Total net assets	\$5,317,580	\$320,996	\$5,638,576
Total expenses	\$1,092,612	\$(268,740)	\$823,872
Change in net assets	\$(42,958)	\$268,740	\$225,782

Discretely Presented Component Units:

It was determined that certain amounts previously recorded for rail properties had been disposed of over a period of years due to capital improvement projects undertaken by the State Rail Authority. During the year the State Rail Authority conducted an extensive review of rail properties and determined the amount to be removed for prior years' retirements. The effect on the removal of these assets from the records of the Department's financial statements impact only the amounts reported for the State Rail Authority and, for the year ended June 30, 2003, is as follows:

	<u>As Previously Reported</u>	<u>Adjustment</u>	<u>Restated</u>
Total capital assets - State Rail Authority	\$34,455	\$(3,932)	\$30,523
Total assets - State Rail Authority	\$36,777	\$(3,932)	\$32,845
Net assets - investment in capital assets, net of debt - State Rail Authority	\$32,217	\$(3,932)	\$28,285
Total net assets - State Rail Authority	\$33,519	\$(3,932)	\$29,587
Loss on disposal - State Rail Authority	\$(515)	\$(448)	\$(963)
Change in net assets - State Rail Authority	\$1,987	\$(448)	\$1,539

COMBINING AND INDIVIDUAL FUND STATEMENTS AND SCHEDULES

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
 COMBINING BALANCE SHEET - NONMAJOR GOVERNMENTAL FUNDS
 JUNE 30, 2003
 (amounts expressed in thousands)

	Motor Vehicle Fees	Public Transit	Aeronautics Commission	Port Authority	Total Nonmajor Governmental Funds
ASSETS					
Assets					
Cash and cash equivalents	\$ 13,898	\$ 838	\$ 770	\$ -	\$ 15,506
Receivables	96	310	103	103	612
Taxes receivable	-	-	123	-	123
Due from other State of West Virginia agencies	43	-	-	-	43
Inventories	1,263	-	-	-	1,263
Other assets	524	-	-	-	524
Total assets	\$ 15,824	\$ 1,148	\$ 996	\$ 103	\$ 18,071
LIABILITIES AND FUND BALANCES					
Liabilities					
Accounts payable	\$ 97	\$ 269	\$ 109	\$ 2	\$ 477
Retainages payable	-	-	22	61	83
Accrued payroll and related liabilities	108	18	6	18	150
Due to other State of West Virginia agencies	148	-	-	-	148
Due to other funds	2,959	-	-	-	2,959
Due to other states	2,729	-	-	-	2,729
Deferred revenue	331	-	-	-	331
Total liabilities	6,372	287	137	81	6,877
Fund balances					
Reserved for inventories	1,263	-	-	-	1,263
Unreserved, undesignated	8,189	861	859	22	9,931
Total fund balances	9,452	861	859	22	11,194
Total liabilities and fund balances	\$ 15,824	\$ 1,148	\$ 996	\$ 103	\$ 18,071

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
 COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES -
 NONMAJOR GOVERNEMENTAL FUNDS
 YEAR ENDED JUNE 30, 2003
 (amounts expressed in thousands)

	Motor Vehicle Fees	Public Transit	Aeronautics Commission	Port Authority	Total Nonmajor Governmental Funds
Revenues					
Taxes					
Aviation fuel	\$ -	\$ -	\$ 497	\$ -	\$ 497
License, fees and permits					
Motor vehicle registrations and licenses	3,087	-	-	-	3,087
Federal aid	6,283	5,788	204	64	12,339
Investment and interest income, net of arbitrage rebate	-	-	11	-	11
Payments from primary government	-	1,455	1,552	520	3,527
Miscellaneous revenues	-	362	-	-	362
	<u>9,370</u>	<u>7,605</u>	<u>2,264</u>	<u>584</u>	<u>19,823</u>
Expenditures					
Current					
Support and administrative operations	8,458	7,557	2,175	562	18,752
	<u>8,458</u>	<u>7,557</u>	<u>2,175</u>	<u>562</u>	<u>18,752</u>
Excess (deficiency) of revenues over expenditures	912	48	89	22	1,071
Fund balances, beginning of year	8,540	813	770	-	10,123
Fund balances, end of year	<u>\$ 9,452</u>	<u>\$ 861</u>	<u>\$ 859</u>	<u>\$ 22</u>	<u>\$ 11,194</u>

COMPLIANCE AND INTERNAL CONTROL REPORTS



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

To the Secretary
West Virginia Department of Transportation
Charleston, West Virginia

We have audited the financial statements of the West Virginia Department of Transportation as of and for the year ended June 30, 2003, and have issued our report thereon dated October 31, 2003, which expressed reliance on other auditors. 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. We did not audit the financial statements of the Parkways, Economic Development and Tourism Authority, a discretely presented component unit. Those statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Parkways, Economic Development and Tourism Authority was based solely on the report of the other auditors. Our report on compliance and internal control over financial reporting, insofar as it relates to compliance and internal control over financial reporting for Parkways, Economic Development and Tourism Authority is based solely on the report of other auditors.

Compliance

As part of obtaining reasonable assurance about whether the West Virginia Department of Transportation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 2003-2 through 2003-5. Additionally, we noted certain immaterial instances of noncompliance that we have reported to management of the West Virginia Department of Transportation in a separate letter dated October 31, 2003.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the West Virginia Department of Transportation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose 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's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described in the accompanying schedule of findings and questioned costs as items 2003-1 through 2003-6.

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A material weakness is a 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 in amounts that would be material in relation to the general purpose 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 in the accompanying schedule of findings and questioned costs is a material weakness. We also noted other matters involving the internal control over financial reporting, which we have reported to management of the West Virginia Department of Transportation in a separate letter dated October 31, 2003.

This report is intended solely for the information of management, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Swindle & Stalaker, PLLC

October 31, 2003



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND INTERNAL CONTROL OVER
COMPLIANCE APPLICABLE TO EACH MAJOR FEDERAL AWARD PROGRAM AND ON THE SCHEDULE
OF EXPENDITURES OF FEDERAL AWARDS**

To the Secretary
West Virginia Department of Transportation
Charleston, West Virginia

Compliance

We have audited the compliance of the West Virginia Department of Transportation with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2003. The West Virginia Department of Transportation's major federal programs are identified in the summary of audit results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal programs is the responsibility of the West Virginia Department of Transportation's management. Our responsibility is to express an opinion on the West Virginia Department of Transportation's compliance based on our audit.

The West Virginia Department of Transportation's financial statements include amounts related to the West Virginia State Rail Authority (Authority), a discretely presented component unit. The Authority disbursed \$90,625 in federal awards which are not included in the accompanying Schedule of Expenditures for Federal Awards for the year ended June 30, 2003. Our audit, described below, did not include the major programs of the West Virginia State Rail Authority because it is responsible for obtaining a separate audit of its federal award programs.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the West Virginia Department of Transportation's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the West Virginia Department of Transportation's compliance with those requirements.

In our opinion, the West Virginia Department of Transportation complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2003. However, the results of our auditing procedures disclosed an instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as item 2003-11.

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Internal Control Over Compliance

The management of the West Virginia Department of Transportation is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the West Virginia Department of Transportation's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance 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 compliance that, in our judgment, could adversely affect the West Virginia Department of Transportation's ability to administer a major federal program in accordance with the requirements of laws, regulations, contracts, and grants. The reportable conditions are described in the accompanying schedule of findings and questioned costs as items 2003-7 through 2003-11.

A material weakness is a 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 noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program 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 compliance 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 that none of the reportable conditions described above is a material weakness.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the West Virginia Department of Transportation as of and for the year ended June 30, 2003, and have issued our report thereon dated October 31, 2003. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analyses as required by OMB Circular A-133 and is not a required part of the financial statements. This schedule is the responsibility of management of the West Virginia Department of Transportation. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects, in relation to the financial statements taken as a whole.

This report is intended solely for the information of management, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Suttle & Stalnaker, PLLC

October 31, 2003

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2003

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>Division</u>	<u>CFDA Number</u>	<u>Expenditures</u>
U.S. Department of Agriculture			
Cooperative Forestry Assistance	DOH	10.664	\$ 45,753
Passed-through State of West Virginia Auditors Office			
Schools and Roads - Grants to States	DOH	10.665	<u>342,678</u>
Total U.S. Department of Agriculture			<u>388,431</u>
U.S. Department of Transportation/U.S. Appalachian Regional Commission			
Airport Improvement Program	AC	20.106	203,300
Airport Improvement Program	PA	20.106	63,925
Highway Planning and Construction Cluster			
Highway Planning and Construction	DOH	20.205	232,154,978
Appalachian Development Highway System	DOH	23.003	166,185,964
Recreational Trails Funding Program	DOH	20.219	338,869
Federal Transit Capital Improvement Grant	PT	20.500	1,643,177
Federal Transit Technical Studies Grant	PT	20.505	251,012
Public Transportation for Nonurbanized Areas	PT	20.509	3,140,459
Capital Assistance Program for Elderly Persons and Persons with Disabilities	PT	20.513	750,207
Highway Safety Cluster			
State and Community Highway Safety	DMV	20.600	5,989,221
Alcohol Traffic Safety and Drunk Driving Prevention Incentive Grants	DMV	20.601	262,571
Occupant Protection Incentive Grants	DMV	20.602	17,780
Federal Highway Safety Data Improvement Incentive Grants	DMV	20.603	13,205
Safety Incentive Grants for Use of Seatbelts	DMV	20.604	<u>289</u>
Total U.S. Department of Transportation/U.S. Appalachian Regional Commission			<u>411,014,957</u>
U.S. Federal Emergency Management Agency			
Passed-through State of West Virginia Office of Emergency Services			
Public Assistance Grants	DOH	83.544	<u>8,436,034</u>
Total U.S. Federal Emergency Management Agency			<u>8,436,034</u>
Total Federal Expenditures			<u>\$ 419,839,422</u>

AC Aeronautics Commission
DMV Division of Motor Vehicles
DOH Division of Highways
PA Port Authority
PT Public Transit

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
 NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 YEAR ENDED JUNE 30, 2003

NOTE 1 - BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the West Virginia Department of Transportation, and is presented on the accrual basis of accounting. The Schedule does not include federal awards received and expended by the discretely presented component units of the Department as described in Note 1 to the Department's financial statements for the year ended June 30, 2003. These organizations are responsible when necessary, for obtaining separate audits of their federal award programs. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

NOTE 2 - SUBRECIPIENTS

Of the federal expenditures presented in the schedule of expenditures of federal awards, the West Virginia Department of Transportation provided federal awards to subrecipients as follows:

<u>Program Title</u>	<u>Federal CFDA No.</u>	<u>Amount Provided to Subrecipients</u>
Highway Planning and Construction	20.205	\$ 8,756,247
Federal Transit Technical Studies Grant	20.505	224,370
Federal Transit Capital Improvement Grants	20.500	761,203
State and Community Highway Safety	20.600	1,710,354
Public Transportation for Nonurbanized Areas	20.509	<u>2,360,166</u>
		<u>\$ 13,812,340</u>

NOTE 3 - MAJOR FEDERAL AWARD PROGRAM

The program guidelines for the U.S. Appalachian Regional Commission "Appalachian Development Highway System" incorporated the U.S. Department of Transportation Program regulations. Accordingly, the combined funding for U.S. Department of Transportation and U.S. Appalachian Regional Commission is treated as a single federal award program cluster for the purpose of compliance testing.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SUMMARY SCHEDULE OF PRIOR YEAR SINGLE AUDIT FINDINGS
YEAR ENDED JUNE 30, 2003

Program	Findings/Noncompliance	Questioned Cost
2001-4/2002-10 CFDA# 20.205/23.003 Highway Planning, Research and Construction Cluster	<p><u>Independent Engineer's Cost Estimate</u> - We noted several instances in which the engineer's cost estimate was not prepared by the Department until after the consultant's price proposal was received.</p> <p><u>Current Year Status</u> - Not Resolved</p> <p><u>Management Response</u> - <i>As noted in our response to the 2002 audit, the Department has undertaken various actions to address this issue. The Department feels that the actions taken this past year will ensure that future cost estimates will be prepared in a timely manner. The actions taken by the Department included vacancies being filled in the Consultant Services Section of the Engineering Division, and additional staff were assigned to Contract Administration Division to address staff and time limitations. The backlog of pending consultant agreements has been reduced from approximately 425+ three years ago to approximately 200 this year. The combination of additional staff and decreasing backlog of agreements will allow the Department to prepare the independent engineer's estimate prior to receipt of the consultant fee proposals. A memorandum has been sent from the Deputy State Highway Engineer, Development, to all Districts and Divisions involved with Consultant Engineering Services, stating that their District/Division must prepare the independent engineers cost estimate prior to receipt of the consultant fee proposal.</i></p>	N/A

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SUMMARY SCHEDULE OF PRIOR YEAR SINGLE AUDIT FINDINGS
YEAR ENDED JUNE 30, 2003

Program	Findings/Noncompliance	Questioned Cost
2002-11 CFDA# 20.205/23.003 Highway Planning, Research and Construction Cluster	<p><u>Procurement of Architectural and Engineering Services</u> - We noted the following during our review of documentation related to the procurement of architectural and engineering services:</p> <ul style="list-style-type: none"> • The Consulting Services Section of the Engineering Division did not have a Consultant Confidential Qualification Questionnaire and/or Consultant Cost Accounting Information Statement on file for one of the projects selected for review. • For several of the projects reviewed, the reasons for why a vendor was selected and the interviews of consultants were not documented. <p><u>Current Year Status</u> - Not Resolved</p> <p><u>Management Response</u> - <i>As noted in our response to the 2002 audit, the Department has undertaken various actions to address this issue. The Department feels that the actions taken this past year will ensure that the required documentation will be maintained in the project files. The actions taken by the Department included a memorandum from the Deputy State Highway Engineer, Development, sent to all Districts and Divisions involved with Consultant Engineering Services. This memorandum emphasizes that all documentation related to procurement of Consultant Engineering Services must be placed in the project files. Each District/Division was instructed to take any necessary action to ensure that project files are maintained, and contain all documentation required by Chapter 5A, Article 8, Section 9 of the West Virginia Code.</i></p>	N/A

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SUMMARY SCHEDULE OF PRIOR YEAR SINGLE AUDIT FINDINGS
YEAR ENDED JUNE 30, 2003

Program	Findings/Noncompliance	Questioned Cost
2002-9 CFDA# 20.205/23.003 & 83.544 Highway Planning, Research and Construction Cluster, Public Assistance Grants	<p><u>Information Systems Controls</u> - The Department 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:</p> <ul style="list-style-type: none"> • There are no formal policies and procedures for review and monitoring of the user account access maintenance. • There are no formal policies and procedures for review and monitoring various information system security reports such as the "failed access report." • There are no policies and procedures in place for conducting periodic intrusion testing of the various computer systems maintained by the Department. • There was inadequate security over certain information stored on the Department's computer. <p><u>Current Year Status</u> - Partially Resolved</p> <p><u>Management Response</u> - <i>We have made progress toward some of the specific items noted with this recommendation. We have established formal network logon/password policies and we have electronically interfaced the monthly mainframe report of terminated personnel with the PC network user accounts system to automate account deletions. Also, we have cooperated fully with the Information Services and Communications Division (IS&C) in the statewide initiative to perform periodic intrusion detection. The first test resulted in no unknown or unacceptable accesses from outside the Department computer network. We will continue to cooperate with IS&C on this and all other security policies and programs.</i></p>	N/A

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SUMMARY SCHEDULE OF PRIOR YEAR SINGLE AUDIT FINDINGS
YEAR ENDED JUNE 30, 2003

Program	Findings/Noncompliance	Questioned Cost
2002-12 CFDA# 20.205/23.003 Highway Planning, Research and Construction Cluster	<p><u>Davis Bacon Compliance</u> - The Department obtains certified payrolls from the contractors/subcontractors and is required to perform prevailing wage inspections and issue reports on their findings. During our review of this process we noted the following:</p> <ul style="list-style-type: none"> • One project had been active for greater than one year and only had three inspections performed, of which the last inspection was performed in August of 2001. Further, the February inspection on one of these projects was not completed until May of 2002. (District 3) • One project that was active for over one year had not been inspected since March of 2001. (District 4) • All contractor payrolls for the items selected were properly submitted; however, neither the Labor Interviews nor the Compliance Inspections were provided. (District 7) <p><u>Current Year Status</u> - Resolved</p>	N/A
2002-13 CFDA# 20.205/23.003 Highway Planning, Research and Construction Cluster	<p><u>Evaluation of Consultant's Work</u> - We noted the following during our review of the Department's evaluation of consultants' work:</p> <ul style="list-style-type: none"> • The Consulting Services Section of the Engineering Division did not have timely periodic evaluations of consultant's efforts on file for two projects reviewed. • The March annual consultant evaluations could not be located for five of the active projects reviewed. <p><u>Current Year Status</u> - Not Resolved</p> <p><u>Management Response</u> - <i>The Department has undertaken various actions to address this issue. The Department feels that the actions taken this past year will ensure that the required documentation will be maintained in the project files. The actions taken by the Department included a memorandum from the Deputy State Highway Engineer, Development, sent to all Districts and Divisions involved with Consultant Engineering Services. This memorandum emphasized the need to perform the required evaluations in a timely fashion. Each District/Division was instructed to take any necessary action to ensure that project files are maintained, and contain all documentation required by Chapter 5A, Article 8, Section 9 of the West Virginia Code.</i></p>	N/A

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SUMMARY SCHEDULE OF PRIOR YEAR SINGLE AUDIT FINDINGS
YEAR ENDED JUNE 30, 2003

Program	Findings/Noncompliance	Questioned Cost
2002-14 CFDA# 20.205/23.003 Highway Planning, Research and Construction Cluster	<p><u>Level of Subcontract/Subconsulting Work</u> - The Consulting Services Section of the Engineering Division reviews the contractors/consultant's cost proposals for the amount of subcontract/subconsulting work proposed; however, the Department has not established procedures to ensure that the contractor/consultant maintains the required 51%.</p> <p><u>Current Year Status</u> - Resolved</p>	N/A
2002-15 CFDA# 20.205/23.003 Highway Planning, Research and Construction Cluster	<p><u>Contractor Awarded Projects Documentation</u> - The Department requires contractors to submit Prequalification Statements 15 days prior to the bid "letting" date. These statements serve to qualify the contractor for the type of work he may be awarded and fixes the amount of incomplete work a contractor may have under contract at any one time. We noted that one contractor award did not submit a Prequalification Statement.</p> <p>The "To Date Quantity Validation Reports" are used in the "finalization" process for the contractors final payment and show the amount of material approved and used for the project. We noted two instances in which there were no authorizing signatures at the project level on the "To Date Quantity Validation Reports."</p> <p>In addition, we noted one instance in which the Department did not have an insurance certificate for a contractor on a specific project.</p> <p><u>Current Year Status</u> - Resolved</p>	N/A

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
 SCHEDULE OF FINDINGS AND QUESTIONED COSTS
 YEAR ENDED JUNE 30, 2003

SECTION I - SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued: Unqualified Opinion

Internal control over financial reporting:

Material weakness(es) identified? _____ yes X no

Reportable condition(s) identified not considered to be material weaknesses? X yes _____ none reported

Noncompliance material to financial statements noted? X yes _____ no

Federal Awards

Internal control over major programs:

Material weakness(es) identified? _____ yes X no

Reportable condition(s) identified that are not considered to be material weaknesses? X yes _____ none reported

Type of auditors' report issued on compliance for major programs: Unqualified Opinion

Any audit findings disclosed that are required to be reported in accordance with section .510(a) of Circular A-133? X yes _____ no

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
	<u>Highway Planning and Construction Cluster</u>
<u>20.205</u>	<u>Highway Planning and Construction</u>
<u>23.003</u>	<u>Appalachian Development Highway System</u>
<u>20.505</u>	<u>Public Transportation for Nonurbanized Areas</u>
	<u>Highway Safety Cluster</u>
<u>20.600</u>	<u>State and Community Highway Safety</u>
<u>20.601</u>	<u>Alcohol Traffic Safety and Drunk Driving Prevention Incentive Grants</u>
<u>20.602</u>	<u>Occupant Protection Incentive Grants</u>
<u>20.603</u>	<u>Federal Highway Safety Data Improvement Incentive Grants</u>
<u>20.604</u>	<u>Safety Incentive Grants for Use of Seatbelts</u>
<u>83.544</u>	<u>Public Assistance Grants</u>

Dollar threshold used to distinguish between Type A and Type B programs: \$3,000,000

Auditee qualified as low-risk auditee? _____ yes X no

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2003

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SECTION II

FINANCIAL STATEMENT

FINDINGS SECTION

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-1

Information Systems Controls

See related finding at 2003-7.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-2	Accounts Receivable Collection and Financial Reporting
Criteria:	Article V of the Constitution of West Virginia states in part that, "the legislative, executive and judicial departments shall be separate and distinct, so that neither shall exercise the powers properly belonging to either of the others." Furthermore, Article 10, Section 6 of the Constitution of West Virginia states in part that, "credit of the state shall not be granted to, or in aid of any county, city, township, corporation or person; nor shall the state ever assume, or become responsible for the debts or liabilities of any county, city, township, corporation or person." Furthermore, the Department's accounts receivable policies and procedures state that entities with past due balances will have credit discontinued until the account is brought current.
Condition:	We noted that management of the Department has extended credit to other entities, including State agencies and political subdivisions that have accounts receivable balances that are past due. Thus, the Department significantly decreases their ability to collect these balances through the regular collection process. (Also noted in prior year)
Context:	The total allowance for doubtful accounts as of June 30, 2003 was approximately \$2.3 million. The total accounts receivable for this category of transactions as of June 30, 2003 was approximately \$8.6 million.
Cause:	Management of the Department has extended credit to entities, including other State agencies and political subdivisions of the State that have accounts receivable balances that are past due.
Effect:	The extension of credit to other State agencies and political subdivisions could be construed as the Department appropriating funds, thus usurping the constitutional authority the legislature.
Recommendation:	We recommend that the Department suspend the extension of credit to entities, including other State agencies and political subdivisions with past due balances until the account is brought current. Also, we recommend that the Department evaluate the requirements of West Virginia State Code and determine if revisions to and/or exclusions to the Code should be considered.
Management Response:	<p><i>The Department agrees with the recommendation that a policy be developed to analyze the accounts for Accounts Receivable. We will incorporate the policy dealing with the collections into the existing collection policy for the Accounts Receivable Section. We also offer the following comments. Please remember the state suffered many disasters the past year and the Department may have extended credit to counties, cities or towns affected. But these will be reviewed and analyzed during the current year.</i></p> <p>1. <i>The Department does cease credit extension for entities that have past due balances. For hauling permit and escort services accounts through our Maintenance Division, and our "SS" accounts (bid letting and specs) no further charges are allowed until the balance is paid in full. Trucks often have to wait at the state line because we will not issue permits or provide escorts on an overdue account. When entities that have leases with Property Management for sign (logo) rental or property rentals become delinquent, they are notified that their lease will be cancelled or their signs removed.</i></p>

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-2

Accounts Receivable Collection and Financial Reporting (Continued)

2. *In the case of governmental entities, the situation is more complicated. The Department aggressively employs every legal recourse available to collect debts from entities such as County Commissions, Public Service Divisions, Towns, School Boards, Prisons, and State Agencies. We have a record of taking many of these entities to the Court of Claims for collection, where we have been overwhelmingly successful. However, this is often a more complex situation than can be dealt with by a simple refusal of services. For example, we have had Emergency Services Organizations with an outstanding balance need gasoline for an ambulance or a school board for its buses. Often in rural areas we are the only source for gasoline in emergency situations. During the past several years the number of governmental entities obtaining gasoline from the Department has significantly decreased. It has been our goal to eliminate this service completely, but emergency situations arise where this is impossible. We receive calls from members of the legislature requesting the Department's services for their constituency in dire circumstances such as water hauling during a drought or assistance from flood damage. Some of these situations are on an emergency status from the Governor's Office and some are not. The Department asserts that government must provide for its citizens particularly in exigent circumstances. The Department has responded to these requests with this premise rather than a strictly financial one. The Department seeks guidance from the Legislature for handling matters such as these and requests for services to governmental entities from the Governor's Office on a non-emergency basis to entities indebted to the Department. The Department is currently carrying balances for many government entities for water emergency services.*

3. *The Department does not agree that the extension of credit to entities with outstanding balances "significantly decreases their ability to collect these balances through the regular collection process". There are two applicable time periods for the collection of debts. We have 2 years to collect non-contractual debts and 10 years to collect debts incurred by contract. The Statute of Limitations begins to run when the debt is incurred or the contract is signed. Therefore, subsequent debts have no effect on collecting a prior debt that has a different Statute of Limitations. During the applicable time period Accounts Receivable, the Claims Division, and ultimately the Legal Division work systematically to obtain payment. Prior to the Statute of Limitations expiring, the debt is referred to the Legal Division where a determination is made whether to file a lawsuit. Many factors are considered primarily being if the entity has sufficient funds or assets to satisfy a judgment. If it appears feasible to file a lawsuit, a case is filed in Circuit Court or a claim in the Court of Claims. When the Department receives a judgment, every means available to execute the judgment is pursued.*

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-3

Independent Engineer's Cost Estimate

See related finding at 2003-8.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-4

Procurement of Architectural and Engineering Services

See related finding at 2003-9.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-5

Evaluation of Consultant's Work

See related finding at 2003-10.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-6

Financial Reporting - Infrastructure

Criteria:

The management of the Department is responsible for establishing and maintaining adequate controls that are sufficient to ensure accounting for capital assets and related depreciation in accordance with Government Auditing Standards Board Statement No. 34 *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments* (GASB 34).

Condition:

GASB 34 was implemented for the year ended June 30, 2002, and required a number of significant changes in reporting, including the requirement to present a government-wide statement of net assets and a government-wide statement of activities in addition to the more traditional fund financial statements. This also required the Department to record infrastructure (roads, bridges, etc.) and the related accumulated depreciation as of June 30, 2003 on the government-wide statement of net assets, and to reflect the effects of this on the government-wide statement of activities. This significant change in reporting presentation required significant resources of the Department to develop an estimate for the infrastructure asset balance and the related accumulated depreciation at June 30, 2002, and to reflect the activity of the 2002 fiscal year. During the development of the information as of and for the year ended June 30, 2003, it was discovered that information extracted from the Department's information systems utilized for the estimate was not correct. As a result, the beginning net asset balance on the government-wide statement of net assets was restated, and Management's Discussion and Analysis was modified accordingly.

Context:

The total restatement to the beginning net asset balance as reported on the Statement of Net Assets was approximately \$321 million out of total net assets of approximately \$6 billion.

Cause:

An undercapitalization of infrastructure assets occurred during the initial implementation of the provisions of GASB 34 and certain projects that met the capitalization criteria were excluded from the work-in-process and other projects that were completed were not properly capitalized into infrastructure.

Effect:

Information previously reported in the government-wide financial statements were restated. There was no effect on the fund or budgetary comparison financial statements of the Department.

Recommendation:

We recommend that the Department continue to develop policies and procedures to ensure that data extracted from the information systems of the Department is accurate and complete. The procedures should include providing for adequate testing of the data extraction runs to minimize the risk of errors in complying with the requirements of GASB 34.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-6

Financial Reporting - Infrastructure (*Internal Control*) (Continued)

Management Response:

The Department has revised the process used to develop infrastructure data and is in the process of updating its infrastructure policy to include the provision for adequate testing of generated data. The reports used to compile the infrastructure figures have been tested and will continue to be tested in the future. In the prior year, we used two reports to obtain the financial information for selected projects, one for open authorizations and one for closed authorizations. Neither of these reports showed all of the authorizations for all projects that met the capitalization threshold. It was determined that in the future years these reports will be modified to include all authorizations for projects that meet the capitalization threshold. In order to determine if all projects meeting the capitalization threshold were properly identified and that amounts capitalized in the current year as work in process were correct, management obtained reports from both the authorization system and the project tracking system and conducted procedures to ensure that all projects that met the capitalization policy were properly identified, all authorizations related to those projects were captured, and that the amounts determined were consistent among the two systems.

Management is confident that the new methods and documentation provide adequate assurance that the data will be accurate in the future. In addition, the documentation format has been revised to facilitate management review and audit.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

SECTION III

FEDERAL AWARD FINDINGS
AND QUESTIONED COSTS SECTION

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-7

Information Systems Controls

Federal Program Information:

CFDA Number

U.S. Department of Transportation	
U.S. Appalachian Regional Commission	
Highway Planning and Construction Cluster	
Highway Planning and Construction	20.205
Appalachian Development Highway System	23.003
Highway Safety Cluster	
State and Community Highway Safety	20.600
Alcohol Traffic Safety and Drunk Driving Prevention Incentive Grants	20.601
Occupant Protection Incentive Grants	20.602
Federal Highway Safety Data Improvement Incentive Grants	20.603
Safety Incentive Grants for Use of Seatbelts	20.604
U.S. Federal Emergency Management Agency	
Public Assistance Grants	83.544

Criteria:

The management of the Department 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 irregularities or defalcations occurring and not being detected.

Condition:

The Department 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:

- There are no formal policies and procedures for review and monitoring of the user account access maintenance. (Also noted in prior year)

Specifically, there are no policies and procedures in place for the review of user account access maintenance in the REMIS system. When user accounts are modified and access rights are changed, it is important to have changes reviewed by a third party to preclude an accidental or intentional inappropriate change.

- There are no formal policies and procedures for review and monitoring of various information system security reports such as the "failed access report." (Also noted in prior year)

Specifically, the Information Services and Communications Department (IS&C) of West Virginia creates a report of failed login attempts; however, there is no review of this report by the Department personnel. A report of failed logins provides information and clues that there may be unauthorized attempts being made at access into the network. Failure to review this report increases the possibility of undetected intrusion attempts.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-7

Information Systems Controls (Continued)

Condition:
(Continued)

Through IS&C, the Department did have a web intrusion vulnerability test conducted during the period of review. However, there are no policies and procedures in place for conducting periodic intrusion vulnerability testing of the various computer systems maintained by the Department. (Also noted in prior year)

Specifically, the intrusion vulnerability test report presentation provided to us during our review had no date of testing. In addition, the presentation showed several severe security vulnerabilities. A second test presentation was provided, which showed many of the vulnerabilities patched, but some still active. No formal test report was available for our review. All testing was performed under the responsibility of the IS&C and was not under the control of the Department. Furthermore, there was no Department or IS&C policy requiring periodic vulnerability testing evident. Also, while it was disclosed that network monitoring is performed, there was no knowledge of what level of intrusion attempt would initiate disclosure to the Department if detected by IS&C. Given the continuous development of intrusion methods, it is very important to have regular testing of known vulnerabilities. Information from the test reports provides the ability to modify and patch the known security weaknesses in systems. Knowledge of the level of intrusion attempt that would initiate notification to the Department provides better assurance that the parties responsible for monitoring intrusion detection systems will provide appropriate protection at appropriate times.

Programmers in the Department's Information Services Department have access to production programs in the REMIS system. This access grants the Department's Information Services Department personnel the same rights as a business user of the application, which allows them access to data and transaction authority.

Questioned Costs:

N/A

Context:

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

Cause:

Policies and procedures have not been adequately updated and information system controls have not been monitored by the Department.

Effect:

Unauthorized access to critical information systems may occur and not be detected.

Recommendation:

We recommend that the Department strengthen their policies and procedures related to information systems controls and ensure that controls are operating as designed. Specifically, we recommend that an individual other than those responsible for adding and making changes to user rights review changes made to user access in the REMIS system. The Department should also consider requiring the individuals who have responsibility for certain system access areas such as payroll, accounts receivable, etc., to periodically review for accuracy the listing of individuals who have access to those systems. These processes should be documented in the policies and procedures of the Department.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-7

Information Systems Controls (Continued)

Recommendation:
(Continued)

Also, we recommend that all intrusion detection reports available be reviewed regularly by authorized personnel. We further recommend that an action plan and procedure be implemented outlining the steps to be taken when an intrusion is detected.

Furthermore, the Department should work with IS&C to ensure that periodic intrusion vulnerability testing is conducted for all significant systems utilized by the Department. Also, we recommend that the Department 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. In addition, the internal audit group of the Department should consider designing audit procedures for the monitoring and review of information system controls.

Management Response:

- *Agree. In the prior year's response we agreed to develop these policies and procedures in conjunction with management. We recommend the following policies and procedures and will include them in the Department's procedures upon approval.*
1. *Assignment of review of users with rights to certain system access areas, such as payroll, accounts receivable, etc., will be to the manager responsible for the system.*
 - a. *Monthly, Information Services will provide a report of user accounts with access to a specific system to the manager responsible for that system. (For example, a report of all users with access to the Personnel System will be sent to the Human Resources Department Director.)*
 - b. *The manager responsible for the system will review the system user access report to identify inaccuracies.*
 - c. *The manager responsible for the system will report inaccuracies to the Director of Information Services and to other management as appropriate.*
 2. *Information Services Department will continue the current practice of sending a monthly user access report to the manager of each organization to confirm that the access privileges for users of their own organization are appropriate.*
- *Agree. In the prior year's response we have been reluctant to commit scarce resources to this task with such a low return on investment. However, we now recommend the following policies and procedures and will include them in the Department's procedures upon approval.*
1. *Information Services Department will review the Failed Access Report each workday to identify patterns of violations (over successive days) that may indicate unauthorized access attempts.*

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-7

Information Systems Controls (Continued)

Management Response:
(Continued)

2. *Information Services will notify the user's management (Department Directors and District Comptrollers) and Transportation Auditing Department of the suspected access violation events so that they may investigate the user's actions and intent.*
3. *Results of the investigation will be reported in a timely manner to the Director of Information Services Department and to other management as appropriate.*
4. *Appropriate corrective actions will be taken as a result of the investigation and consultation with appropriate management.*
- *Agree. Access from the DOT network to the Internet is through the State's backbone, exclusively. Therefore, the intrusion detection services of IS&C and Trust Wave, the contract vendor, provide us with comprehensive coverage. This service has performed well and we have been alerted to some events to which we have taken immediate and appropriate action.*

The results of the two vulnerability tests have not revealed any unknown or unacceptable security vulnerabilities and no security patching was required. The openings in our network that were identified in these vulnerability tests were: internet/e-mail, which we must have to conduct business and that we protect with a firewall, Websense and with F-Secure and Antigen antivirus programs; FTP (File Transfer Protocol) which is user identified and authenticated by password for contractor's and others; and VPN (Virtual Private Network) which permits controlled, user identified and password authenticated access for employees and some of our IT contractors.

We have recommended to IS&C that statewide policies are needed for their intrusion detection program. These policies should include the intrusion reporting parameters and they should also include intrusion response policies and procedures. Also, we have recommended to IS&C that vulnerability testing be conducted at least twice per year and that formal reports be provided.

We are committed to continuing to work with IS&C on the intrusion detection and vulnerability testing policies and procedures issues. Also, we will develop intrusion response policies and procedures, once the statewide policies are issued.

- *Agree. Change Management Control is the issue here with the fundamental control being a 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.*

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.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-7

Information Systems Controls (Continued)

Management Response:
(Continued)

However, we will review our operations and practices against the standards of Change Management. Following this review, we will develop a proposal, including costs, and present this proposal to the Business Manager for decision-making. Upon receipt of a decision, we will develop the approved plan including policies and procedures regarding programmer access as well as mitigating controls and required documentation.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-8

Independent Engineer's Cost Estimate

Federal Program Information:

CFDA Number

U.S. Department of Transportation

U.S. Appalachian Regional Commission

Highway Planning and Construction Cluster

Highway Planning and Construction

Appalachian Development Highway System

20.205

23.003

Criteria: Section 157-1-7.7b of the Code of State Rules requires the director of the Department initiating the request for service to be responsible for preparing an independent engineer's cost estimate prior to the receipt of the fee proposal from the consultant.

Condition: As noted in the prior year, we noted several instances in which the engineer's cost estimate was not prepared by the Department until after the consultant's price proposal was received.

Questioned Costs: N/A

Context: Total expenditures for architectural and engineering services were approximately \$81.9 million for the year ended June 30, 2003.

Cause: Due to staff and time limitations, the Department has been unable to prepare the independent engineer's cost estimate prior to receipt of the fee proposal from the consultant.

Effect: The Department is in noncompliance with the Code of State Rules and cost estimates prepared by the Department risk being influenced by submitted proposals.

Recommendation: We recommend that the Department devote the necessary resources to ensure that the Code of State Rules and its policies and procedures are followed and cost estimates are prepared in a timely manner.

Management Response: *The Department has undertaken various actions to address this issue, including devoting additional resources to preparation of the independent engineer's cost estimate. The Department feels that the previous actions undertaken, and the additional resources taken this past year will ensure that future cost estimates will be prepared in a timely manner.*

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-9 Procurement of Architectural and Engineering Services

Federal Program Information:

CFDA Number

U.S. Department of Transportation
U.S. Appalachian Regional Commission
Highway Planning and Construction Cluster
Highway Planning and Construction
Appalachian Development Highway System

20.205
23.003

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..." Further, Section 157-1-7.16 states: "Record Keeping. Unless otherwise noted, all documentation under this procedure will be retained on file at the Department of Highways and would be available for review by the FHWA."

Condition:

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

- The Consulting Services Section of the Engineering Department did not have a Consultant Confidential Qualification Questionnaire and/or Consultant Cost Accounting Information Statement on file for seven of the projects tested. (Also noted in prior year)
- For several of the projects reviewed, the reasons for why a vendor was selected and the interviews of consultants were not documented. (Also noted in prior year)
- The Consulting Services Section of the Engineering Department does not document that the consultant; 1) is registered and is in good standing with the State Tax Department and Bureau of Employment Programs; and 2) that at least one of the key consultants anticipated to be used on the project is registered and is in good standing with the Board of Registration for Professional Engineers.

Questioned Costs:

N/A

Context:

Total expenditures for architectural and engineering services were \$81.9 million for the year ended June 30, 2003.

Cause:

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

Effect:

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

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-9

Procurement of Architectural and Engineering Services

Recommendation:

We recommend that the Department strengthen their policies and procedures regarding required documentation for the procurement of architectural and engineering services.

Management Response:

- *The Department will retain the necessary information in our project files to show that a Consultant Confidential Qualification Questionnaire and Consultant Cost Accounting Information Statement was on file during the year that the consultants were selected.*
- *The Department disagrees with this part of the finding. The Department feels that the necessary documentation is contained in the files. The memo from the pre-selection committee states that everyone on the short-list has been interviewed by at least one member of the pre-selection committee. The pre-selection committee states the reasons why the firms were selected for the short-list, and that they have met the selection criteria. All firms on the short list are considered to be equal and the selection committee is required only to select the firm to provide the required services, and to select a 1st and 2nd alternate if an agreement can not be reached with the selected firm.*
- *The Department will document that all the firms on the short-list are in good standing with the State Tax Department and Bureau of Employment Programs, and that they have at least one WV Registered Professional Engineer in their firm that will supervise all engineering work. This will be reviewed again at the time a contract is executed with the engineering firm.*

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

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2003-10

Evaluation of Consultant's Work

Federal Program Information:

CFDA Number

U.S. Department of Transportation

U.S. Appalachian Regional Commission

Highway Planning and Construction Cluster

Highway Planning and Construction

Appalachian Development Highway System

20.205

23.003

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 Department 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 Department but the final invoice has not been paid, the consultant will not need to be evaluated..."

Condition:

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

- The March annual consultant evaluations could not be located for seven of the active projects reviewed. (Also noted in prior year)
- For one project reviewed, there were no progress notes, even though a "Notice to Proceed" was given to the consultant.

Questioned Costs:

N/A

Context:

Total expenditures for architectural and engineering services were \$81.9 million for the year ended June 30, 2003.

Cause:

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

Recommendation:

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

Management Response:

All evaluations of consultant work will be placed in the files in the Consultant Services Section of the Engineering Department. The Department has undertaken new efforts to prepare consultant evaluations at each major milestone of the project. The Department will amend the Department procedures to reflect this new procedure for consultant evaluations.

WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2003

2003-11

Subrecipient Monitoring

Federal Program Information:

CFDA Number

U.S. Department of Transportation
Highway Safety Cluster

State and Community Highway Safety	20.600
Alcohol Traffic Safety and Drunk Driving Prevention Incentive Grants	20.601
Occupant Protection Incentive Grants	20.602
Federal Highway Safety Data Improvement Incentive Grants	20.603
Safety Incentive Grants for Use of Seatbelts	20.604

Criteria: Pass-through entities are required to develop programmatic and financial monitoring procedures to ensure subrecipients have used federal funds for authorized purposes. In addition, all subrecipients subject to OMB Circular A-133 with fiscal years ending after 1996 and spending more than \$300,000 in federal awards must have audits completed in accordance with OMB Circular A-133 and provide copies of their audit reports to the primary recipient.

Condition: The Division of Motor Vehicles has not developed a monitoring plan for the monitoring of subrecipients and was unable to provide documentation of all on-site monitoring performed. Furthermore, as of the date of our fieldwork, the Division of Motor Vehicles did not have any of the required audit reports from subrecipients on file.

Questioned Costs: Unknown

Context: Total federal expenditures for subrecipients and total federal expenditures for the Highway Safety Cluster were \$1,710,354 and \$6,283,066, respectively, for the year ended June 30, 2003.

Cause: The Division of Motor Vehicles does not have a formalized monitoring plan in place to ensure that federal funds are spent for authorized purposes and did not have the required subrecipient audit reports on file.

Effect: Management indicated that policies and procedures were not established at the program's inception; however, policies and procedures have now been drafted and will go into effect January 1, 2004. The subrecipients failed to submit a copy of their annual audit reports to the Division of Motor Vehicles.

Recommendation: The Division of Motor Vehicles should ensure that the monitoring procedures drafted are implemented and ensure that all subrecipients subject to the requirements of OMB Circular A-133 have the required audits completed in a timely manner and submitted to the Division of Motor Vehicles for review.

Management Response: *The Division will do all it can to implement the appropriate monitoring procedures and ensure compliance with OMB Circular A-133.*