SUPPLEMENT TO OFFICIAL STATEMENT

$650,635,000
Commonwealth of Pennsylvania
General Obligation Bonds
$300,000,000 First Series of 2002
$350,635,000 First Refunding Series of 2002

This Supplement to the Official Statement dated February 13, 2002, for the Commonwealth of Pennsylvania's General Obligation Bonds, First Series of 2002 Bonds and First Refunding Series of 2002 (the "Official Statement"), provides supplemental information in connection with the issuance of the First Refunding Series of 2002 Bonds. **Investors should read the information herein in conjunction with the information in the Official Statement**.

The Official Statement in the table on the top of page 6 misstated the amount and maturities of the Commonwealth's Third Series of 1994 General Obligation Bonds being refunded. In particular, the incorrect table stated that the Third Series of 1994 Bonds maturing on November 15, 2006 (the "2006 Maturity Bonds"), will be (1) refunded with the proceeds of the First Refunding Series of 2002 Bonds and (2) redeemed on November 15, 2004. The 2006 Maturity Bonds will NOT be refunded with the proceeds of the First Refunding Series of 2002 Bonds, and the Commonwealth currently has no plans to refund such bonds or provide for their redemption prior to maturity.

The correct principal amount and maturities of the Third Series of 1994 Bonds to be refunded and redeemed prior to their scheduled maturities are:

Principal Amount to be Refunded	Bond Series	Date of Issue	Bonds Maturing on	Date of Redemption
$152,410,000	Third Series of 1994	November 15, 1994	November 15, 2007-2014	November 15, 2004

Certain maturities of the Commonwealth's First Series of 1992 Bonds and Third Series of 1992 Bonds are being refunded and redeemed as described on page 6.

The Date of this Supplement is February 21, 2002.

NEW ISSUE - BOOK-ENTRY ONLY

Ratings: Moody's: Aa2
Standard & Poor's: AA
Fitch: AA
(See "Ratings" herein)

In the opinion of Bond Counsel, under existing law, and subject to continuing compliance by the Commonwealth with certain covenants to comply with provisions of the Internal Revenue Code of 1986, as amended (the "Code"), interest on and accruals of original issue discount with respect to the Bonds are excluded from gross income for federal income tax purposes and are not items of tax preference for purposes of the federal alternative minimum tax on individuals and corporations; however, with respect to corporations (as corporations are defined for federal income tax purposes) such interest and accruals are taken into account in determining adjusted current earnings for the purpose of computing the alternative minimum tax. The Bonds are exempt from personal property taxes in Pennsylvania and the interest on the Bonds is exempt from Pennsylvania corporate net income tax and from personal income taxation by the Commonwealth of Pennsylvania. (See "TAX MATTERS" herein).

$650,635,000
Commonwealth of Pennsylvania
General Obligation Bonds
$300,000,000 First Series of 2002
$350,635,000 First Refunding Series of 2002

Dated: February 1, 2002 **Due: February 1, as shown on inside cover**

The Bonds will be issued only in book-entry form initially registered in the name of Cede & Co., as nominee for The Depository Trust Company ("DTC"), New York, New York. DTC will act as securities depository for the Bonds. Interest on the Bonds will be payable semi-annually on February 1 and August 1, commencing August 1, 2002. First Union National Bank, Philadelphia, Pennsylvania, is the Loan and Transfer Agent for the Bonds. Principal of and interest and redemption premium, if any, on the Bonds are payable to Cede & Co. See "THE BONDS – Book-Entry Only System."

The First Series of 2002 Bonds are subject to redemption as set forth herein. See "THE BONDS – Optional Redemption." The First Refunding Series of 2002 Bonds are not subject to redemption prior to maturity.

The Bonds are direct and general obligations of the Commonwealth and the full faith and credit of the Commonwealth are pledged for the payment of principal of and interest on the Bonds.

Payment of the principal and interest, when due, on the First Series of 2002 Bonds maturing on February 1, 2012, 2020 and 2021, and on the First Refunding Series of 2002 Bonds maturing on February 1, 2014 (indicated by an asterisk (*) in the table on the following page) will be insured by a municipal bond insurance policy to be issued by Financial Guaranty Insurance Company simultaneously with the delivery of the Bonds. See Appendix H herein titled "FINANCIAL GUARANTY INSURANCE COMPANY INSURANCE POLICY."

FGIC. Financial Guaranty Insurance Company

FGIC is a registered service mark used by Financial Guaranty Insurance Company, a private company not affiliated with any U.S. Government agency.

This cover page contains certain information for quick reference only. It is not a summary of the issue. Investors must read the entire Official Statement to obtain information essential to the making of an informed investment decision regarding the Bonds.

The Bonds are offered when, as and if issued, and are subject to the receipt of the legal opinions of the Attorney General of the Commonwealth of Pennsylvania and of Klett Rooney Lieber & Schorling, A Professional Corporation, Pittsburgh, Pennsylvania, Bond Counsel. The Commonwealth expects that the Bonds will be available through the facilities of DTC in New York, New York, on or about February 28, 2002.

Dated: February 13, 2002

$650,635,000
Commonwealth of Pennsylvania
General Obligation Bonds

$300,000,000 First Series of 2002
$350,635,000 First Refunding Series of 2002

MATURITY SCHEDULE

(Base CUSIP Number: 709141)

Due February 1	First Series of 2002 Principal Amount	Interest Rate	Yield	CUSIP Number	First Refunding Series of 2002 Principal Amount	Interest Rate	Yield	CUSIP Number
2003	$9,855,000	4.000%	1.55%	TZ8	…	…	…	…
2004	10,320,000	4.000	2.41	UA1	…	…	…	…
2005	10,810,000	5.000	2.85	UB9	$12,870,000	5.000%	2.85 %	UV5
2006	11,310,000	5.000	3.16	UC7	23,310,000	5.000	3.16	UW3
2007	11,845,000	5.000	3.51	UD5	23,685,000	5.000	3.51	UX1
2008	12,405,000	5.000	3.74	UE3	37,290,000	5.000	3.74	UY9
2009	12,985,000	5.000	3.95	UF0	38,670,000	5.000	3.95	UZ6
2010	13,595,000	5.250	4.08	UG8	40,105,000	5.250	4.08	VA0
2011	14,235,000	5.250	4.18	UH6	41,730,000	5.250	4.18	VB8
2012	14,910,000 *	5.250	4.27	UJ2	43,420,000	5.500	4.28	VC6
2013	14,330,000	5.375	4.41?	UK9	45,240,000	5.500	4.40	VD4
2014	15,005,000	5.250	4.50?	UL7	21,580,000*	5.500	4.50	VE2
2015	15,715,000	5.250	4.58?	UM5	22,735,000	5.500	4.55	VF9
2016	16,445,000	5.250	4.68?	UN3	…	…	…	…
2017	17,220,000	5.250	4.77?	UP8	…	…	…	…
2018	18,030,000	5.250	4.86?	UQ6	…	…	…	…
2019	18,875,000	5.250	4.92?	UR4	…	…	…	…
2020	19,760,000*	5.000	5.07	US2	…	…	…	…
2021	20,695,000*	5.000	5.10	UT0	…	…	…	…
2022	21,655,000	5.000	5.09	UU7	…	…	…	…

+ These maturities have been priced to call at par.
* Maturities insured by a municipal bond insurance policy to be issued by Financial Guaranty Insurance Company.

(Accrued interest to be added)

The interest rates shown above are the interest rates per annum payable by the Commonwealth on the Bonds of each maturity date as indicated. The yields shown above for each maturity were furnished to the Commonwealth by the group of banks and investment banking firms who purchased the Bonds from the Commonwealth on February 13, 2002, and may not reflect the current market prices of the Bonds. All information concerning the re-offering of the Bonds should be obtained from the underwriters and not from the Commonwealth.

THE ISSUING OFFICIALS

Governor .... *MARK S. SCHWEIKER*
State Treasurer..*BARBARA HAFER*
Auditor General ....*ROBERT P. CASEY, JR.*

OFFICE OF THE BUDGET

Secretary... *ROBERT A. BITTENBENDER*

Attorney General of the Commonwealth of Pennsylvania

D. Michael Fisher

Bond Counsel

Klett Rooney Lieber & Schorling, A Professional Corporation
Pittsburgh, Pennsylvania

Special Disclosure Counsel

Hunton & Williams
Richmond, Virginia

Financial Advisor

Commerce Capital Markets, Inc.
Philadelphia, Pennsylvania

No dealer, broker, salesperson or other person has been authorized to give any information or to make any representations, other than as contained in this Official Statement, in connection with the offering contained herein, and, if given or made, such other information or representations must not be relied upon as having been authorized by the Commonwealth of Pennsylvania. This Official Statement does not constitute an offer to sell, or a solicitation of an offer to buy, nor shall there be any sale of the Bonds by any person in any jurisdiction where such sale would be unlawful.

Except as otherwise noted, the information herein speaks as of its date and is as of the date of this Official Statement and is subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, in any circumstances, create any implication that there has been no change in the affairs of the Commonwealth of Pennsylvania since the date hereof.

The order and placement of the information in this Official Statement, including the Appendices hereto and the information incorporated herein by reference, are not to be deemed to be a determination of relevance, materiality or importance, and this Official Statement, including the Appendices, and the information incorporated herein by reference, must be considered in its entirety.

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SUMMARY INFORMATION

THIS SUMMARY STATEMENT IS SUBJECT IN ALL RESPECTS TO THE MORE COMPLETE INFORMATION CONTAINED IN THIS OFFICIAL STATEMENT. OFFERING OF THE BONDS TO THE POTENTIAL PURCHASERS IS MADE ONLY BY MEANS OF THIS ENTIRE OFFICIAL STATEMENT, INCLUDING THE COVER AND APPENDICES HERETO AND THE INFORMATION INCORPORATED BY REFERENCE.

Issuer.. Commonwealth of Pennsylvania

Offering.................................... $650,635,000 Commonwealth of Pennsylvania, General Obligation Bonds, consisting of $300,000,000 First Series of 2002 Bonds (the "First Series Bonds") and $350,635,000 First Refunding Series of 2002 Bonds (the "Refunding Series Bonds," and collectively the "Bonds")

Dated Date............................... February 1, 2002

Security.................................... General obligations of the Commonwealth of Pennsylvania; full faith and credit pledged

Use of Proceeds....................... The Commonwealth of Pennsylvania is issuing the Bonds for the following purposes:

Purpose	Principal Amount
First Series Bonds	
Capital Facilities Projects	$300,000,000
Refunding Series Bonds	
Refunding	$350,635,000

Redemption............................. The First Series Bonds maturing on or after February 1, 2013 are subject to optional redemption in whole or in part at any time on and after February 1, 2012 at par plus accrued interest to the date fixed for redemption.
The Refunding Series Bonds are not subject to redemption prior to maturity.

Authorized Denominations.... $5,000 or integral multiples thereof.

Form of Bonds .... Bonds are issued in fully registered form through a book-entry only system.

Loan & Transfer Agent.......... First Union National Bank, Philadelphia, Pennsylvania.

Legal Opinions......................... Klett Rooney Lieber & Schorling, A Professional Corporation, Bond Counsel.
D. Michael Fisher, Attorney General of the Commonwealth of Pennsylvania.

Bond Ratings............................ Moody's Investors Service............................ Aa2
Standard & Poor's Rating Services, a division of the McGraw-Hill Companies ....AA
Fitch Ratings...AA

Official Statement
$650,635,000
Commonwealth of Pennsylvania
General Obligation Bonds
$300,000,00First Series of 2002
$350,635,000 First Refunding Series of 2002

INTRODUCTION

This Official Statement of the Commonwealth of Pennsylvania (the "Commonwealth"), including the cover page and appendices, presents certain information in connection with the issuance of $650,635,000 aggregate principal amount of the Commonwealth's general obligation bonds consisting of $300,000,000 aggregate principal amount of Commonwealth of Pennsylvania General Obligation Bonds, First Series of 2002 (the "First Series Bonds") and $350,635,000 aggregate principal amount of Commonwealth of Pennsylvania General Obligation Bonds, First Refunding Series of 2002 (the "Refunding Series Bonds" and collectively with the First Series Bonds, the "Bonds"). The First Series Bonds are being issued to finance various capital budget projects. The Refunding Bonds are being issued to refund certain outstanding bond issues of the Commonwealth. See "USE OF PROCEEDS."

The Bonds are general obligations of the Commonwealth to which the full faith and credit of the Commonwealth are pledged. See "SECURITY AND SOURCE OF PAYMENT FOR BONDS." Principal of and interest payments on the Bonds will be paid from the General Fund. See "COMMONWEALTH FINANCIAL PERFORMANCE" and "COMMONWEALTH FINANCIAL STRUCTURE AND PROCEDURES."

When issued, the Bonds will be registered in the name of Cede & Co., as nominee for The Depository Trust Company, securities depository for the Bonds under a book-entry only registration system. See "THE BONDS — Book-Entry Only System" and Appendix D.

The Bonds are authorized investments for fiduciaries and personal representatives, as defined in the Probate, Estates and Fiduciaries Code within the Commonwealth; are legal investments for Pennsylvania banks, trust companies, bank and trust companies, savings banks, and insurance companies; and are acceptable as security for deposits of the funds of the Commonwealth. See "LEGALITY FOR INVESTMENT."

Except where otherwise expressly noted, the financial and other information provided in this Official Statement is generally derived from the records of the Commonwealth. All estimates and assumptions are based on the best information available but do not constitute factual information. All estimates of future performance or events constituting "forward looking statements" may or may not be realized because of a wide variety of economic and other circumstances. Included in such forward-looking statements are numbers and other information from budgets for current and future fiscal years. The references to, and summaries of, Constitutional and statutory provisions of the Commonwealth and to bond resolutions and other documents are qualified in their entirety by reference to the complete provisions of such documents and to any judicial interpretations thereof.

THE BONDS

Description of the Bonds

The Bonds will be dated February 1, 2002, will bear interest initially from such date, at the rate per annum for each maturity as specified on the cover page hereof, payable semi-annually on each February 1and August 1, commencing August 1, 2002, calculated on the basis of a 360-day year of twelve 30-day months, and will mature in the amounts and on the dates as set forth on the inside of the cover page hereof.

The Resolutions (as hereinafter defined) and all provisions thereof are incorporated by reference in the text of the Bonds, including, without limitation, those provisions setting forth the conditions under which the Resolutions may be modified. The Bonds provide that each registered owner, Beneficial Owner, DTC Participant or Indirect Participant (as hereinafter defined) in DTC, by acceptance of a Bond (including receipt of a book-entry credit evidencing an interest therein), assents to all of such provisions as an explicit and material portion of the consideration running to the Commonwealth to induce it to adopt the Resolutions and to issue such Bond. Copies of the Resolutions, including the full text of the form of the Bonds, are on file at the designated office of the Loan and Transfer Agent.

Interest on the Bonds will be payable by check or draft mailed or other transfer made to the persons in whose names the Bonds shall be registered at the close of business on the fifteenth day of the calendar month next preceding such interest payment date (the “Record Date”). Any interest on any Bond not timely paid or duly provided for shall cease to be payable to the person who is the registered owner as of the regular Record Date, and shall be payable to the person who is the registered owner at the close of business on a special record date for the payment of such defaulted interest. A special record date shall be a date not more than fifteen nor less than ten days prior to the date of the proposed payment and shall be fixed whenever moneys become available for payment of the defaulted interest. Notice of a special record date shall be given to registered owners of the Bonds not less than fifteen days prior thereto.

Whenever the due date for payment of interest on or principal of the Bonds or the date fixed for redemption of any Bond shall be a Saturday, a Sunday, a legal holiday or a day on which banks in the Commonwealth are required or authorized by law (including by executive order) to close, then payment of such interest, principal or redemption price need not be made on such date, but may be made on the next succeeding day which is not a Saturday, a Sunday, a legal holiday or a day upon which banks in the Commonwealth are required or authorized by law (including by executive order) to close, with the same force and effect as if made on the due date for payment of principal, interest or redemption price, and no interest shall accrue thereon for any period after such due date.

Book-Entry Only System

The Depository Trust Company, New York, New York (“DTC”) will act as securities depository for the Bonds pursuant to a book-entry only system. Information regarding DTC and its book-entry system, provided by DTC, appears as Appendix D. Such information has been provided by DTC, and the Commonwealth does not assume any responsibility for the accuracy or completeness of such information. The Commonwealth may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Bond certificates will be printed and delivered.

For so long as the Bonds are registered in the name of DTC, or its nominee Cede & Co., the Commonwealth and the Loan and Transfer Agent will treat Cede & Co. as the registered owner of the Bonds for all purposes, including payments, notices and voting.

Neither the Commonwealth nor the Loan and Transfer Agent shall have any responsibility or obligation to any Direct or Indirect Participant or Beneficial Owner (as defined in Appendix D) with respect to (i) the accuracy of any records maintained by DTC or any Direct or Indirect Participant with respect to any beneficial ownership interest in any Bonds; (ii) the payment by any Direct or Indirect Participant of any amount due to any Beneficial Owner in respect of the principal of, premium, if any, and interest on the Bonds; (iii) the delivery or timeliness of delivery by any Direct or Indirect Participant of any notice to any Beneficial Owner with respect to the Bonds, including, without limitation, any notice of redemption; or (iv) other action taken by DTC or Cede & Co., including the effectiveness of any action taken pursuant to an Omnibus Proxy.

Payments made by or on behalf of the Commonwealth to DTC or its nominee shall satisfy the Commonwealth’s payment obligations with respect to the Bonds to the extent of such payments.

Optional Redemption

The First Series Bonds, or portions thereof in integral multiples of $5,000, maturing on and after February 1, 2013, are subject to redemption at the option of the Commonwealth prior to scheduled maturity, on or after February 1, 2012, as a whole or in part at any time and from time to time, in any order of maturity determined by the Commonwealth and by lot within a maturity in such manner as the Commonwealth in its discretion may determine, on at least 30 days’ (but not more than 60 days’) notice, at par plus accrued interest to the date fixed for redemption.

The Refunding Series Bonds are not subject to optional redemption prior to maturity.

As long as the Bonds are registered pursuant to a book-entry only system, notice of redemption will be given, as required by the procedures of DTC (or any successor depository), to DTC, its nominee, or successor securities depository as registered owner of the Bonds. So long as Cede & Co. is the registered owner of the Bonds, the Commonwealth will not be responsible for mailing notices of redemption to anyone other than DTC or its nominee.

Notice of redemption shall be given by the Loan and Transfer Agent via first-class mail not less than 30 days, nor more than 60 days, prior to the date fixed for redemption to the persons in whose names the Bonds to be redeemed are registered at the close of business on the fifth (5^{th}) business day prior to such mailings; provided, however, that any defect in the notice or in the mailing thereof with respect to any registered owner shall not affect the validity of the proceedings for such redemption as to any other registered owner. Deposit of any such notice in the United States mail shall constitute constructive receipt of such notice by the registered owner to whom such notice is sent. Notice having been given as aforesaid and provision having been made for redemption from funds on deposit with the Loan and Transfer Agent, no interest on Bonds, or portions thereof, called for redemption shall accrue after the date fixed for redemption, and the registered holders of the Bonds, or portions thereof, called for redemption shall thereafter have no further right except to receive payment of the redemption price plus accrued interest to the redemption date.

In addition to the notice of redemption to the registered owners of the Bonds, the Loan and Transfer Agent shall cause copies of the original redemption notice to be sent by facsimile transmission, overnight delivery or certified mail with return receipt requested (or other similar means that can provide evidence of receipt) to all registered securities depositories then in the business of holding obligations similar to the Bonds, and to two or more national information services that disseminate redemption information; provided however, that failure to send such copies of the original redemption notice or any defect therein shall not affect the validity of the redemption proceedings.

SECURITY AND SOURCE OF PAYMENT FOR BONDS

The Bonds are direct and general obligations of the Commonwealth to which the full faith and credit of the Commonwealth have been pledged for the payment of the interest thereon as it becomes due and the payment of the principal thereof at maturity or prior redemption. The various acts authorizing the incurrence of debt by the Commonwealth require the General Assembly to appropriate annually the moneys necessary to pay such interest and principal for which other provisions are not made. See the statutes described in the subsection “Authorization” below. Principal of and interest payments on the First Series Bonds will be made from the General Fund, and on the Refunding Series Bonds from the General Fund and the Motor License Fund.

The Constitution of the Commonwealth of Pennsylvania (the “Constitution”) places a claim on revenues of the Commonwealth as security for the payment of principal of and interest on all debt of the Commonwealth. Article VIII, Section 7(d) of the Constitution provides that if sufficient funds are not appropriated for the timely payment of the interest on and principal of all Commonwealth debt, the State Treasurer shall set apart from the first revenues thereafter received applicable to the appropriate fund, a sum sufficient to pay such interest and principal, and shall so apply the money so set apart.

The State Treasurer may be required to set aside and apply such revenues at the suit of any holder of Commonwealth obligations.

For a description of the constitutional provisions relating to the Bonds, see Appendix E. The proposed form of the opinion of the Attorney General is in Appendix F and the proposed form of the opinion of Bond Counsel is in Appendix G.

Authorization

The Bonds are authorized and issued pursuant to and in full compliance with the provisions, restrictions and limitations of Sections 7 and 16 of Article VIII of the Constitution; the laws of the Commonwealth, including the Capital Facilities Debt Enabling Act, Act No. 1999-1, approved February 9, 1999, as amended, annual capital budget bills and various bond authorization bills enacted by the General Assembly; the Agricultural Area Security Law, Act No. 1981-43, approved June 30, 1981, as amended; a constitutional referendum question approved by the voters of the Commonwealth on November 3, 1987; the Land and Water Conservation and Reclamation Act, Act No 1967-443, approved January 19, 1968, as amended; the Water Facilities Restoration Act, Act No. 1982-167, approved June 22, 1982; a constitutional referendum question approved by the voters of the Commonwealth on November 3, 1981; the Pennsylvania Infrastructure Investment Authority Act, Act No. 1988-16, approved March 1, 1988; constitutional referendum questions approved by the voters of the Commonwealth on April 28, 1988 and April 28, 1992; the Volunteer Fire Company, Ambulance Service and Rescue Squad Assistance Act, Act No. 1976-208, approved July 15, 1976, as amended, constitutional referendum questions approved by the voters of the Commonwealth on November 4, 1975, November 3, 1981, and November 6, 1990; the Pennsylvania Economic Revitalization Act, Act No. 1984-104, approved July 2, 1984; a constitutional referendum question approved by the voters of the Commonwealth on April 10, 1984; the Keystone Recreation, Park and Conservation Fund Act, Act No. 1993-50, approved July 2, 1993, a constitutional referendum question approved by the voters of the Commonwealth on November 2, 1993; the Prison Facilities Improvement Act, Act No. 1990-71, approved July 1, 1990; and a constitutional referendum question approved by the voters of the Commonwealth on November 6, 1990. The Bonds are also authorized and issued pursuant to resolutions adopted by the Governor, the State Treasurer, and the Auditor General (the "Issuing Officials") on February 7, 2002, and February 13, 2002 (collectively, the "Resolutions").

Debt Limits

The Constitution (Article VIII, Section 7(a)) permits debt to be incurred for purposes itemized in law and approved by voter referendum, and without approval of the electorate for the rehabilitation of areas affected by man-made or natural disasters and for capital facilities projects specifically itemized in a capital budget if such debt does not cause the amount of all net debt outstanding (as defined for purposes of that Section) to exceed one and three quarters times (1.75x) the average of the annual tax revenues of the Commonwealth deposited in all funds in the previous five fiscal years, as certified by the Auditor General (the "Constitutional Debt Limit"). The most recent semi-annual computation of the Constitutional Debt Limit and the amount of net debt outstanding subject to such limit is shown in Table 1.

Table 1
Constitutional Debt Limit[a]
August 31, 2001
(In Millions)

Average Annual Tax Revenues Fiscal 1997-2001	$ 23,008.4
Times 1.75	40,264.7
Less: Net Debt Outstanding[b]	4,554.3
Debt Issuable Within Limit	$ 35,710.4

[a] As certified by the Auditor General on August 31, 2001 (Appendix A).
[b] After credit for refunded debt.

Table 2
Aggregate Capital Debt Authorization
(In Millions)

Capital Facilities Projects Category	Debt Authorized	Issued[a]	Authorized But Unissued	Pro Forma Remaining After Issuance Of the Bonds
Buildings and Structures	$ 11,011.3	$ 4,928.0	$ 6,083.3	$ 5,883.3
Furniture and Equipment	503.0	311.5	191.5	181.5
Transportation Assistance	4,330.7	1,782.8	2,547.9	2,467.9
Redevelopment Assistance	7,415.4	991.0	6,424.4	6,416.4
Community Colleges	35.8	28.0	7.8	7.8
Highway and Highway Bridge	15,791.0	2,630.5	13,160.5	13,160.5
Advance Construction Interstate	450.0	450.0	0	0
Flood Control	141.8	30.8	111.0	109.0
Site Development	150.0	150.0	0	0
Total	$ 39,829.0	$ 11,302.6	$ 28,526.4	$ 28,226.4

[a] Not all are outstanding.

The amount of debt that may be issued during the fiscal year for capital projects authorized in current or previous capital budgets is enacted annually by the General Assembly and approved by the Governor. The fiscal 2002 capital budget provided that such budget will be in effect until the fiscal 2003 capital budget is enacted. The maximum amount of debt currently authorized by the fiscal 2002 capital budget is as follows:

Table 3
Fiscal 2002 Capital Budget Debt Limits[(a)]
(In Millions)

Capital Facilities Projects Category	Limits	Issued to Date	Remaining Issuable Within Limit	Pro Forma Remaining After Issuance Of the Bonds
Buildings and Structures	$ 685.0	$ 190.0	$ 495.0	$ 295.0
Furniture and Equipment	35.0	0.0	35.0	25.0
Transportation Assistance	180.0	20.0	160.0	80.0
Redevelopment Assistance	365.0	90.0	275.0	267.0
Flood Control	6.0	0.0	6.0	4.0
Total	$ 1,271.0	$ 300.0	$ 971.0	$ 671.0

(a) The fiscal 2002 capital budget debt limits became effective July 1, 2001, and will remain in force until the fiscal 2003 capital budget debt limit becomes effective.

For a discussion of the Commonwealth's outstanding debt and projected future issuance of general obligation debt, see "OUTSTANDING INDEBTEDNESS OF THE COMMONWEALTH."

USE OF PROCEEDS

The Commonwealth is issuing the Bonds for the following purposes:

(i) $300,000,000 of the First Series Bonds to provide for the construction and acquisition of capital facilities projects as described below under "Capital Facilities";

(ii) $350,635,000 Refunding Series Bonds to refund a portion of the Commonwealth of Pennsylvania General Obligation Bonds (the "Prior Bonds") described below under "Plan of Refunding";

The proceeds received from the sale of the Bonds, after paying the costs of issuance, will be applied by the Commonwealth to pay the costs of various purposes described below. Any accrued interest payable upon original delivery of the Bonds will be credited ratably to the funds from which debt service on the Bonds is paid and will be used for debt service on the Bonds.

Capital Facilities

The proceeds of the First Series Bonds will be deposited into the Capital Facilities Fund and applied to defray the costs of issuance of the First Series Bonds and the financial costs of various capital facilities projects of the Commonwealth. Of the $300 million aggregate principal amount of the Bonds issued for capital facilities projects, $200 million is to be allocated to the Department of General Services and used to pay for the construction and major rehabilitation of public buildings for the Commonwealth and its institutions; $10 million is to be allocated to the Department of General Services to purchase furniture and equipment for Commonwealth buildings; $8 million is to be allocated to the Department of Community and Economic Development to fund redevelopment assistance projects; $80 million is to be allocated to the Department of Transportation to fund transportation assistance projects; and $2 million is to be allocated to the Department of Environmental Protection to fund flood control projects. Pending application to the above purposes, the proceeds of the Bonds allocated to these purposes will be held by the State Treasurer in the Capital Facilities Fund and invested in accordance with applicable state and federal laws.

Earnings from the investment of moneys deposited in Capital Facilities Fund will be retained in that fund and used for the purposes of the fund.

Plan of Refunding

The Commonwealth is refunding the Prior Bonds in order to reduce debt service payable by the Commonwealth on its Prior Bonds. Because interest rates were higher at the time the Prior Bonds were sold, the Commonwealth anticipates interest savings from the refunding.

The Prior Bonds to be refunded are as follows:

Principal Amount to be Refunded	Bond Series	Date of Issue	Bonds Maturing on	Date of Redemption
$147,050,000	First Series of 1992	March 15, 1992	September 15, 2004-2012	March 15, 2002
49,600,000	Third Series of 1992	December 1, 1992	December 1, 2005-2012	December 1, 2002
166,525,000	Third Series of 1994	November 15, 1994	November 15, 2006-2014	November 15, 2004

The refunding of the Prior Bonds will be accomplished by applying a portion of the proceeds from the sale of the Refunding Series Bonds to cash and the purchase of United States Treasury Securities – State and Local Government Series (the "Escrow Obligations"), which will mature and bear interest at such times and in such amounts in order that sufficient moneys will be available therefrom to pay, when due, all interest on the Prior Bonds, and to and including their respective redemption dates and to redeem on such dates all then outstanding Prior Bonds at their applicable redemption price. Such Escrow Obligations and cash will be deposited with the State Treasurer of the Commonwealth of Pennsylvania, to be applied solely to the payment of the principal or redemption price of and interest on the Prior Bonds to the redemption dates shown above.

COMMONWEALTH GOVERNMENT

The Commonwealth is organized into three separate branches of government — executive, legislative and judicial — as defined in the Constitution. Five officials of the Commonwealth's executive branch are elected in statewide elections for four-year terms expiring on the dates shown below.

Name	Office	Term Expires
Mark Schweiker	Governor	January 21, 2003
Robert C. Jubelirer	Lieutenant Governor	January 21, 2003
D. Michael Fisher	Attorney General	January 18, 2005
Barbara Hafer	State Treasurer	January 18, 2005
Robert P. Casey, Jr.	Auditor General	January 18, 2005

A more detailed description of the Commonwealth's government and fiscal administration is included in Appendix C.

Commonwealth Employees

Table 4 presents the number of approved and filled positions under the Governor's jurisdiction for the period 1997 through 2001.

Table 4
Filled Salaried Positions and Employees
Under the Governor's Jurisdiction[(a)]
1997-2001

As of July 1	Total Full and Part Time Filled Salaried Positions	Total Full Time Salaried Employees	Civil Service Salaried Positions	Civil Service As a % of Total Filled Salaried Positions
1997	79,606	78,894	56,488	71.0
1998	79,495	78,834	56,247	70.8
1999	78,690	78,131	55,331	70.3
2000	79,207	78,712	55,453	70.0
2001	80,240	79,695	56,448	70.3

[(a)] Excludes employees of the legislative and judicial branches, the Department of the Auditor General, the Treasury Department, the State System of Higher Education and independent agencies, boards and commissions.
Source: Office of Administration, *Governor's Annual Work Force Reports*.

Employees are permitted to organize and bargain collectively. As of July 2000, 83.7 percent of the full-time salaried employees under the Governor's jurisdiction were covered by collective bargaining agreements or memoranda of understanding. Approximately 47.2 percent of state employees are represented by the American Federation of State, County and Municipal Employees ("AFSCME").

Contracts effective July 1, 1999 were executed by AFSCME, Pennsylvania Social Services Union and most other employee unions that provide for 13.0 percent salary increases over a four-year period ending on June 30, 2003.

COMMONWEALTH FINANCIAL STRUCTURE AND PROCEDURES

The Constitution and the laws of the Commonwealth require all payments from the State Treasury, with the exception of refunds of taxes, licenses, fees and other charges, to be made only by duly enacted appropriations. Amounts appropriated from a fund may not exceed its actual and estimated revenues for the fiscal year plus any unappropriated surplus available. Appropriations from the principal operating funds of the Commonwealth (the General Fund, the Motor License Fund and the State Lottery Fund) are generally made for one fiscal year and are returned to the unappropriated surplus of the fund (a lapse) if not spent or encumbered by the end of the fiscal year. The Commonwealth's fiscal year begins July 1 and ends June 30. (Fiscal year 2002 refers to the fiscal year ending June 30, 2002.) See Appendix C for a further description of the fiscal administration of the Commonwealth.

Description of Funds

The Commonwealth utilizes the fund method of accounting. For purposes of governmental accounting, a "fund" is defined as an independent fiscal and accounting entity with a self-balancing set of accounts. Each fund records the cash and/or other resources together with all related liabilities and equities that are segregated for the purpose of the fund. In the Commonwealth, funds are established by legislative enactment or in certain limited cases by administrative action. Over 150 funds have been established and currently exist for the purpose of recording the receipt and disbursement of moneys received by the Commonwealth. Annual budgets are adopted each fiscal year for the principal operating funds of the Commonwealth and several other special revenue funds. Expenditures and encumbrances against these funds may be made only pursuant to appropriation measures enacted by the General Assembly and approved by the Governor.

The General Fund, the Commonwealth's largest fund, receives all tax revenues, non-tax revenues and federal grants and entitlements that are not specified by law to be deposited elsewhere. The majority of the Commonwealth's operating and administrative expenses are payable from the General Fund. Debt service on all bond indebtedness of the Commonwealth, except that issued for highway purposes or for the benefit of other special revenue funds, is payable from the General Fund.

The Motor License Fund receives all tax and fee revenues relating to motor fuels and vehicles except the revenues from one-half cent per gallon of the liquid fuels tax that are deposited in the Liquid Fuels Tax Fund for distribution to local municipalities. All revenues relating to motor fuels and vehicles are required by the Constitution to be used only for highway purposes. Most federal aid revenues designated for transportation programs and tax revenues relating to aviation fuels are also deposited in the Motor License Fund. Operating and administrative costs for the Department of Transportation and other Commonwealth departments conducting transportation related programs, including the highway patrol activities of the Pennsylvania State Police, are also paid from the Motor License Fund. Debt service on bonds issued by the Commonwealth for highway purposes is payable from the Motor License Fund.

Other special revenue funds have been established by law to receive specified revenues that are appropriated to departments, boards and/or commissions for payment of their operating and administrative costs. Such funds include the Game, Fish, Boat, Banking Department, Milk Marketing, State Farm Products Show, Environmental Stewardship, State Racing, State Lottery, and Tobacco Settlement Funds. Some of these special revenue funds are required to transfer excess revenues to the General Fund, and some receive funding, in addition to their specified revenues, through appropriations from the General Fund.

The State Lottery Fund is a special revenue fund for the receipt of lottery ticket sales and lottery licenses and fees. Its revenues, after payment of prizes, are dedicated to paying the costs of programs benefiting the elderly in Pennsylvania.

The Tobacco Settlement Fund is a special revenue fund established to receive tobacco litigation settlement payments paid to the Commonwealth. The Commonwealth is one of forty-six states that settled certain smoking-related litigation in a November 1998 master settlement agreement with participating tobacco product manufacturers (the "Tobacco MSA"). Under the Tobacco MSA the Commonwealth is entitled to receive a portion of payments made pursuant to the Tobacco MSA by tobacco product manufacturers participating in the Tobacco MSA. As of June 30, 2001, the Commonwealth had received approximately $809 million in payments under the Tobacco MSA. Most revenues to the Tobacco Settlement Fund are subject to annual appropriation by the General Assembly and approval by the Governor.

The Tax Stabilization Reserve Fund is a special revenue fund established in 1986 that receives a statutorily determined portion of the budgetary basis fiscal year-end surplus of the General Fund and all proceeds from the disposition of assets of the Commonwealth not designated for deposit elsewhere. The Tax Stabilization Reserve Fund is to be used for emergencies threatening the health, safety or welfare of citizens or to offset unanticipated revenue shortfalls due to economic downturns. Assets of the fund may be used upon recommendation by the Governor and an approving vote by two-thirds of the members of each house of the General Assembly. For GAAP reporting purposes, the Tax Stabilization Reserve Fund is reported as a fund balance reservation under the General Fund category. Prior to fiscal year 1999, the Tax Stabilization Reserve Fund was reported, on a GAAP basis, as a designation of the General Fund unreserved fund balance.

The Commonwealth maintains trust and agency funds that are used to administer funds received pursuant to a specific bequest or as an agent for other governmental units or individuals.

Enterprise funds are maintained for departments or programs operated like private enterprises. The largest of these funds is the State Stores Fund, which is used for the receipts and disbursements of the Commonwealth's liquor store system. Sale and distribution of all liquor within Pennsylvania is a government enterprise.

In addition, the Commonwealth maintains funds classified as working capital, bond, and sinking funds for specified purposes.

Accounting Practices

Financial information for the principal operating funds of the Commonwealth is maintained on a budgetary basis of accounting. The Commonwealth also prepares annual financial statements in accordance with generally accepted accounting principles ("GAAP"). Annual financial statements prepared in accordance with GAAP are audited jointly by the Auditor General of the Commonwealth and an independent public accounting firm.

Budgetary Basis

A budgetary basis of accounting is used for insuring compliance with the enacted operating budget and is governed by applicable statutes of the Commonwealth and by administrative procedures. The Constitution provides that operating budget appropriations shall not exceed the actual and estimated revenues and unappropriated surplus available in the fiscal year for which funds are appropriated. Annual budgets are enacted for the General Fund and certain special revenue funds that together represent the majority of expenditures of the Commonwealth. The annual budget classifies fund revenues as Commonwealth revenues, augmentations, federal revenues, or restricted receipts and revenues. Commonwealth revenues are revenues from taxes and from non-tax sources such as licenses and fee charges, penalties, interest, investment income and other miscellaneous sources. Augmentations consist of departmental and institutional billings that supplement an appropriation of Commonwealth revenues, thereby increasing authorized spending. For example, patient billings for services at Commonwealth-owned institutions are augmentations that supplement Commonwealth revenues appropriated to each institution for operating costs. Federal revenues are those federal aid receipts that pay for or reimburse the Commonwealth for funds disbursed for federally assisted programs. Restricted receipts and revenues are funds that are restricted to a specific use or uses by state law, administrative decision, or by the provider of the funds. Only Commonwealth revenues and expenditures from these revenues are included in the computation made to determine whether an enacted budget is constitutionally balanced. Augmenting revenues and federal revenues are considered to be self-balancing with expenditures from their respective revenue sources.

The Commonwealth's budgetary basis financial reports are based on a modified cash basis of accounting as opposed to a modified accrual basis prescribed by GAAP. Under the Commonwealth's budgetary basis of accounting, tax receipts, non-tax revenues, augmentations and all other receipts are recorded at the time cash is received. An adjustment is made at fiscal year-end to include accrued revenue unrealized; that is, revenues earned but not collected. Revenues accrued include estimated receipts from (i) sales and use, personal income, realty transfer, inheritance, cigarette, liquor, liquid fuel, fuels, and oil company franchise taxes, and interest earnings and (ii) federal government commitments to the Commonwealth. Expenditures are recorded at the time payment requisitions and invoices are submitted to the Treasury Department for payment. Appropriated amounts are reserved for payment of contracts for the delivery of goods or services to the Commonwealth through an encumbrance process. Unencumbered appropriated funds are automatically lapsed at fiscal year-end and are available for re-appropriation. Estimated encumbrances are established at fiscal year-end to pay certain direct expenditures for salaries, wages, travel, and utility costs payable against current year appropriations but disbursed in the subsequent fiscal year. Recording of the applicable expenditure liquidates the encumbered amount. Over-estimates of fiscal year-end encumbrances are lapsed in the subsequent fiscal year and under-estimates are charged to a subsequent fiscal year appropriation. Appropriation encumbrances are shown on the Commonwealth's balance sheet as a reservation of fund balance.

Other reservations of fund balance include (i) the unexpended balance of continuing appropriations (that is, appropriations that do not lapse at fiscal year-end), and (ii) requested appropriation supplements and deficiency appropriations. Revenues dedicated for specific purposes and remaining unexpended at the fiscal year-end are likewise reserved.

GAAP Financial Reporting

At fiscal year-end, budgetary basis financial information, both revenues and expenditures, is adjusted to reflect appropriate accruals for financial reporting in conformity with GAAP. The Commonwealth is not required to prepare GAAP financial statements and does not prepare them on an interim basis. GAAP financial reporting requires a modified accrual basis of accounting for governmental, expendable trust, and agency funds, while proprietary and pension trust funds are reported on the accrual basis of accounting.

Financial statements of the Commonwealth prepared under GAAP differ from those traditionally prepared on a budgetary basis for several reasons. Among other differences, the GAAP statements (i) generally recognize revenues when they become measurable and available rather than when cash is received, (ii) report expenditures when goods and services are received and a liability incurred rather than when cash is disbursed, (iii) include a combined balance sheet for the Commonwealth presented by GAAP fund type rather than by Commonwealth fund, and (iv) include activities of all funds in the reporting entity, including agencies and authorities usually considered as independent of the Commonwealth for budgetary purposes. Adjustments to budgetary basis revenues and expenditures required to conform to GAAP accounting generally require including (i) corporation tax accruals and audit adjustments for other accrued taxes, (ii) tax refunds payable and tax credits, and (iii) expenses not covered by appropriations.

An independent public accounting firm and the Auditor General jointly audit the Commonwealth's annual GAAP basis financial statements. The audited General Purpose Financial Statements are a component of the Commonwealth's Comprehensive Annual Financial Report ("CAFR"). The CAFRs for recent fiscal years are available in the Budget & Financial Reports section of the Office of the Budget's web site - www.budget.state.pa.us - and such CAFRs are incorporated herein by reference.

Governmental Accounting Standards Board Statement No. 34

In June 1999, the Governmental Accounting Standards Board ("GASB") issued its Statement 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*. The Commonwealth is implementing the new standard effective for the fiscal year that began on July 1, 2001. The fiscal year ending June 30, 2001 has been reported following existing standards; the fiscal year ending June 30, 2002 will be reported based on the new requirements. Implementation of the GASB Statement will significantly change the way state and local governments report their finances to the public. Specifically, "general purpose financial statements" will be replaced by "basic financial statements," which will include entity-wide and major fund financial statements, and supplementary information on "management's discussion and analysis" ("MD&A") of the financial statements. Adoption of the new standard requires, among other things, that the Commonwealth choose accounting and reporting policies necessary for compliance. One of the new features of entity wide financial statements will be infrastructure reporting and related depreciation. (Currently, the Commonwealth does not report infrastructure nor does it report accumulated depreciation related to general fixed assets.) The incremental costs of preparing and auditing basic financial statements have not been determined.

One of the goals of the GASB, in issuing the new standard, is to make financial statement information more useful for the public, creditors and other groups. One objective for requiring the MD&A is to provide easily understandable explanations of the content of the basic financial statements. The Commonwealth intends to continue its long-standing policy of providing complete financial information in accordance with GAAP. Implementation of the new standard is not expected to materially affect Commonwealth cash flows or budgetary reporting. Currently, it is not practical to quantify the various financial reporting changes on a GAAP basis resulting from the implementation of the new standard. However, comparability of GAAP basis reporting to years prior to the implementation of GASB Statement 34 may be hampered.

Investment of Funds

The Treasury Department is responsible for the deposit and investment of most funds belonging to the Commonwealth, including the proceeds of the Bonds and the funds held for the periodic payment of interest on and maturing principal of the Bonds. The Commonwealth's Fiscal Code contains statutory limitations on the investment of funds by the Treasury Department. The Board of Finance and Revenue, a six-person board of state officials chaired by the State Treasurer, is authorized to establish the aggregate amount of funds that may be invested in some of the various categories of permitted investments. The State Treasurer ultimately determines the asset allocation and selects the investments within the parameters of the law.

The Commonwealth's Fiscal Code permits investments in the following types of securities: (i) United States Treasury securities and United States Agency securities maturing within two years of issue; (ii) commercial paper issued by industrial, common carrier or finance companies rated "Prime One" or its equivalent; (iii) certificates of deposit of Pennsylvania-based commercial banks, savings banks or savings and loans; (iv) repurchase obligations secured with obligations described under (i); (v) banker's acceptances written by domestic commercial banks with a rating of "Aa" or better, or its equivalent; and (vi) other non-equity investments subject to a "prudent investor" test not to exceed ten percent of assets. The Treasury Department maintains additional investment restrictions contained in its Investment Policy Guidelines. A summary of the Investment Policy Guidelines and a report on investment activity and performance of funds invested by the Treasury Department are contained in a report periodically prepared and publicly distributed by the Treasury Department.

Additionally, in June 1999, legislation authorized the State Treasurer to invest Commonwealth moneys in equity securities under a prudent person standard. A portion of the cash balance in each of the General, Motor License and Tax Stabilization Reserve Funds not immediately needed for disbursement is being managed by an investment advisor for such investments. The legislative authorization to invest in equity securities expires in December 2004 unless extended by the General Assembly.

Tax Stabilization Reserve Fund

Balances in the Tax Stabilization Reserve Fund may be used to alleviate emergencies threatening the health, safety or welfare of the Commonwealth's citizens or to offset unanticipated revenue shortfalls due to economic downturns. Income to the fund is provided by the transfer of a legislatively determined portion of the General Fund budgetary basis unappropriated surplus at the close of a fiscal year, by investment income to the fund, and by specific appropriation from other available funds by the General Assembly. For the 2001 fiscal year, pursuant to enacted legislation, no transfer was made to the Tax Stabilization Reserve Fund from the General Fund unappropriated surplus balance. Under current state law, for the 2002 fiscal year and subsequent fiscal years, the annual transfer amount is to be 10 percent of the General Fund's budgetary basis fiscal year-end surplus representing a return to the percentage in effect from fiscal year 1992 through fiscal year 1997. From fiscal year 1998 through fiscal year 2000, fifteen percent of each fiscal year-end surplus in the General Fund had been transferred. In addition to the transfers from the General Fund, any proceeds received from the disposition of assets of the Commonwealth not specified to be deposited elsewhere are also to be deposited into the Tax Stabilization Reserve Fund. To date, no proceeds of asset dispositions have been deposited into the fund and the Commonwealth has not prepared estimates of such sales.

Assets of the Tax Stabilization Reserve Fund may be used only upon the recommendation by the Governor and an approving vote by two-thirds of the members of each house of the General Assembly. In February 1991, in response to a projected fiscal 1991 General Fund budgetary deficit caused by lower revenues and higher expenditures than budgeted, the Governor recommended, and the General Assembly authorized, the then available balance of $133.8 million in the Tax Stabilization Reserve Fund be used to pay medical assistance and special education costs not covered by budgeted funds. Since 1991, deposits to the fund and net investment earnings have produced a balance in the Tax Stabilization Reserve Fund as of December 31, 2001 in excess of $1 billion. In his proposed budget for fiscal year 2003, the Governor has recommended using $550 million of the balance to partially offset the anticipated fiscal year 2002 revenue shortfall.

COMMONWEALTH FINANCIAL PERFORMANCE

Recent Developments

Audited financial statements prepared on a GAAP basis for the fiscal year ended June 30, 2001 were released in December 2001. For the general funds the unreserved-undesignated fund balance declined by $175.3 million from the prior fiscal year balance (see “Fiscal Year 2001 Financial Results”).

The current national recession was unanticipated in the revenue and expenditure projections incorporated in the enacted budget for fiscal year 2002. Consequently, actual Commonwealth revenues through January 2002 are $438.4 million, or 4.0 percent, below estimate and are anticipated to be $678 million below budget estimates by the end of the 2001-02 fiscal year. The Governor has taken action to reduce current fiscal year expenditures and proposed other actions to maintain a balanced budget. See “Fiscal Year 2002 Budget.”

On February 5, 2002, the Governor submitted to the General Assembly his proposed fiscal year 2003 budget. See “Fiscal Year 2003 Proposed Budget.”

Introduction

The financial tables that follow containing GAAP basis financial data are unaudited but are derived from the Commonwealth’s audited financial statements. The discussion of financial performance on a budgetary basis for prior fiscal years is based on an analysis of budget numbers and not on numbers prepared in accordance with GAAP. Likewise, the discussion on the enacted fiscal year 2002 budget and proposed fiscal year 2003 budget reflects a budgetary basis analysis rather than a GAAP basis analysis.

The most recent audited general purpose financial statements for a fiscal year are available in the CAFR issued by the Commonwealth for the fiscal period ended June 30, 2001. Copies of CAFRs recently issued by the Commonwealth are available from (i) any of the nationally recognized municipal securities information repositories (“NRMSIR”) listed in the section “CONTINUING DISCLOSURE”, (ii) from the Secretary of the Budget, Mr. Robert A. Bittenbender, Attn: Mr. Mike Higgins, 6th Floor, Strawberry Square Bell Tower, Harrisburg, Pennsylvania 17101 (Telephone (717) 787-5312), and (iii) the Budget & Financial Reports section of the Office of the Budget’s web site at www.budget.state.pa.us, which CAFRs are incorporated herein by reference. The general purpose financial statements for the fiscal year ending June 30, 2001 are incorporated by the above reference to their availability by other than in this Official Statement. This means that (i) the incorporated information is considered part of this Official Statement and (ii) such information should be reviewed by prospective purchasers of the Bonds as a part of their review of this entire Official Statement.

Financial Results for Governmental Fund Types During Recent Fiscal Years (GAAP Basis).

During fiscal year 2001 assets in the Commonwealth's governmental fund types rose to $11,461.9 million, an increase of 1.5 percent. Liabilities for the governmental fund types during fiscal year 2001 increased by 6.0 percent to $4,941.7 million. A larger gain in liabilities than in assets during fiscal year 2001 for governmental fund types produced a $116.3 million decline in equity and other credits at June 30, 2001. Equity and other credits at the end of fiscal year 2001 totaled $6,520.2 million. The five-year period ending with fiscal year 2001 generally was a time of economic growth with modest rates of growth at the beginning of the period, larger increases during the most recent fiscal years until the beginning of a recession late in fiscal year 2001. Throughout the period, inflation has remained relatively low, helping to restrain expenditure growth. Favorable economic conditions have helped amounts categorized as total revenues and other sources rise at an average annual rate of 5.1 percent during the five-year period. Tax revenues, the largest revenue source, increased at an average annual rate of 4.0 percent during the five-year period. License and fee revenues rose at a 9.7 percent average annual rate, largely because of various motor vehicle fee increases effective beginning in fiscal year 1998. Other revenues, mostly charges for sales and services and investment income, increased at an average annual rate of 14.7 percent during the five-year period. Expenditure and other uses during the fiscal year 1997 through fiscal year 2001 period rose at a 5.7 percent average annual rate, led by a 26.8 percent average annual increase for capital outlay and 25.5 percent average annual increase for economic development and assistance costs. Capital outlay costs reflect increased spending on community and economic development projects through the capital budget while expansion of business financing tools and increased funds for community revitalization projects are responsible for the increased economic development and assistance costs. Public health and welfare programs, the largest single category of expenditures, have experienced a 5.9 percent average annual increase for expenditures, slightly above the average for total expenditures.

Table 5 presents a summary of revenues and expenditures (GAAP basis) for the governmental fund types for the fiscal years 1997 through 2001. More detailed information with respect to the General Fund, the Motor License Fund and the State Lottery Fund, major operating funds that are categorized as governmental funds and included in Table 5, is presented in subsequent tables.

Table 5
Results of Operations–Governmental Fund Types
GAAP Basis–Unaudited
(In Thousands)

	Fiscal Year Ended June 30				
	1997	**1998**	**1999**	**2000**	**2001**
Fund Balance — Beginning of Period	$ 1,986,330	$ 2,900,933	$ 3,791,830	$ 5,151,794	$ 6,636,476
Restatements	-	15,104	-	-	-
Fund Balance — Beginning of Period, as Restated	$ 1,986,330	$ 2,916,037	$ 3,791,830	$ 5,151,794	$ 6,636,476
Revenues:					
Taxes	$ 18,168,581	$ 19,043,735	$ 20,105,276	$ 20,956,743	$ 21,232,196
Licenses and fees	810,904	1,004,050	1,019,256	1,143,789	1,172,372
Intergovernmental	9,504,476	9,669,407	10,563,455	11,093,738	12,086,372
Lottery revenues	1,722,558	1,684,015	1,659,305	1,695,371	1,788,333
Other revenues	1,866,855	2,101,780	2,530,154	3,541,781	3,235,568
Other Financing Sources:					
Bond proceeds	554,414	415,135	856,839	590,731	663,919
Operating transfers in	1,169,581	1,179,051	1,344,985	1,372,501	1,097,698
Other additions	5,283	5,250	28,835	14,556	6,607
TOTAL REVENUES AND OTHER SOURCES	$ 33,802,652	$ 35,102,423	$ 38,108,105	$ 40,409,210	$ 41,283,065
Expenditures:					
General government	$ 2,468,746	$ 2,586,529	$ 2,722,917	$ 2,817,426	$ 3,292,188
Protection of persons and property	2,462,026	2,613,021	2,785,269	2,933,612	3,044,074
Public health and welfare	13,907,167	14,341,539	15,320,410	16,486,542	17,483,315
Public education	7,397,274	7,714,443	7,842,732	8,283,144	8,677,284
Conservation of natural resources	369,467	396,087	436,601	510,732	568,757
Economic development and assistance	300,310	338,984	469,005	539,068	745,143
Transportation	2,912,583	3,243,334	3,654,269	3,679,188	4,065,124
Capital outlay	253,758	360,238	582,863	586,801	655,248
Debt service	725,746	698,446	706,344	756,394	758,591
Other Uses:					
Operating transfers out	1,818,757	1,887,009	2,074,468	2,154,157	1,934,142
Other uses	364,785	-	-	-	-
TOTAL EXPENDITURES AND OTHER USES	$ 32,980,619	$ 34,179,630	$ 36,594,878	$ 38,747,064	$ 41,223,866
REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURES AND OTHER USES	822,033	922,793	1,513,227	1,662,146	59,199
Residual Equity Transfers In (Out)	92,570	(47,000)	(153,263)	(177,464)	(175,442)
Fund Balance — End of Period	$ 2,900,933	$ 3,791,830	$ 5,151,794	$ 6,636,476	$ 6,520,233
Components of Fund Balance:					
Reserved for encumbrances	$ 853,711	$ 1,266,321	$ 1,196,574	$ 1,630,841	$ 1,647,666
Reserved for advances and other	321,885	183,089	1,443,090	1,597,643	1,551,460
Unreserved — designated	1,214,817	1,683,459	873,051	1,425,310	1,493,933
Unreserved — undesignated	510,520	658,961	1,639,079	1,982,682	1,827,174
TOTAL FUND BALANCE	$ 2,900,933	$ 3,791,830	$ 5,151,794	$ 6,636,476	$ 6,520,233

Note: Interfund eliminations have not been made.
Source: Compiled from Office of the Budget, Comprehensive Annual Financial Report for fiscal years ended June 30, 2001, 2000, 1999, 1998, and 1997.

Beginning with fiscal year 1999, the Tax Stabilization Reserve Fund balance and other certain amounts previously reported as unreserved-designated in the fund balance were reclassified to the reserved for advances and other category to more accurately reflect their status. This modification accounts for a large portion of the change in these components of fund balance between fiscal years 1998 and 1999 shown in Table 5.

General Fund

Table 6 presents a summary of revenues and expenditures (GAAP basis) for the General Fund (including the Tax Stabilization Reserve Fund) for the fiscal years 1997 through 2001.

Table 6
Results of Operations–General Fund
GAAP Basis–Unaudited
(In Thousands)

	Fiscal Year Ended June 30				
	1997	**1998**	**1999**	**2000**	**2001**
Fund Balance — Beginning of Period	$ 635,182	$ 1,364,900	$ 1,958,881	$ 2,863,420	$ 4,263,641
Restatements	-	3,066	-	-	-
Fund Balance — Beginning of Period, as Restated	$ 635,182	$ 1,367,966	$ 1,958,881	$ 2,863,420	$ 4,263,641
Revenues:					
Taxes	$ 16,502,772	$ 17,201,195	$ 18,162,547	$ 19,046,032	$ 19,297,659
Licenses and fees	164,189	170,129	147,051	197,012	202,591
Intergovernmental	8,469,358	8,766,562	9,462,123	10,062,420	10,588,526
Other revenues	1,499,140	1,666,071	2,089,638	3,069,378	2,779,739
Other Financing Sources:					
Operating transfers in	121,494	103,662	106,667	78,723	75,491
Other additions	940	519	20,499	594	2,789
TOTAL REVENUES AND OTHER SOURCES	$ 26,757,893	$ 27,908,138	$ 29,988,525	$ 32,454,159	$ 32,946,795
Expenditures:					
General government	$ 969,809	$ 1,108,098	$ 1,231,556	$ 1,333,114	$ 1,613,383
Protection of persons and property	2,430,269	2,590,304	2,764,332	2,912,289	3,026,625
Public health and welfare	13,245,591	13,648,551	14,591,847	15,645,577	16,645,180
Public education	7,397,080	7,713,683	7,841,624	8,281,804	8,667,618
Conservation of natural resources	116,955	127,543	138,417	134,511	155,468
Economic development and assistance	244,098	296,189	388,709	471,716	522,073
Transportation	311,648	371,659	372,848	399,412	401,621
Capital outlay	9,804	10,809	38,473	44,998	117,354
Debt service	17,834	6,353	-	-	-
Other Uses:					
Operating transfers out	1,381,769	1,425,034	1,602,767	1,707,038	1,460,431
TOTAL EXPENDITURES AND OTHER USES	$ 26,124,857	$ 27,298,223	$ 28,970,573	$ 30,930,459	$ 32,609,753
REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURE AND OTHER USES	633,036	609,915	1,017,952	1,523,700	337,042
Residual Equity Transfer In (Out)	96,682	(19,000)	(113,413)	(123,479)	(115,688)
Fund Balance — End of Period	$ 1,364,900	$ 1,958,881	$ 2,863,420	$ 4,263,641	$ 4,484,995
Components of Fund Balance					
Reserved for encumbrances	$ 242,435	$ 224,929	$ 279,912	$ 397,827	$ 426,956
Reserved for advances and other	102,726	92,310	1,347,853	1,487,789	1,454,146
Unreserved — designated	832,435	1,144,001	180,490	677,897	1,079,047
Unreserved — undesignated	187,304	497,641	1,055,165	1,700,128	1,524,846
TOTAL FUND BALANCE	$ 1,364,900	$ 1,958,881	$ 2,863,420	$ 4,263,641	$ 4,484,995

Note: Interfund eliminations have not been made.
Source: Compiled from Office of the Budget, Comprehensive Annual Financial Report for fiscal years ended June 30, 2001, 2000, 1999, 1998, and 1997.

Financial Results for Recent Fiscal Years (GAAP Basis).

During the five-year period from fiscal year 1997 through fiscal year 2001, revenues and other sources increased by an average 5.3 percent annually. Tax revenues during this same period increased by an annual average of 4.0 percent. The largest growth rate during the five-year period was for the other revenues category. Those revenues increased at an average annual rate of 16.7 percent. Increases in charges for sales and services and in investment income constitute the largest portion of other revenues and are the principal reason for this rate of growth. Expenditures and other uses during the fiscal years 1997 through year 2001 period rose at an average annual rate of 5.7 percent. Program costs for capital outlay and for economic development and assistance activities recorded the largest percentage increases during the period. Public health and welfare program costs, the largest program of expenditures, increased at a 5.9 percent average annual rate during the period. Efforts to control costs for various social programs and the presence of favorable economic conditions have helped restrain these costs.

Beginning with fiscal year 1999, the Tax Stabilization Reserve Fund balance and certain other amounts previously reported as unreserved-designated in the fund balance were reclassified to the reserved for advances and other category to more accurately reflect their status. This change accounts for a large portion of the change between fiscal years 1998 and 1999 in these components of fund balance as shown in Table 6.

The fund balance at June 30, 2001 totaled $4,485.0 million, an increase of $221.4 million over the $4,263.6 million balance at June 30, 2000. The fiscal year 2001 year-end unreserved-undesignated balance of $1,524.8 million is $175.3 million below the amount recorded for fiscal year 2000.

Fiscal Year 2000 Financial Results.

GAAP Basis. During the 2000 fiscal year, assets increased $1,731.4 million, chiefly due to higher temporary investments. Liabilities also rose during the period by $331.1 million. Together, these changes produced a $1,400.3 million increase to the fund balance at June 30, 2000. The fund balance at the end of fiscal year 2000 was $4,263.6 million, the largest fund balance achieved since audited GAAP reporting was instituted in 1984 for the Commonwealth. The $1,105 million June 30, 2000 balance in the Tax Stabilization Reserve Fund is included in the GAAP basis fund balance for the General Fund.

Revenues from taxes and other sources during fiscal year 2000 increased 5.9 percent over the fiscal year 1999 level. Taxes increased by $888.5 million representing a 4.9 percent increase while other revenues rose by $979.7 million. Expenditures and other uses rose during the fiscal year by 6.8 percent, led by a 21.4 percent increase in expenditures for economic development and assistance costs. However, that increase only accounted for $83.0 million of expenditure increase for the fiscal year. Expenditures in the largest expenditure category, public health and welfare, increased by $1,053.7 million representing a 7.2 percent increase.

Budgetary Basis. The following information is derived from the Commonwealth's unaudited budgetary basis financial statements. At the end of the 2000 fiscal year the unappropriated surplus balance (prior to the transfer to the Tax Stabilization Reserve Fund) totaled $718.3 million, a $280.6 million increase from the 1999 fiscal year-end. The gain was due to higher than anticipated Commonwealth revenues and to appropriation lapses that were partially offset by additional supplemental appropriations and reserves for tax refunds. An amount of $107.7 million was transferred from the surplus to the Tax Stabilization Reserve Fund representing the then statutorily required 15 percent annual transfer. The remaining $610.5 million fiscal year-end unappropriated surplus balance was carried over to the 2001 fiscal year for the General Fund. Commonwealth revenues for the 2000 fiscal year totaled $20,256.7 million, an increase of 5.4 percent ($1,030.0 million) over the prior fiscal year. The amount authorized and reserved for tax refunds was increased by $171.0 million (26.6 percent) as actual fiscal year 1999 tax refund payments exceeded the reserved amount. The additional tax refunds were made from fiscal year 2000 reserves. After adjustment for reserves for tax refunds, net Commonwealth revenues were 4.6 percent above those of the prior fiscal year.

Commonwealth tax revenues, net of an estimated $390.2 million of tax reductions enacted with the fiscal year 2000 budget, increased by 5.2 percent for the fiscal year. Among the major tax sources, the sales tax increased by 6.2 percent, the personal income tax by 5.7 percent, and the corporate net income tax by 7.8 percent. Non-tax revenues increased by 13.6 percent ($53.5 million) largely from higher investment earnings. Higher than anticipated available cash balances and higher interest rates provided the gains in investment earnings. Tax cuts enacted for the fiscal year included:

(i) a reduction of the tax rate for the capital stock and franchise taxes by one mill to 10.99 mills and a reduction in the minimum tax by $100 to $200 ($107.8 million); (ii) repeal of the gross receipts tax on regulated natural gas companies ($78.4 million); (iii) increase the weighting from 50 percent to 60 percent of the sales factor used in the apportionment formula to calculate Pennsylvania taxable income for corporate net income purposes ($31.5 million); (iv) restructure the public utility realty tax ($54.6 million); and (v) expand the income limit to qualify for personal income tax forgiveness by $500 to $6,500 per dependent ($7.5 million).

Expenditures for the fiscal year (excluding intergovernmental transfer transaction expenditures and net of appropriation lapses) were $19,171.0 million representing a 5.7 percent ($1,026.0 million) increase over the prior fiscal year. Expenditures include $220.1 million in net supplemental appropriations enacted late in the fiscal year, primarily for corrections, education and public welfare programs. Also included in this amount is $103 million of capital projects funding, a non-recurring budget item. This amount funds several capital projects and will be in lieu of Commonwealth debt financing. Lapses of appropriation authority during the fiscal year totaled $255.3 million, including $124.3 million of prior fiscal year appropriation lapses. The lapsed appropriation amounts provided funding for the supplemental appropriations enacted.

Fiscal Year 2001 Financial Results.

GAAP Basis. For fiscal year 2001 assets increased $454.2 million, a 5.9 percent increase over fiscal year 2000 to $8,183.2 million, primarily due to higher amount of funds in investments. Liabilities also rose during fiscal year 2001, increasing $232.9 million to $3,698.2 million. The increase of assets over liabilities for fiscal year 2000 caused the fund balance to increase by $221.3 million to $4,485.0 million as of June 30, 2001. The unreserved-undesignated fund balance as of June 30, 2001 was $1,524.8 million, a $175.3 million reduction from the prior fiscal year.

Revenues and other sources for fiscal 2001 increased by 5.3 percent over the prior fiscal year while expenditures and other uses grew by 5.7 percent. However, revenues and other sources for the fiscal year exceeded expenditures, other uses, and residual equity transfers to produce a $221.3 million increase in fund balance at June 30, 2001. An increase in tobacco settlement amounts of $384.5 million included in other designated funds accounted for all of the increase in fund balance during the fiscal year. Correspondingly, the unreserved-undesignated fund balance declined by $175.3 million from the prior fiscal year.

Budgetary Basis. The following information is derived from the Commonwealth's unaudited budgetary basis financial statements. For the 2001 fiscal year, revenues were above estimate and expenditures were lower than projected, enabling the General Fund to end the fiscal year with an unappropriated surplus balance of $335.5 million. Expenditures from Commonwealth revenues for the fiscal year, net of appropriation lapses and intergovernmental transfer transaction contributions, totaled $19,966.2 million against Commonwealth revenues, net of tax refund and rebate reserves, of $19,691.1 million. Financial operations during the fiscal year caused the total unappropriated surplus balance to decline by $275 million as of June 30, 2001, an amount smaller than budgeted.

Commonwealth revenues (prior to reserves for tax refunds) totaled $20,561.7 million, $81.2 million (0.4 percent) above the estimate made at the time the budget was enacted. Commonwealth tax revenues for the fiscal year increased by 1.4 percent over fiscal year 2000 tax receipts. The growth of tax receipts during the fiscal year was constrained by $444.6 million of tax reductions enacted for the fiscal year and the slowing rate of economic growth experienced in the nation and the state during this period. Among Commonwealth receipts for the fiscal year, the capital stock and franchise tax, the personal income tax and miscellaneous non-tax income were substantially higher than budgeted. Although fiscal year receipts from the capital stock and franchise tax were above budget estimates, receipts were 1.9 percent below fiscal year 2000 receipts, in part, due to a tax rate cut effective during the fiscal year. Receipts from the personal income tax increased 6.0 percent for the fiscal year led by a 6.5 percent gain in withholding receipts. Miscellaneous revenues increased 6.8 percent over the prior fiscal year, largely due to earnings on invested balances. Major Commonwealth revenue sources whose actual revenues were significantly under their budgeted amounts include the corporate net income and the sales taxes. Corporate net income tax receipts, reflecting a trend of falling business profits, declined by 13.8 percent for fiscal year 2001. Sales tax receipts, though below budget, increased by 2.6 percent over receipts during the previous fiscal year.

Reserves for tax refunds in fiscal year 2001 were $870 million, an increase of 6.7 percent over fiscal year 2000 reserves. Actual tax refund payments in recent fiscal years have been rising at a rate faster than the increase in reserves for tax refunds, causing the amount of reserves carried over from one fiscal year to the next to decline. At the end of fiscal year 2001, approximately $184 million of reserves were available for making tax refunds in the following fiscal year.

Appropriations from Commonwealth funds in the enacted budget for fiscal year 2001 (including supplemental appropriations) were 2.9 percent over fiscal year 2000 appropriations. Major program areas receiving funding increases above the 2.9 percent average include basic education, higher education, and medical assistance. These programs are discussed in more detail in the section titled "COMMONWEALTH REVENUES AND EXPENDITURES."

The fiscal year 2001 budget continued the Governor's emphasis of tax cuts targeted to making Pennsylvania competitive for attracting new employment opportunities and retaining existing jobs. Tax cuts for fiscal year 2001 totaled an estimated $444.6 million in the General Fund. The major components of the tax reductions and their estimated fiscal year 2001 General Fund cost are: (i) initiate a phase-out of the capital stock and franchise tax by a two mill reduction in the tax rate for the capital stock and franchise taxes to 8.99 mills ($270.5 million); (ii) reduce the inheritance tax rate for certain decedents ($78.0 million); (iii) eliminate the current $200 minimum annual capital stock and franchise tax payment ($29.5 million); and (iv) expand the income limit to qualify for personal income tax forgiveness by $1,000 to $7,500 per dependent ($16.2 million). Most major changes were effective on January 1, 2000.

Table 7
Sources, Uses and Changes in Unappropriated Balance
General Fund and Other Funding Sources — Unaudited Budgetary Basis
Commonwealth Revenues Only
(In Millions)

	Actual Fiscal 2000	Actual Fiscal 2001	Estimated Fiscal 2002[(a)]
Sources:			
Cash revenues	$ 20,256.7	$ 20,561.7	$ 20,650.6
Tax Rebate	0.0	(249.0)	0.0
Tax Refunds	(815.0)	(870.0)	(967.2)
Intergovernmental transfer transactions[(b)]	248.4	248.4	798.4
TOTAL SOURCES	$ 19,690.1	$ 19,691.1	$ 20,481.8
Uses:			
General fund appropriations	$ 19,426.3	$ 19,980.7	$ 20,769.6
Lapses and other reductions[(c)]	(255.3)	(262.9)	(500.0)
Intergovernmental transfer transactions[(b)]	248.4	248.4	798.4
TOTAL USES	$ 19,419.4	$ 19,966.2	$ 21,068.0
OPERATING BALANCE	$ 270.7	$ (275.0)	$ (586.2)
BEGINNING UNAPPROPRIATED BALANCE	447.5	610.5	335.5
ADJUSTMENT TO UNAPPROPRIATED BALANCE	0.0	0.0	1.0
TRANSFER (TO)/FROM TAX STABILIZATION RESERVE FUND	(107.7)	(0.0)	550.0
ENDING UNAPPROPRIATED BALANCE	$ 610.5	$ 335.5	$ 300.3

Totals may not add due to rounding.

(a) As in revised estimate contained in fiscal year 2003 budget proposal. Assumes $678 million revenue shortfall to budget estimate. Includes proposed revenue enhancements and spending restraints.

(b) Only includes funds replacing Commonwealth funds.

(c) Includes prior year appropriation lapses for fiscal year 2000 of $124.3 million and $143.9 million for fiscal year 2001. Fiscal year 2002 includes the effect of a $309.9 million freeze of current appropriations and $66 million of proposed appropriation lapses from the Tobacco Settlement Fund.

Fiscal Year 2002 Budget.

The following financial information is based on the Commonwealth's budgetary basis financial data.

Budgetary Basis. The enacted fiscal year 2002 budget provided for $20,689.9 million of appropriations from Commonwealth revenues, an increase of 3.5 percent over appropriations for fiscal year 2001. Commonwealth revenues are budgeted to total $20,361.1 million (after providing for enacted tax cuts), an increase of 3.4 percent over fiscal year 2001 actual receipts. The difference between the amount of projected revenues and appropriations budgeted is to be taken from the $335 million fiscal year beginning balance. The amount of the anticipated balance draw down does not take into consideration the possible availability of appropriation lapses that normally occur during a fiscal year and fund supplemental appropriations or increase unappropriated surplus.

The fiscal year 2002 estimate for Commonwealth revenues was prepared in June 2001 at the time of budget enactment based upon an economic forecast for national real gross domestic product to grow at a 2.8 percent rate from the second quarter of 2001 to the second quarter of 2002. The forecast anticipated more rapid national economic growth compared to the rate of growth that occurred during fiscal 2001. The higher rate of economic growth was anticipated in response to national fiscal and monetary policies designed to stimulate economic activity. The national unemployment rate was forecast to rise to above the 5 percent rate and inflation was expected to remain quite moderate during the period. Trends for the Pennsylvania economy were expected to maintain a close association with national economic trends. Personal income growth in Pennsylvania was anticipated to remain slightly below that of the U.S., while the Pennsylvania unemployment rate was anticipated to be very close to the national rate.

The fiscal year 2002 enacted budget includes $549.6 million for medical assistance intergovernmental transfers, a higher amount than the $248.4 million that has been budgeted in each of the most recent fiscal years. Under these intergovernmental transfer transactions, certain county governments contribute funds to the Commonwealth to help pay Medicaid expenses. The Commonwealth receives these contributions as augmentations to appropriations of Commonwealth revenues for the medical assistance program. These augmentations have the effect of supplementing the amount of Commonwealth revenues available for the medical assistance program funding and are available to match federal Medicaid funds. Federal authority for Pennsylvania to use these county contributions to pooling transactions to match additional federal funds gradually will be limited beyond fiscal year 2010.

Through calendar year 2001, economic growth in the nation and the state has been below the projections used to estimate fiscal year 2002 revenues. A national economic recession during the fiscal year was not anticipated in budget estimates. Consequently, actual Commonwealth revenues for the fiscal year to-date through January 2002 are $438.4 million below estimate for that period, a shortfall of 4.0 percent. Corporation taxes are $149.7 million below estimate, an 11.5 percent shortfall to the year-to-date estimate. Personal income tax payments are $156.5 million below estimate through January reflecting the recession's effect on employment and income. Non-tax revenues have also been affected by the recession. Through January, non-tax revenues are $75.1 million below estimate for that period, primarily due to lower returns on investments than anticipated. Recent forecasts for the national economy consulted by the Commonwealth expect a continuation of the national recession through the first quarter of 2002. The Commonwealth now anticipates, based on these revised forecasts, that Commonwealth revenues may be $678 million below budget estimates, a 3.2 percent reduction from the official budget estimate for the fiscal year. Consequently, Commonwealth revenue growth for fiscal year 2002 over actual fiscal year 2001 revenues now is expected to be approximately 0.4 percent compared to a projected 3.7 percent growth rate contained in the enacted budget.

Expenditure estimates for fiscal year 2002 have also been affected by the current economic recession, principally through trends for medical assistance caseloads and costs. Currently, the Commonwealth anticipates $78.7 million of supplemental appropriations to meet fiscal year costs, primarily to pay increased social service costs attributable to the recession. Additional supplemental appropriations may be required for certain programs whose expenditures are historically sensitive to economic conditions in the Commonwealth.

Responding to these current and expected economic and budgetary conditions, the Governor has directed $309.9 million of fiscal year 2002 General Fund appropriations from Commonwealth revenues be placed in budgetary reserve and be unavailable for encumbrance or expenditure. Further reviews of fiscal year 2002 appropriations may result in additional appropriation authority being transferred to budgetary reserve by the Governor during the fiscal year. At the end of fiscal year 2002, appropriated funds remaining in budgetary reserve will be lapsed into the budgetary balance and be available to offset revenue shortfalls, to fund supplemental appropriations, or to be re-appropriated for other budget purposes. In addition to placing a portion of appropriated fund into budgetary reserves, the Governor has proposed that an estimated $66 million of appropriation lapses in the Tobacco Settlement Fund be transferred to the General Fund for re-appropriation; proposed additional intergovernmental transfer funds be used to pay certain medical assistance costs; and has recommended the General Assembly approve the transfer of $550 million from the Tax Stabilization Reserve Fund to the General Fund as a partial offset of revenue shortfalls due to the recession. Based on the realization of the actions proposed by the Governor and achievement of the current revised expenditure and revenue estimates, the Commonwealth projects a fiscal year ending unappropriated surplus balance of $300.3 million. The Commonwealth is considering what other administrative and legislative actions may be taken to identify and obtain continuing or one-time additional revenues and expenditure reductions to address any budget negative balance that may occur due to realized revenue shortfalls and additional expenditure needs occurring during the current fiscal year.

Most of the Governor's recommended actions, other than the placing of appropriations into budgetary reserve, require approval by the General Assembly. Current law requires a two-thirds majority vote to approve transfers or appropriations from the Tax Stabilization Reserve Fund. No assurance can be given that the General Assembly will take the budgetary actions recommended by the Governor.

Achieving the financial results as budgeted or re-estimated may be adversely affected by a number of trends or events, including developments in the national and state economy as a result of current economic recession and adverse developments in industries accounting for significant employment and economic production in the Commonwealth.

Fiscal Year 2003 Proposed Budget.

A proposed fiscal year 2003 budget was submitted by the Governor to the General Assembly on February 5, 2002. The proposed budget recommended appropriations totaling $20.9 billion of Commonwealth funds against estimated revenues, net of tax refunds and proposed tax reductions of $20.6 billion. The $0.3 billion difference between estimated revenues and recommended appropriations is to be funded by a draw down of the anticipated $0.3 billion beginning balance. Achieving the projected fiscal year beginning balance is dependent upon the transfer of $550 million from the Tax Stabilization Reserve Fund in fiscal year 2002 recommended by the Governor (see "Fiscal Year 2002 Budget"). The Governor is also recommending the current annual tax rate reduction for the capital stock and franchise tax enacted in fiscal year 2001 be modified to a one-half mill rate reduction for tax years 2002 and 2003. Together with a proposed rise in the income limit to qualify for personal income tax forgiveness of income these proposed tax cuts total $103 million for the fiscal year.

The General Assembly may change, eliminate or add amounts and items to the proposed budget submitted by the Governor and there can be no assurance that the budget, as proposed by the Governor, will be enacted into law. See Appendix C for additional information on the budget enactment process.

Motor License Fund

The Constitution requires all proceeds of motor fuels taxes, vehicle registration fees, license taxes, operators' license fees and other excise taxes imposed on products used in motor transportation to be used exclusively for construction, reconstruction, maintenance and repair of and safety on highways and bridges and for debt service on obligations incurred for these purposes. The Motor License Fund is the fund through which most such revenues are accounted for and expended. Portions of certain taxes whose receipts are deposited into the Motor License Fund are legislatively restricted to specific transportation programs. These receipts are accounted for in restricted accounts in the Motor License Fund and are not included in the budgetary basis presentations or discussions on the Motor License Fund. The Motor License Fund budgetary basis includes only unrestricted revenue available for annual appropriation for highway and bridge purposes. The GAAP basis presentations include restricted account revenues and expenditures.

The most recent audited general purpose financial statements for a fiscal year are available in the CAFR issued by the Commonwealth for the fiscal period ended June 30, 2001.

Financial Results for Recent Fiscal Periods (GAAP Basis).

The fund balance at June 30, 2001 was $752.0 million, a $67.3 million increase from the June 30, 2000 fund balance. Revenues and other sources increased during fiscal year 2001 by 12.6 percent due to 55.4 percent increase in intergovernmental revenues. Over the five fiscal years of fiscal years 1997 through 2001, revenues and other sources have averaged an annual 7.7 percent increase. A substantial portion of that growth occurred in fiscal year 1998 due to tax and fee increases enacted in April 1997. Expenditures and other uses during the period from fiscal years1997 through 2001 have averaged an 8.1 percent annual increase. Table 8 on the following page sets forth a condensed summary of revenues and expenditures (presented on a GAAP basis) for the Motor License Fund for the fiscal years 1997 through 2001.

Table 8
Results of Operations–Motor License Fund
GAAP Basis–Unaudited
(In Thousands)

	Fiscal Year Ended June 30				
	1997	**1998**	**1999**	**2000**	**2001**
Fund Balance — Beginning of Period	$ 426,566	$ 535,540	$ 664,897	$ 711,558	$ 684,681
Restatements	-	1,091	-	-	-
Fund Balance — Beginning of Period, as Restated	$ 426,566	$ 536,631	$ 664,897	$ 711,558	$ 684,681
Revenues:					
Taxes	$ 1,378,134	$ 1,571,570	$ 1,619,365	$ 1,632,698	$ 1,647,122
Licenses and fees	515,309	708,488	743,784	806,256	806,726
Intergovernmental	841,224	722,000	912,119	840,092	1,305,345
Other revenues	145,426	151,656	155,369	159,639	123,480
Other Financing Sources:					
Operating transfers in	-	-	-	-	-
Other additions	4,343	4,731	8,372	13,962	3,818
TOTAL REVENUES AND OTHER SOURCES	$ 2,884,436	$ 3,158,445	$ 3,439,009	$ 3,452,647	$ 3,886,491
Expenditures:					
General government	$ 364,669	$ 345,614	$ 324,808	$ 383,151	$ 399,531
Transportation	2,226,024	2,487,352	2,849,515	2,884,897	3,234,879
Capital outlay	33,285	23,552	41,449	53,494	46,712
Other Uses:					
Operating transfers out	151,484	145,661	144,226	129,982	110,089
TOTAL EXPENDITURES AND OTHER USES	$ 2,775,462	$ 3,002,179	$ 3,359,998	$ 3,451,524	$ 3,791,211
REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURE AND OTHER USES	108,974	156,266	79,011	1,123	95,280
Residual Equity Transfers In (Out)	-	(28,000)	(32,350)	(28,000)	(28,000)
Fund Balance — End of Period	$ 535,540	$ 664,897	$ 711,558	$ 684,681	$ 751,961
Components of Fund Balance					
Reserved for encumbrances	$ 187,146	$ 300,787	$ 314,633	$ 250,948	$ 382,462
Reserved for long-term investments	131,992	-	-	-	-
Unreserved - designated - highways	169,444	223,234	213,622	250,743	182,670
Unreserved - undesignated	46,958	140,876	183,303	182,990	186,829
TOTAL FUND BALANCE	$ 535,540	$ 664,897	$ 711,558	$ 684,681	$ 751,961

Note: Interfund eliminations have not been made.
Source: Compiled from Office of the Budget, Comprehensive Annual Financial Report for fiscal years ended June 30, 2001, 2000, 1999, 1998, and 1997.

The following budgetary basis information is derived from the Commonwealth's unaudited budgetary basis financial statements.

Fiscal Year 2000 Financial Results.

Budgetary Basis. The Motor License Fund ended the fiscal year with an unappropriated surplus balance of $112.1 million, an increase of $22.6 million during the fiscal year. The increase resulted from Commonwealth revenues of $1,959.4 million and expenditures, net of appropriation lapses, of $1,936.7 million. Commonwealth revenues were 3.9 percent ($74.4 million) above those in the prior fiscal year. License and fee revenue had the largest growth rate at 6.9 percent, while liquid fuels taxes, the largest category of revenue, increased 1.8 percent. Expenditures rose 1.4 percent over the prior fiscal year, led by highway construction and maintenance programs, and the highway patrol activities of the Pennsylvania State Police.

Fiscal Year 2001 Financial Results.

Budgetary Basis. Lower than expected revenues for the fiscal year 2001 budget were offset by appropriation lapses, causing the unappropriated surplus balance to rise $2.7 million during the fiscal year. In a reflection of lower economic growth in the national economy, during fiscal year 2001 fuel tax and motor vehicle license and fees revenues were below estimate. The revenue category of other revenues was also below estimate, largely due to earnings on investments that were below projections. Expenditures totaled $1,973.4 million against Commonwealth revenues and appropriation lapses that totaled $1,976.1 million. Total liquid fuels receipts, the largest revenue category for the fund, during the fiscal year rose 1.5 percent compared to fiscal year 2000 revenues.

Fiscal Year 2002 Budget.

Budgetary Basis. Commonwealth revenues to the Motor License fund are estimated to be $1,955.8 million, an increase of 0.2 percent over actual fiscal year 2001 revenues. This growth rate is largely due to the expectation for liquid fuels taxes to maintain their recent historic low growth rate. Appropriations of Commonwealth revenues in the adopted budget total $2,061.0 million. This amount represents a 4.4 percent increase over appropriations in fiscal year 2001 and represents a planned $105.2 million draw down of the $114.9 million fiscal year beginning balance. The adopted budget projects a $9.6 million unappropriated surplus balance at the end of fiscal year 2002. This projection does not take into consideration the possible availability of appropriation lapses that normally occur during a fiscal year and fund supplemental appropriations or increase unappropriated surplus.

Through January 2002, Commonwealth revenues in the Motor License Fund have totaled $66.7 million, 5.8 percent, above the revenue estimate for that period.

The achievement of the budgeted results may be adversely affected by a number of trends or events, including developments in the national and state economy and adverse developments in the price and availability of motor vehicle fuels.

Fiscal Year 2003 Proposed Budget.

A budget proposing $2.1 billion of appropriations from Commonwealth funds for fiscal year 2003 has been submitted to the General Assembly. The requested amount of appropriations is virtually the same as the amount appropriated for fiscal year 2002. The proposed budget projects the maintenance of a minimal balance at fiscal year-end.

State Lottery Fund

The Commonwealth operates a statewide lottery program that consists of various lottery games using computer sales terminals located throughout the state, and instant games using preprinted tickets. The net proceeds of all lottery game sales less sales commissions and directly paid prizes are deposited into the State Lottery Fund.

State Lottery Fund receipts support programs to financially assist elderly and handicapped individuals, primarily through property tax and rent rebate assistance and a pharmaceutical assistance program to recipients who meet specified income limits, and the provision of free mass transit rides during off-peak hours. Certain administrative costs and the payment to the General Fund of the personal income tax due on lottery prizes, making the prizes free of Pennsylvania state income taxes to the recipients, which taxes and costs were previously paid from the State Lottery Fund, are now being paid by the General Fund, beginning in fiscal year 2000.

The most recent audited general purpose financial statements for a fiscal year are available in the CAFR issued by the Commonwealth for the fiscal period ended June 30, 2001.

Financial Results for Recent Fiscal Periods (GAAP Basis).

In fiscal year 2001, revenues and other sources increased by 6.2 percent over those in fiscal year 2000, due to gains in lottery revenues and intergovernmental revenue. Lottery revenues constitute approximately 95 percent of revenue and other sources for the State Lottery Fund and historically have increased and declined in response to marketing efforts, economic conditions, prize levels, and alternate gaming opportunities. Expenditures and other uses for fiscal year 2001 increased by a 10.4 percent due in part to higher sales commissions that arise because the highest commission games are experiencing the largest sales growth. In recent years, costs of programs funded from the State Lottery Fund have risen faster than fund resources. Consequently, certain expenditures previously paid from the State Lottery Fund were transferred to the General Fund in order to maintain a positive balance in the State Lottery Fund. Beginning with fiscal year 2000, approximately $86 million of annual State Lottery Fund administrative costs for operations were shifted to the General Fund.

Table 9 below sets forth a condensed summary of revenues and expenditures (presented on a GAAP basis) for the State Lottery Fund for fiscal years 1997 through 2001.

Table 9
Results of Operations–State Lottery Fund
GAAP Basis–Unaudited
(In Thousands)

	Fiscal Year Ended June 30				
	1997	**1998**	**1999**	**2000**	**2001**
Fund Balance — Beginning of Period	$ 33,859	$ 131,127	$ 215,179	$ 213,409	$ 242,987
Restatements	-	10,947	-	-	-
Fund Balance — Beginning of Period, as Restated	$ 33,859	$ 142,074	$ 215,179	$ 213,409	$ 242,987
Revenues:					
Lottery revenues	1,722,558	1,684,015	1,659,305	1,695,371	1,788,333
Intergovernmental	55,578	57,361	59,463	57,057	67,758
Investment income	-	15,366	5,383	22,065	21,645
Other revenues	19,180	8,361	13,973	(128)	7,478
Other Financing Sources:					
Operating transfers in	82	-	-	-	-
TOTAL REVENUES AND OTHER SOURCES	$ 1,797,398	$ 1,765,103	$ 1,738,124	$ 1,774,365	$ 1,885,214
Expenditures:					
General government	$ 1,039,705	$ 1,011,709	$ 1,039,634	$ 991,257	$ 1,167,001
Public health and welfare	300,392	311,087	314,279	389,847	355,720
Transportation	110,959	108,621	102,105	103,567	114,265
Debt Service	-	-	-	116	-
Other Uses:					
Operating transfers out	249,074	260,581	283,876	260,000	290,000
TOTAL EXPENDITURES AND OTHER USES	$ 1,700,130	$ 1,691,998	$ 1,739,894	$ 1,744,787	$ 1,926,986
REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURE AND OTHER USES	97,268	73,105	(1,770)	29,578	(41,772)
Fund Balance — End of Period	$ 131,127	$ 215,179	$ 213,409	$ 242,987	$ 201,215
Components of Fund Balance					
Reserved for encumbrances	$ 2,954	$ 955	$ 1,675	$ 1,290	$ 5
Reserved for long-term investments	6,201	16,968	-	-	-
Reserved for other	8	8	-	-	13
Unreserved - designated - other	264	275	275	264	264
Unreserved - undesignated (deficit)	121,700	196,973	211,459	241,433	200,933
TOTAL FUND BALANCE	$ 131,127	$ 215,179	$ 213,409	$ 242,987	$ 201,215

Note: Interfund eliminations have not been made.
Source: Compiled from Office of the Budget, Comprehensive Annual Financial Report for fiscal years ended June 30, 2001, 2000, 1999, 1998, and 1997.

The following budgetary basis information is derived from the Commonwealth's unaudited budgetary basis financial statements.

Fiscal Year 2000 Financial Results.

Budgetary Basis. During fiscal year 2000, ticket sales rose by 1.1 percent to $1,686.7 million and were slightly ahead of the budget estimate. After deduction of prizes and commissions and the inclusion of miscellaneous income, net revenue for the fiscal year totaled $929.3 million, a 0.4 percent increase over the prior fiscal year. Expenditures, net of current year lapses for the fiscal year, declined by 5.4% percent to $854.6 million. The decline in net expenditures was due to the transfer of certain lottery administrative costs and the Pennsylvania personal income tax liability on prizes to the General Fund. Approximately $86 million of costs were transferred to the General Fund.

Fiscal Year 2001 Financial Results*.*

Budgetary Basis. Lottery ticket sales rose 5.5 percent from fiscal year 2000 actual sales and produced net revenues of $858.5 million, 5.5 percent below the prior fiscal year. Instant ticket sales, which are subject to higher commissions, accounted for a greater proportion of total sales, leading to the divergent trends for gross and net sales revenues during the fiscal year. Expenditures for the programs funded from lottery receipts increased by 9.9 percent to $938.9 million. Legislated eligibility changes for property and rent rebate payments and rising pharmaceutical costs were the principal sources of the growth in program disbursements. Expenditures in excess of fiscal year revenues were funded from a $55.2 million draw down in the unappropriated fund balance and reserve. The fiscal year ending balance was $391.0 million (including $160 million of reserves).

Fiscal Year 2002 Budget.

Budgetary Basis. The enacted budget projects a 4.2 percent increase in gross ticket sales and total revenues of $970.1 million. Budgeted expenditures total $1,050.9 million, 14.9 percent above fiscal year 2001 expenditures. The excess of budgeted expenditures over estimated revenues is planned to be funded by a partial draw down in the unappropriated fund balance and reserve. The fiscal year-ending balance is projected to total $254.9 million (including $100 million of reserves).

Trend projections for fiscal years beyond fiscal year 2002 show estimated program and administrative costs above estimated net revenues. The estimated expenditures in excess of estimated revenues will be funded from a further draw down of available reserves and balances in the State Lottery Fund. Based upon current projections, higher revenues and/or lower expenditures will be required for the State Lottery Fund to balance operations within a fiscal year.

The achievement of the budgeted results may be adversely affected by a number of factors, including failure of the marketing and game strategies to achieve the projected rise in revenues and increased competition from other forms of gaming that may be available to Pennsylvania lottery players.

Fiscal Year 2003 Proposed Budget.

The Governor's proposed fiscal year 2003 budget anticipates a 16.7 percent increase in revenues, mostly from the Commonwealth's participation in the multi-state Powerball game administered by the Multi-State Lottery Association. Appropriations totaling $1.2 billion are recommended. The fiscal year-end balance and reserve is projected to total $251.3 million, a slight decline from fiscal year 2002.

COMMONWEALTH REVENUES AND EXPENDITURES

Recent Receipts and Forecasts

Table 10 on the following page presents the Commonwealth revenue receipts, including net revenues accrued but not deposited, on a budgetary basis, for the major operating funds of the Commonwealth as actually received for fiscal years 1996 through 2001 and as budgeted in the enacted budget for fiscal year 2002.

[INTENTIONALLY BLANK – TABLE 10 FOLLOWS]

Table 10
Commonwealth Revenues [a]
General Fund, Motor License Fund and State Lottery Fund - Unaudited
Fiscal Year 1996 – Fiscal Year 2001 and Fiscal Year 2002 Estimate
(In Millions)

	Fiscal Year Ended June 30						Estimate
	1996	1997	1998	1999	2000	2001	2002
General Fund							
Tax Revenues:							
Sales and use	$ 5,682.4	$ 6,036.5	$ 6,152.2	$ 6,605.8	$ 7,018.3	$ 7,203.8	$ 7,318.1
Personal income	5,374.3	5,745.6	6,236.4	6,683.6	7,066.0	7,491.5	7,612.9
Corporate (b)	2,505.4	2,651.6	2,733.7	2,825.3	2,943.7	2,666.4	2,378.4
Public utility (c)	816.6	854.7	831.7	794.8	762.1	705.8	793.1
Inheritance	553.5	615.5	710.9	760.7	819.1	799.8	778.1
Financial and insurance (d)	404.8	389.9	420.1	455.2	475.9	481.3	484.7
Cigarette	297.7	291.6	279.0	275.8	272.4	269.3	265.2
Realty transfer	178.2	200.9	241.5	258.0	271.9	268.8	283.2
Alcoholic beverages (e)	149.5	155.9	161.4	170.5	179.6	187.6	196.6
Other	13.5	16.0	7.9	4.8	1.9	16.6	5.2
TOTAL TAX REVENUES	$15,975.9	$16,958.2	$17,774.8	$18,834.5	$19,810.9	$20,090.9	$ 20,115.5
Non-Tax Revenues:							
Liquor store profits	$ 42.0	$ 50.0	$ 50.0	$ 50.0	$ 50.0	$ 50.0	$ 120.0
Licenses, fees and miscellaneous	299.7	280.4	270.1	314.4	368.7	387.7	387.5
Fines, penalties and interest	21.1	32.0	28.4	27.9	27.1	33.1	27.6
TOTAL NON-TAX REVENUES	$ 362.8	$ 362.4	$ 348.5	$ 392.3	$ 445.8	$ 470.8	$ 535.1
TOTAL GENERAL FUND	$16,338.7	$17,320.6	$18,123.3	$19,226.8	$20,256.7	$20,561.7	$ 20,650.6
Motor License Fund							
Tax Revenues:							
Liquid fuels	$ 533.0	$ 550.3	$ 593.5	$ 536.7	$ 555.4	$ 567.8	$ 583.1
Fuels use	132.9	143.1	142.0	150.4	148.0	146.2	148.4
Oil company franchise	303.5	310.5	293.7	322.0	326.4	324.5	328.3
Motorbus & alt fuels	12.7	(4.1)	(2.2)	19.0	17.2	31.7	28.5
TOTAL TAX REVENUES (f)	$ 982.1	$ 999.8	$ 1,027.0	$ 1,028.1	$ 1,047.0	$ 1,070.2	$ 1,088.3
Non-Tax Revenues:							
Licenses and fees	$ 506.1	$ 519.6	$ 703.1	$ 755.4	$ 807.9	$ 795.4	$ 803.4
Other and miscellaneous	78.2	78.1	87.3	94.7	97.5	86.3	86.9
TOTAL NON-TAX REVENUES	$ 584.3	$ 597.7	$ 790.4	$ 850.1	$ 905.4	$ 881.7	$ 890.3
TOTAL MOTOR LICENSE FUND(f)	$ 1,566.4	$ 1,597.5	$ 1,817.4	$ 1,878.2	$ 1,952.4	$ 1,951.9	$ 1,978.6
State Lottery Fund							
Non-Tax Revenues:							
Lottery revenues	$ 856.4	$ 928.3	$ 909.8	$ 899.7	$ 908.8	$ 858.5	$ 949.6
Other and miscellaneous	6.4	15.6	17.0	26.4	20.5	23.0	20.5
TOTAL NON-TAX REVENUES	$ 862.8	$ 943.9	$ 926.8	$ 926.1	$ 929.3	$ 881.5	$ 970.1
TOTAL STATE LOTTERY FUND	$ 862.8	$ 943.9	$ 926.8	$ 926.1	$ 929.3	$ 881.5	$ 970.1

Source: Office of the Budget. Totals may not add due to rounding
(a) Budgetary basis including taxes and interest accrued but not deposited by the Commonwealth by June 30 of each fiscal year.
(b) Includes the corporate net income and the capital stock and franchises taxes.
(c) Includes the utility gross receipts and utility property taxes.
(d) Includes the financial institution and insurance premium taxes.
(e) Includes the liquor and malt beverage taxes.
(f) Includes net accrued revenues of (millions): 1996 – $4.4; 1997 – ($4.4); 1998 – ($7.1); 1999, 2000, 2001, and 2002 – $0.

Table 11 presents a comparison of the actual revenues on a budgetary basis to the official revenue estimate for the General Fund and the Motor License Fund for fiscal years 1997 through 2001.

Table 11
Commonwealth Revenues — Official Estimate vs. Actual[(a)]
General Fund and Motor License Fund – Unaudited
Fiscal Year 1997 — Fiscal Year 2001
(In Millions)

	General Fund			Motor License Fund		
Fiscal Year Ended June 30	Official Estimate[(b)]	Actual	Variance	Official Estimate [(b)]	Actual	Variance
1997	$16,744.5	$17,320.6	$576.1	$1,560.1	$1,602.3	42.2
1998	17,447.0	18,123.2	676.1	1,801.6	1,805.7	4.1
1999	18,453.6	19,226.7	773.0	1,885.0	1,841.9	43.1
2000	19,374.9	20,256.7	881.8	1,884.0	1,959.4	75.4
2001	20,480.5	20,561.7	81.2	1,970.4	1,951.8	-18.6

Source: Office of the Budget.
(a) Budgetary basis including taxes and interest accrued but not deposited by the Commonwealth by June 30 of each fiscal year.
(b) As certified for budget enactment.

Tax Revenues

Tax revenues constitute approximately 98 percent of Commonwealth revenues in the General Fund. The major tax sources for the General Fund of the Commonwealth are the sales tax, the personal income tax, the corporate net income tax, and the capital stock and franchise tax. Together these four taxes produce over 86 percent of General Fund tax revenues.

The major tax sources for the Motor License Fund are the liquid fuels taxes and the oil company franchise tax. Together these taxes produce over 45 percent of Motor License Fund revenues. Portions of certain taxes whose receipts are deposited into the Motor License Fund are legislatively restricted to specific transportation programs. These receipts are accounted for in restricted accounts in the Motor License Fund and are not included in the discussions of the tax revenues of the Motor License Fund.

The major tax sources for the General Fund and the Motor License Fund are described briefly below. The tax receipt amounts in the descriptions are on a budgetary basis.

Sales Tax. This tax accounted for $7,203.8 million or 35.1 percent of fiscal year 2001 General Fund Commonwealth revenues. The tax is levied at a rate of 6 percent on the sale, use, storage, rental or consumption of tangible personal property, cigarettes, and certain services, and upon the occupancy of hotel rooms. Substantial exemptions from the tax include clothing, food purchased in grocery stores or supermarkets, medical supplies, drugs, residential use of certain utilities, motor fuels, and machinery, equipment and items used in manufacturing, processing, farming or dairying, and utility service. The tax base was expanded in fiscal year 1992 to include a number of services not previously taxed. Beginning in fiscal year 1998, 1.22 percent of collections, up to an annual limit of $75 million, are transferred to a special fund for mass transit assistance.

Vendors collecting $600 or more in the previous year's third quarter are required to remit collections monthly within 20 days of the last day of the collection month.

Personal Income Tax. This tax accounted for $7,491.5 million or 36.4 percent of fiscal year 2001 General Fund Commonwealth revenues. The tax is levied at a flat rate on the taxable income of all residents and resident trusts and estates and taxable income attributable to Pennsylvania non-resident estates and trusts. The current tax rate of 2.8 percent became effective on July 1, 1992, having been reduced from the 3.1 percent rate in effect since July 1, 1991. Prior to July 1, 1991, the tax rate was 2.1 percent. Credit against the tax is allowed for gross or net income taxes paid to other states by Pennsylvania residents.

Withholding is required by employers from all persons liable for the tax with the size of collections determining the frequency for remittance to the Commonwealth. A declaration and partial payment of the estimated tax is required for those individuals with taxable incomes over $8,000 per year, other than wages subject to withholding.

Individuals and families meeting qualifying income limits do not pay personal income tax on all or a portion of their taxable income with the exemptions depending on their total income. A qualifying family of four owes no personal income tax on taxable income up to $30,000 annually.

Corporate Net Income Tax. The Commonwealth received $1,603.4 million, or 7.8 percent of fiscal year 2001 General Fund Commonwealth revenues from this tax. The tax is paid by all domestic and foreign corporations for the privilege of doing business, carrying on activities, or employing capital or property in Pennsylvania and is levied on federal net taxable income with Pennsylvania modifications. Building and loan associations, banks, savings institutions, trust companies, insurance and surety companies, Pennsylvania S corporations and non-profit corporations are exempt from the tax. When less than the entire business of any corporation is transacted within the Commonwealth, the taxable income in Pennsylvania is determined by an apportionment formula.

The current tax rate of 9.99 percent became effective for fiscal years beginning on or after January 1, 1995. The previous tax rate of 11.99 percent had been in effect since January 1, 1994.

The corporate net income tax is to be paid in four equal installments throughout the corporation’s tax year based on estimated taxes due for the entire tax year. Any remaining portion of taxes due is to be paid with the corporation’s annual report due three and one-half months following the end of the corporation’s tax year.

Capital Stock and Franchise Taxes. These taxes generated $1,063.0 million for the Commonwealth in fiscal year 2001, or 5.1 percent of General Fund Commonwealth revenues. They are levied on the capital stock value of domestic and foreign corporations doing business or having property or capital employed in Pennsylvania on that portion of capital stock value apportionable to Pennsylvania under a statutory formula.

Capital stock and franchise tax tentative payments are payable quarterly based on 90 percent of the tax liability of the year preceding the immediate prior year. The General Fund tax rate for tax years that began in 2001 is 7.74 mills having been reduced from 8.74 mills effective January 1, 2001. The rate is scheduled to decline by one mill to 6.74 mills on January 1, 2002, however, the Governor, responding to reduced revenue estimates, has proposed the tax rate for 2002 be reduced to 6.99 mills, a one-half mill reduction. An additional one-quarter mill tax is levied for purposes of the Hazardous Sites Cleanup Fund. The one-quarter mill tax dedicated to the Hazardous Sites Cleanup Fund rate remains in effect until the available balance in the Hazardous Site Cleanup Fund rises above a specified amount. These taxes are scheduled to be phased out by annual rate reductions through 2008 under legislation enacted in 2000.

Collection of certain prior fiscal year revenues under the capital stock and franchise taxes is the subject of litigation. See “LITIGATION - *PPG Industries, Inc. v. Commonwealth of Pennsylvania*.”

Utility Gross Receipts Tax. This tax accounted for $705.8 million, or 3.4 percent of fiscal year 2001 General Fund Commonwealth revenues. The tax is levied on the gross receipts from business transacted within Pennsylvania by specified public utilities owned, operated or leased by corporations, associations or individuals. Public utilities owned or operated by a municipality or a municipal authority furnishing public utility services within the limits of the municipality are exempt from paying tax on the receipts arising from business done within the municipality. The tax rate is 50 mills, which became effective in July 1991, having been raised from its prior tax rate of 44 mills for all utilities except electric utilities, which are taxed at the rate of 44 mills. The tax rate for electric utilities is adjusted annually under provisions of a formula enacted with the deregulation of electric generation in Pennsylvania. Beginning with fiscal year 1999, 0.18 percent of receipts are transferred to a special fund for mass transit purposes. Revenue from 0.2 mills of the tax is deposited in the Alternative Fuels Incentive Grant Fund.

All firms, except public utilities owned or operated by a municipality or a municipal authority, and motor transportation companies, are required to file estimated revenue reports annually together with the tentative payment of the current year’s tax calculated by applying the current tax rate to 90 percent of the tax base for the preceding year. Effective for tax years effective after January 1, 2000, natural gas companies will become exempt from the tax. The tax report and tentative payment are required to be made by March 15. The remaining tax is due and payable by the succeeding March 15.

Inheritance and Estate Taxes. Collections of these taxes were $799.8 million in fiscal year 2001, or 3.6 percent of General Fund Commonwealth revenues. The inheritance tax is levied on the value of property transferred to heirs of a deceased person. Prior to July 1, 2000, the tax rate was 6 percent of the value, if passing to lineal heirs, and 15 percent if passing to collateral heirs. Effective July 1, 2000, the tax rate on transfers to parents, grandparents and lineal descendents was lowered to 4.5 percent and a new tax rate of 12 percent on transfers to siblings was established. The estate tax is a "pick-up" tax in the amount of the maximum federal tax credit less State death taxes paid. Counties collect the inheritance and estate tax, which is due within nine months following the death of the person whose property is being transferred. In 2001, the U.S. Congress enacted legislation reducing the credit for State death taxes permitted to be taken by taxpayers to reduce federal estate taxes owed. The smaller federal credit available to taxpayers is expected to lower the amount of estate tax revenues received by the Commonwealth in fiscal year 2003 and beyond.

Cigarette Tax. Collections of this tax totaled $269.3 million in fiscal year 2001, or 1.2 percent of General Fund Commonwealth revenues. The tax is imposed and assessed on the sale or possession of cigarettes within the Commonwealth. It is levied on the consumer but is collected by the sale of stamps and meter units to dealers who affix them to each package. The current rate is 31 cents per package of 20 cigarettes and was increased from 18 cents in 1991. The 6 percent sales tax is also imposed on the retail sale of cigarettes. For fiscal years 1992 through 1997, collections from two cents of the tax were transferred to a special fund for children. Beginning with fiscal year 1998, three cents of the tax rate are transferred for this purpose. Also, collections from two cents of the tax are transferred to a special fund for preserving farmland.

Insurance Premiums Tax. This tax is levied at the rate of 2 percent of the gross premiums (subject to retaliatory provisions) on all business of domestic and foreign insurance companies transacted within the Commonwealth during each calendar year. Revenues from the two percent tax on foreign fire and casualty companies accrues to special revenue funds while the remaining taxes accrue to the General Fund. The tax on foreign companies is based on the amount of business transacted in Pennsylvania. Marine insurance companies, both domestic and foreign, pay a 5 percent tax on underwriting profits attributable to Pennsylvania in lieu of the gross premium tax.

A 90 percent tentative payment is required for insurance companies, except foreign fire and casualty companies, calculated on the tax base of the preceding tax year. As an alternative, the taxpayer may elect to make a tentative payment in an amount not less than 90 percent of the tax as finally reported. Payments must be submitted by March 15 of each year while the remaining amount due must be paid by April 15 of the following year.

Realty Transfer Tax. This tax is levied at the rate of 1 percent of the value of the real property transferred, as represented by deed, instrument or other writing. The tax is collected by the recorders of deeds in the counties and transmitted to the Commonwealth when collected. Fifteen percent of the revenues from this tax is transferred to the Keystone Recreation, Park and Conservation Fund, and the remaining portion is deposited in the General Fund.

Liquor Tax. This tax is levied at the rate of 18 percent of the net purchase price on all liquor sold by the Pennsylvania Liquor Control Board. Revenues from this tax accrue to the General Fund. The 6 percent sales tax is also imposed on all liquor sold by the Pennsylvania Liquor Control Board and is included in the sales tax receipts.

Financial Institution Taxes. The bank shares tax is levied at the rate of 1.25 percent of the value of shares of state and national banks and title insurance companies. Each institution computes the tax base by averaging the share value, adjusted to exclude the value of United States obligations, for each quarter of the previous calendar year. A payment of the tax for the current tax year is due by March 15 of that year. Revenues of this tax are deposited into the General Fund.

The mutual thrift institutions tax is levied on the taxable net income of such institutions at the rate of 11.5 percent. Revenues of this tax accrue to the General Fund. Annually, the mutual thrift institutions are required to transmit tentative reports together with a tentative payment of the current year's tax computed by applying the current tax rate to 90 percent of the tax base for the second preceding tax year. The taxpayer may elect to make a tentative payment at an amount not less than 90 percent of the tax as finally reported. Tentative reports and prepayments are due by March 15 of the current calendar year, with the remaining amount payable by April 15 of the next year.

Public Utility Realty Tax. The tax is levied on the state taxable value of utility real property belonging to a firm or other entity (i) furnishing utility service and (ii) regulated by the Pennsylvania Public Utility Commission or similar regulatory body. State taxable value is the current market value derived from assessed values for county real estate tax purposes. Certain items are specifically exempt from the tax. The tax rate for the General Fund portion of the tax is set annually by the Secretary of Revenue. The tax rate is to be set at a rate intended to produce revenues sufficient to reimburse local taxing authorities for foregone property tax. Revenues from an additional 7.6 mill tax are deposited into a special revenue fund.

The tax is subject to a tentative payment of the then current year's tax liability. The tentative reports and tax payments are due in May. The remaining tax payments must be paid in September.

Malt Beverage Tax. This tax is levied on all malt or brewed beverages sold in Pennsylvania. The tax rate is $^{2}/_{3}$ cent per half-pint, 1 cent per pint and $2.48 per barrel. The various manufacturers pay the tax monthly to the Department of Revenue. Revenues from this tax are deposited into the General Fund.

Liquid Fuels Tax. This tax accounted for $567.8 million, or 29.0 percent of Motor License Fund Commonwealth revenues in fiscal year 2001. It is an excise tax imposed upon all liquid fuels used or sold within the Commonwealth. The tax is imposed upon and collected by the fuel distributor. After discounts, all monies collected are placed in the Motor License Fund, except that an amount equal to one-half cent per gallon is placed in the Liquid Fuels Tax Fund. Fuels sold and delivered to the U.S. government, the Commonwealth and any of its political subdivisions, public authorities, non-profit schools, volunteer fire companies, ambulance services, rescue squads, and fuels sold and delivered in interstate commerce, are exempt from payment of the tax. In addition to these exemptions, reimbursement is made for fuels used for certain agricultural purposes. The present rate of the liquid fuels tax is 12 cents per gallon.

Oil Company Franchise Tax. This tax accounted for $324.5 million, or 16.6 percent of fiscal year 2001 Motor License Fund Commonwealth revenues . The tax is levied on the privilege of selling petroleum products subject to liquid fuels taxes for transportation purposes at the rate of 153.5 mills upon each dollar of such revenues. The tax rate was increased by 38.5 mills in May 1997 to its current rate. By law, portions of the tax are dedicated to certain highway purposes, including transfers to local governments for roads and highways. Exemptions from the tax are the same as those provided from the liquid fuels tax.

Fuels Tax. This tax accounted for $146.2 million, or 7.5 percent of fiscal year 2001 Motor License Fund Commonwealth revenues. It is an excise tax imposed on fuels (primarily diesel fuel) used or sold within the Commonwealth. The tax is imposed upon and collected by the distributor. After discounts, all monies collected are placed in the Motor License Fund, except an amount equal to one-half cent per gallon placed in the Liquid Fuels Tax Fund for distribution to local governments. The present tax rate is 12 cents per gallon for fuel used in the Commonwealth.

Fuels exempt from this tax are those delivered in interstate commerce, those used by and sold to the Commonwealth and any of its political subdivisions, those sold and delivered to the U.S. government, those (less than 50 gallons) brought into the Commonwealth in the fuel tanks of motor vehicles, those used by public authorities, volunteer fire companies, ambulance services, rescue squads and non-profit schools, and those used for certain agricultural purposes.

Motor Carriers Road Tax. This tax is levied on motor carrier vehicles having a gross weight in excess of 26,000 pounds. All monies collected are placed in the Motor License Fund. The current rate is 12 cents per gallon, plus an additional factor based on the oil company franchise tax for fuel used within the Commonwealth. In May 1997 the tax rate was reduced by 6 cents to its current level. The revenue lost from the tax reduction is being covered by an additional 55 mills tax rate for the oil company franchise tax. Both the repealed and the new tax portions are dedicated to bridge improvement.

Non-Tax Revenues

Licenses and Fees. License and fee receipts in the General Fund for fiscal year 2001 totaled $86.6 million representing 0.4 percent of Commonwealth revenues to the General Fund. Revenues from motor vehicle licenses and fees in fiscal 2001 were $795.4 million, representing 40.8 percent of total fiscal year 2001 Motor License Fund Commonwealth revenues. A general increase in various fees and licenses was enacted in April 1997 and effective beginning with the 1998 fiscal year.

Miscellaneous Revenue. Revenues from non-tax sources not categorized elsewhere are credited to miscellaneous revenues. Interest earnings on securities and deposits are included in this source.

State Stores Fund Transfers. This is an amount determined by the Liquor Control Board to be available for transfer to the General Fund. The amount transferred for fiscal year 2001 was $50.0 million. In Pennsylvania, the distribution and sale of liquor is a state enterprise.

Fines, Penalties and Interest. This revenue source includes all fines, penalties and interest collected in the enforcement of tax regulations. The amount deposited to the General Fund for fiscal year 2001 was $33.1 million. The largest portion is from corporation tax penalties.

Tobacco Settlement Payments. The Commonwealth's portion of payments made by cigarette manufacturers participating in the Tobacco MSA are deposited in the Tobacco Settlement Fund to be used for certain health-related programs. See "COMMONWEALTH FINANCAL STRUCTURE AND PROCEDURES – Description of Funds." Settlement payments received during fiscal year 2000 totaled $465 million. Settlement payments in the amount of $345 million were received during fiscal year 2001.

Federal Revenues

Receipts by the Commonwealth in its General Fund, Motor License Fund and State Lottery Fund from the federal government during fiscal year 2001 totaled $11.7 billion. Approximately $8.2 billion, or 70.3 percent of total federal revenue to the Commonwealth for fiscal year 2001, was attributable to public health and welfare programs, the largest of which were for the medical assistance and temporary assistance to needy families programs.

For fiscal year 2002, funds to be received from the federal government in the General Fund, the Motor License Fund and the State Lottery Fund are estimated to be $13.5 billion.

Major Commonwealth Expenditures

The Commonwealth's major operating funds—the General Fund, the Motor License Fund and the State Lottery Fund—provide financial resources to operate programs and fund grants. Trends in expenditures from those funds for various program areas are discussed below based on budgetary basis financial statements for fiscal year 2001 and the enacted fiscal year 2002 budget.

Education

In fiscal year 2001, expenditures from Commonwealth revenues for education purposes were just over $8.4 billion. The enacted budget for fiscal year 2002 includes over $8.75 billion in education funding, an increase of 3.9 percent over fiscal year 2001.

Table 12
Fall Enrollment in Pennsylvania Public and Non-Public Elementary Schools and Secondary Schools
School Years 1997-2001
(In Thousands)

	School Year Ended June				
	1997	**1998**	**1999**	**2000**	**2001**
Elementary Schools					
Public	990	990	985	977	967
Nonpublic	252	250	247	245	242
Secondary Schools					
Public	814	825	832	840	847
Nonpublic	82	83	84	85	85
Total					
Public	1,804	1,815	1,817	1,817	1,814
Nonpublic	334	333	331	331	327
Total	2,138	2,148	2,148	2,148	2,141

Source: Pennsylvania Department of Education.

Elementary and Secondary Education. The financing of public elementary and secondary education in Pennsylvania is shared by the Commonwealth and local school districts. There are 501 local school districts in the state. Each is governed by a locally elected school board responsible for the administration of the public schools in the school district with the authority to levy taxes within the limits prescribed by the Public School Code of 1949, as amended. Funds supplied by the Commonwealth supplement the funds raised locally. Local school districts receive various subsidy payments for basic instruction, vocational education, debt service, pupil transportation, employee retirement programs including social security, and various special education programs from the Commonwealth. The largest such subsidy is the Basic Education Funding subsidy (formerly known as the Equalized Subsidy for Basic Education or ESBE). The Basic Education Funding subsidy of nearly $3.79 billion provided nearly 59 percent of all Commonwealth aid to local schools in fiscal year 2001. The enacted budget for fiscal year 2002 increases Basic Education Funding by $168.1 million, or nearly 4.5 percent, to over $3.96 billion. The increase includes a base supplement based on school district enrollment and relative wealth, a small district assistance component and a supplement for school districts whose relative wealth is declining. Every school district is guaranteed a 2 percent increase over its fiscal year 2001 total allocation. Also, every district is guaranteed at least a 1 percent increase in Basic Education Funding per student (average daily membership) over the amount received in fiscal year 2001.

Certain specialized education programs are operated and administered in Pennsylvania by 29 intermediate units established by the component local school districts. These intermediate units are funded from annual General Fund appropriations and contributions from member school districts. Programs operated by intermediate units generally are special education programs for the gifted, for the mentally and physically disabled, and for support of nonpublic schools through the provision of auxiliary services and the lending of instructional materials such as textbooks to children attending nonpublic schools in Pennsylvania.

Total Commonwealth expenditures for basic education programs in fiscal year 2001 were over $6.4 billion, representing 76.5 percent of all Commonwealth expenditures for education in fiscal year 2001. The enacted budget for fiscal year 2002 includes just over $6.7 billion for basic education programs.

Higher Education. Higher education in Pennsylvania is provided through 239 degree-granting institutions that include the fourteen universities of the State System of Higher Education ("SSHE"), four State-related universities, community colleges, independent colleges/universities and specialized degree-granting institutions. SSHE, created in 1982 from the fourteen state-owned colleges, is administered by a Board of Governors whose members are appointed by the Governor and confirmed by the Senate. Over $1.86 billion was expended by the Commonwealth in the 2001 fiscal year for these institutions and for student financial assistance. The enacted budget for fiscal year 2002 includes over $1.9 billion for higher education, an increase of nearly 2.0 percent over fiscal year 2001.

Table 13
Full-Time Equivalent Enrollment at State-Supported Institutions of Higher Education
School Years 1996-2000
(In Thousands)

	School Year Ended June				
	1997	**1998**	**1999**	**2000**	**2001**
State System of Higher Education	86	87	88	89	90
State-Related Universities	125	128	129	131	133
Community Colleges[a]	64	64	65	64	67
State-Aided Institutions	33	34	35	37	38
Total	308	313	317	321	328

Source: Governor's Executive Budget, various years.
[a] Decrease in 1997 due to change in calculation method.

Philadelphia School District. The Philadelphia School District projects a current fiscal year deficit in excess of $240 million and significant deficits in subsequent fiscal years. The Secretary of Education of the Commonwealth, under the provisions of the Commonwealth's Public School Code (the "School Code"), declared the Philadelphia School District as distressed effective December 22, 2001. During the period of distress covered by that declaration all powers and duties of the Philadelphia School District Board of Education granted under the School Code or any other law are suspended and all such powers and duties are vested in a school reform commission. The school reform commission statutorily consists of five members, four appointed by the Governor and one appointed by the Mayor of the City of Philadelphia. The school reform commission's objectives are to improve the levels of academic achievement and achieve financial stability within the school district. Termination of the declaration of distress by the Secretary of Education of the Commonwealth may be made only upon the recommendation of a majority of the members of the school reform commission. Upon termination of the declaration of distress the Philadelphia School District Board of Education will resume the exercise of its powers.

In order for the Philadelphia School District to continue to meet payroll and other expenditure requirements, the Commonwealth has advanced $350 million of appropriated amounts to the Philadelphia School District. In negotiations between the Commonwealth and the City of Philadelphia that led to the declaration of distress in December 2001, the Governor announced his support for $75 million of additional annual funding to the Philadelphia School District by the Commonwealth. This, and any additional financial resources that may be committed to the Philadelphia School District by the Commonwealth will need to be obtained from appropriation of additional amounts (subject to legislative approval) from the Commonwealth's General Fund.

Public Health and Human Services

The Commonwealth provides temporary support for its residents who are seeking to achieve and sustain independence. It also provides care, treatment and rehabilitation to persons with mental and physical disabilities and supports programs to prevent or reduce social, mental and physical disease and disabilities. In addition, it plans for and coordinates all the health resources within Pennsylvania. Services are provided directly through administration of programs and services, and indirectly through programs of standard setting, regulation, supervision, licensing, grants, subsidies and purchases of services.

Fiscal year 2001 public health and human services expenditures were $16.7 billion. For fiscal year 2002, $18.6 billion has been budgeted for these purposes, an increase of 18.8 percent. Of the fiscal year 2002 expenditures, $7.0 billion will be from the General Fund, an increase of $221 million from amounts available for fiscal year 2001. Federal funds will increase by $1.1 billion while augmentations will increase by $329 million for fiscal year 2002. The fiscal year 2002 budget also includes $286.5 million of receipts from the Tobacco Settlement Fund that will be expended for health care. Federal funds matching the additional state Tobacco MSA funds are included in the increase noted above. Public health and human service programs are the largest single component of combined state and federal spending in the Commonwealth's operating budget. Even with the declining caseload from implementing welfare reform, the overall budget increase reflects higher costs to provide support for former welfare clients obtaining work, federal mandates, litigation and continued support of county operated programs for child welfare, mental health and mental retardation.

Programs providing temporary financial assistance and medical assistance comprise the largest portion of public health and human services expenditures. General Fund expenditures for these assistance programs by the Commonwealth amounted to $3.6 billion in fiscal year 2001 and the same amount is budgeted from the General Fund for fiscal year 2002. The enacted budget provides for use of approximately $250 million of additional funds obtained from an intergovernmental transfer transaction for expected fiscal year 2002 program cost increases. Approximately 41 percent of the total cost of assistance to the economically needy is supported by Commonwealth funds appropriated from the General Fund. The balance is provided from reimbursements by the federal government and through various program collection activities conducted by the Commonwealth.

Medical assistance is a large component of public health and human services expenditures that continues to grow. Despite implementation of Commonwealth initiatives to restrain costs and to reduce the number of eligible persons the program continues to grow due to technology improvements and general medical inflation. Expenditures for medical assistance increased during the period from fiscal years 1991 2001 by an average annual rate of 10.7 percent. Fiscal year 2001 expenditures from Commonwealth funds were $3.29 billion and the enacted budget for fiscal year 2002 is $3.35 billion, an increase of 1.5 percent over the previous fiscal year. The low rate of increase reflects the use of additional intergovernmental transfer transaction funding in place of Commonwealth revenues as noted above. Program funding for fiscal year 2002 reflects normal inflationary increases for long-term nursing home care and the accrued fee-for-service cost for acute care clients in the Lehigh/Capital region of the state anticipated to be included in mandatory managed care for the full year. The Commonwealth has begun to experience the rise in medical and pharmaceutical costs that has been occurring nationwide. This increase is particularly evident in the rates requested by the managed care providers and in services for children. Cost trends in the future will also be affected by a recent federal court decision that, coupled with the requirements of the federal Americans with Disabilities Act requirements, creates a near entitlement for increased community services for disabled people.

Income maintenance cash assistance payments to families in transition to independence totaled $679 million for fiscal year 2001, of which $292 million was from the General Fund. The enacted budget for fiscal year 2002 includes a total of $638 million with $257 million provided from the General Fund. The expected availability of additional revenues from federal grants and other sources during fiscal year 2002, together with anticipated continuing decline in caseload, are responsible for the $35 million reduction in cash assistance costs budgeted from the General Fund in fiscal year 2002. Cash assistance is time-limited and requires participation in work activities to maintain eligibility. To support a client's finding and retaining employment, small grants are available to clients to overcome employment obstacles such as childcare, transportation, vision and hearing difficulties, and other such barriers. In fiscal year 2002 and the future, increased cost will be incurred in training and support for the most hard to place clients. These increased costs will include some state-only payments for clients who are working the required amount but still require assistance to complete training.

Transportation

The Commonwealth is responsible for the construction, restoration and maintenance of the highways and bridges in the 40,000 mile state highway system, including certain city streets that are a part of the state highway system. Assistance for the maintenance and construction of local roads and bridges is provided to municipalities through grants of financial aid. Highway maintenance costs, construction costs and assistance grants are paid from the Motor License Fund. The General Fund, the State Lottery Fund and other special funds, including the Public Transportation Assistance Fund, the Liquid Fuels Tax Fund, the Highway Beautification Fund and the Motor Vehicle Transaction Recovery Fund provide the remainder of funding for transportation programs.

In addition to its unrestricted state funds, the Motor License Fund includes five restricted revenue accounts funded by specific state revenues legislatively dedicated to specific purposes. Some of the restricted purposes funded from these accounts also receive funding by annual appropriations of unrestricted Motor License Fund revenues. Programs receiving funds from a restricted account include highway bridges, highway construction and maintenance, grants to municipalities for highways and bridges, and airport development.

In addition to its support of the highway system, the Commonwealth provides subsidies for mass transit systems including passenger rail and bus service. The Commonwealth assists local mass transit systems through grants and payment for free rides by senior citizens during non-peak hours. In addition, transit operators receive payments for providing senior citizen transportation service on a shared-ride basis generally in areas where fixed route service is not available. A total of $475.4 million in Commonwealth funds was expended from the General Fund and the State Lottery Fund for such purposes in fiscal 2001, and $490.9 million is available for fiscal year 2002. Beginning with fiscal year 1998, 1.22 percent of sales and use tax collections in the General Fund, up to an annual limit of $75 million, is transferred to a separate account and used to pay mass transportation operating grants to local mass transit systems.

In 1991, the Public Transportation Assistance Fund was created with dedicated sources of funding for mass transit systems. Funds totaling $181.1 million were expended from this fund in fiscal year 2001, and $175.6 million is budgeted for fiscal year 2002.

Liquid fuels tax and license and fee increases enacted in 1997 are providing resources for a substantial expansion of expenditures for highway construction and maintenance. Major portions of the revenues generated by these recent increases were restricted to certain transportation purposes. Motor License Fund restricted revenues expended for highway construction purposes totaled $703.2 million in fiscal year 2001, and $667.2 million is available for fiscal year 2002. Combined Motor License Fund and restricted revenues expended for highway maintenance in fiscal year 2001 was $1,097.2 million, and $1,074.9 million is available for fiscal year 2002. Support of highway and bridge expenditures by local governments through grants paid from Motor License Fund and restricted revenues resulted in expenditures of $258.0 million in fiscal 2001, and $277.2 million is budgeted for fiscal year 2002.

The Commonwealth's current aviation program funds the development of public airport facilities through a grant program providing for airport development, runway rehabilitation, and real estate tax rebates for public use airports. Taxes levied on aviation and jet fuel provide revenues for a restricted account for aviation programs in the Motor License Fund. In fiscal year 2001, $7.2 million was expended from the aviation restricted account for such purposes and $7.8 million is available for fiscal year 2002.

The Commonwealth is not responsible for the toll roads and bridges in Pennsylvania. These are under the jurisdiction of various authorities and commissions. See "OTHER STATE-RELATED OBLIGATIONS — Debt of Governmental Agencies, Authorities and Commissions."

OUTSTANDING INDEBTEDNESS OF THE COMMONWEALTH

General

The Constitution permits the Commonwealth to incur the following types of debt: (i) debt to suppress insurrection or rehabilitate areas affected by disaster, (ii) electorate approved debt, (iii) debt for capital projects subject to an aggregate debt limit of 1.75 times the annual average tax revenues of the preceding five fiscal years, and (iv) tax anticipation notes payable in the fiscal year of issuance. All debt except tax anticipation notes must be amortized in substantial and regular amounts. See Appendix E for the text of selected constitutional provisions relating to the finances of the Commonwealth.

Debt service on Commonwealth general obligation debt is paid from appropriations out of the General Fund except for debt issued for highway purposes, which is paid from Motor License Fund appropriations.

Table 14
General Obligation Debt Outstanding[(a)]
Fiscal Years 1992-2001
(In Millions)

June 30	General Obligation Debt Outstanding
1992	$4,875.1
1993	5,038.8
1994	5,075.8
1995	5,045.4
1996	5,056.1
1997	4,795.1
1998	4,724.5
1999	4,921.5
2000	5,014.9
2001	5,416.2

(a) Net of sinking fund balances for all debt. Includes outstanding debt of State Highway and Bridge Authority.

Net outstanding general obligation debt totaled $5,416.2 million at June 30, 2001, a net increase of $401.3 million from June 30, 2000. Over 60 percent of this increase is attributed to a $254.3 million decline in sinking fund balances during the fiscal year. By using balances to pay debt service, fiscal year 2001 debt service appropriation amounts from the General Fund were reduced. Over the 10-year period ended June 30, 2001, total net outstanding general obligation debt increased at an annual rate of 1.3 percent. Within the most recent 5-year period, outstanding general obligation debt has increased at an annual rate of 1.4 percent.

General obligation debt for non-highway purposes of $5,068.7 million was outstanding on June 30, 2001. Outstanding debt for these purposes increased a net $481.0 million since June 30, 2000. For the period ended June 30, 2001, the 10-year and 5-year average annual compound growth rate for total outstanding debt for non-highway purposes has been 4.7 percent and 3.8 percent respectively. In its current debt financing plan, Commonwealth infrastructure investment projects include improvement and rehabilitation of existing capital facilities, such as water supply systems, and construction of new facilities, such as prisons, transit facilities, economic development and community facilities, including major league sports stadiums and public buildings.

Outstanding general obligation debt for highway purposes was $347.6 million on June 30, 2001, a decrease of $79.6 million from June 30, 2000. Highway outstanding debt has declined over the most recent 10-year and 5-year periods ended June 30, 2001, by the annual average rates of 14.0 percent and 16.3 percent respectively. The decline in outstanding highway debt is due to the policy begun in 1980 of funding highway capital projects with current revenues except for very limited exceptions. No debt issuance for highway capital projects is currently planned.

Table 15 below shows selected debt ratios for the Commonwealth for fiscal year 1991 and for fiscal years 1997 through 2001.

Table 15
Selected Debt Ratios
Fiscal Years 1991 and 1997 to 2001

	Fiscal Year Ended June 30					
	1991	1997	1998	1999	2000	2001
Net Outstanding Debt (Millions)						
General Obligation Debt(a)	$ 4,788	$ 4,795	$ 4,725	$ 4,925	$ 5,015	$ 5,416
Lease Payment Obligations(b)	N/A	886	830	787	747	712
Total	$ 4,788	$ 5,681	$ 5,555	$ 5,712	$ 5,762	$ 6,128
% Increase (Decrease) over prior year	3.3%	(5.3%)	(2.2%)	2.8%	0.9%	6.4%
Population (Thousands)	11,943	12,015	12,002	11,994	12,283	12,287
Per Capital Debt	$ 401	$ 473	$ 463	$ 476	$ 469	$ 499
Personal Income (Millions)	$ 244,892	$ 313,457	$ 330,731	$ 343,197	$ 362,989	N/A
Debt as a % of Personal Income(c)	2.0%	1.8%	1.7%	1.7%	1.6%	1.7%
Debt Service (Millions)(d)						
Highway Bonds(e)	$ 219	$ 148	$ 144	$ 141	$ 128	$ 121
All Other Bonds(f)	406	552	536	557	613	636
Lease Payments	16	103	101	86	80	74
Total	$ 641	$ 803	$ 781	$ 784	$ 821	$ 831
Increase (Decrease) Over Prior Year	(0.8%)	(2.7%)	(2.7%)	0.4%	4.7%	1.2%
Cash Revenues (Million)(g)						
Motor License Fund	$ 1,541	$ 1,609	$ 1,813	$ 1,885	$ 1,959	$ 1,952
General Fund	11,862	17,321	18,123	19,227	20,257	20,562
Total	$ 13,403	$ 18,930	$ 19,936	$ 21,112	$ 22,216	$ 22,514
% Increase Over Prior Year	0.1%	5.7%	5.3%	5.9%	5.2%	1.3%
Highway Bond Debt Service as a % of Motor License Fund Revenues	14.2%	9.2%	7.9%	7.5%	6.5%	6.2%
All Other Bond Debt Service and Lease Payments as a % of General Fund Revenues	3.6%	3.8%	3.5%	3.3%	3.4%	3.5%
Total Debt Service and Lease Payments as a % of Motor License Fund and General Fund Revenues	4.8%	4.2%	3.9%	3.7%	3.7%	3.7%

N/A – Not Available
(a) Net of all sinking fund balances. That portion of Commonwealth payments applicable to principal made to its authorities for debt service prior to repayment of debt is deducted. Includes bond anticipation notes.
(b) Data not available prior to 1992. Includes unduplicated data of issues contained in Table 20.
(c) 2001 percentage uses 2000 data.
(d) As paid from appropriations.
(e) Highway Bonds, interest portion of Advance Construction Bonds, Highway Public Improvement Bonds, State Highway and Bridge Authority Bonds, General Authority Rentals, and Highway Bridge Improvement Bonds.
(f) Fiscal years 1998, 1999 and 2000 exclude additional amounts appropriated but not used to pay debt service in those years.
(g) Commonwealth revenues only.

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General Obligation Debt Outstanding

As of June 30, 2001, the Commonwealth had the following amount of general obligation debt outstanding:

Table 16
General Obligation Debt Outstanding as of June 30, 2001[a]
(In Thousands)

	Debt Outstanding[b]	Less: Refunding Escrow[c]	Less: Sinking Fund[d]	Net Debt Outstanding
Capital Projects Debt:				
Capital Facilities Bonds	$ 3,757,735	$ (213,455)	$ (128,779)	$ 3,415,501
Highway Bonds	206,610	(63,005)	-	143,605
Refunding Bonds	1,014,709	(6,522)	-	1,008,187
Total Capital Projects Debt Outstanding	$ 4,979,054	$ (282,982)	$ (128,779)	$ 4,567,293
Electorate Approved Debt:				
PA Economic Revitalization Bonds	$ 56,510	$ (33,045)	$ (69)	$ 23,396
Land & Water Development Bonds	20,810	(1,150)	(17)	19,643
Nursing Home Loan Development Bonds	1,075	-	(1)	1,074
Volunteer Companies' Loan Bonds	20,675	-	(1)	20,674
Vietnam Veterans Compensation Bonds	1,365	-	-	1,365
Water Facilities Restoration-1981 Referendum	107,905	(9,025)	-	98,880
Pennvest—1988 Referendum Bonds	151,620	(11,525)	-	140,095
Pennvest—1992 Referendum Bonds	90,840	-	(1)	90,839
Agricultural Conservation Easement Bonds	70,990	(4,920)	(1)	66,069
Local Criminal Justice Bonds	146,600	-	(1)	146,599
Keystone Recreation, Parks & Conservation Bonds	41,640	-	-	41,640
Total Electorate Approved Debt Outstanding	$ 710,030	$ (59,665)	$ (91)	$ 650,274
Other Bonded Debt:				
Disaster Relief Bonds	$ 37,550	$ -	$ (1)	$ 37,549
Refunding Bonds	162,143	(1,049)	-	161,094
Total Other Bonded Debt Outstanding	$ 199,693	$ (1,049)	$ (1)	$ 198,643
Total General Obligation Debt Outstanding	$ 5,888,777	$ (343,696)	$ (128,871)	$ 5,416,210

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[a] Subsequent to June 30, 2001, the Commonwealth issued $301 million of bonds.
[b] Accreted value of capital appreciation bonds included.
[c] Principal amount of bonds refunded to be paid from State Treasurer escrow account.
[d] Balance in sinking fund.

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Debt service payable during each fiscal year on outstanding general obligation debt, net of refunding escrow amounts, as of June 30, 2001, for the years shown is as follows:

Table 17
Bond Debt Service
(In Thousands)

Fiscal Year Ending June 30	**Principal**	**Interest**	**Total**
2002	$ 479,395	$ 284,413	$ 763,808
2003	445,621	262,325	707,946
2004	421,940	238,743	660,683
2005	377,687	229,415	607,102
2006	372,650	205,642	578,292
2007	365,729	181,452	547,180
2008	358,817	162,386	521,203
2009	353,605	143,299	496,904
2010	341,860	120,341	462,201
2011	336,030	101,978	438,008
2012	326,680	84,174	410,854
2013	295,690	67,440	363,130
2014	238,855	52,481	291,336
2015	202,660	40,037	242,697
2016	166,165	29,818	195,983
2017	137,250	21,340	158,590
2018	119,620	14,194	133,814
2019	98,120	8,171	106,291
2020	56,045	3,646	59,691
2021	27,625	1,132	28,757
Grand Total	$ 5,522,043	$ 2,252,426	$ 7,774,469

Totals may not add due to rounding.

Nature of Commonwealth Debt

Capital Projects Debt. The Commonwealth may incur debt to fund capital projects for community colleges, highways, public improvements, transportation assistance, flood control, redevelopment assistance, site development and the Pennsylvania Industrial Development Authority. Before a project may be funded, it must be itemized in a capital budget bill adopted by the General Assembly. An annual capital budget bill states the maximum amount of debt for capital projects that may be incurred during the current fiscal year for projects authorized in the current or previous years' capital budget bills. Capital projects debt is subject to a constitutional limit on debt.

Once capital projects debt has been authorized by the necessary legislation, issuance authority rests with two of the Issuing Officials (the Governor, the State Treasurer and the Auditor General), one of whom must be the Governor.

Electorate Approved Debt. The issuance of electorate approved debt is subject to the enactment of legislation that places on the ballot the question of whether debt shall be incurred. The legislation authorizing the referendum must state the purposes for which the debt is to be authorized and, as a matter of practice, includes a maximum amount of funds to be borrowed. Upon electorate approval and enactment of legislation implementing the proposed debt-funded program, bonds may be issued. All such authorizing legislation to date has given issuance authority to two of the Issuing Officials, one of whom must be the Governor.

Other Bonded Debt. Debt issued to rehabilitate areas affected by disasters is authorized by specific legislation. Authorizing legislation has given issuance authority to two of the Issuing Officials, one of whom must be the Governor.

Tax Anticipation Notes. Due to the timing of major tax payment dates, the Commonwealth's General Fund cash receipts are generally concentrated in the last four months of the fiscal year, from March through June. Disbursements are distributed more evenly throughout the fiscal year. As a result, operating cash shortages can occur during certain months of the fiscal year. When necessary, the Commonwealth engages in short-term borrowing to fund expenses within the fiscal year through the sale of tax anticipation notes. The authority to issue such notes rests with the Issuing Officials.

The Commonwealth may issue tax anticipation notes only for the account of the General Fund or the Motor License Fund or both such funds. The principal amount issued, when added to that outstanding, may not exceed in the aggregate 20 percent of the revenues estimated to accrue to the appropriate fund or both funds in the fiscal year.

Tax anticipation notes must mature within the fiscal year in which they were issued. The Commonwealth is not permitted to fund deficits between fiscal years with any form of debt. Any year-end deficit balances must be funded within the succeeding fiscal year's budget.

Currently, the Commonwealth has no tax anticipation notes outstanding. The fiscal year 2002 budget does not anticipate issuing tax anticipation notes.

In the last five fiscal years the Commonwealth has issued tax anticipation notes in the principal amounts shown below.

Table 18
Tax Anticipation Notes
Fiscal Years 1997-2001
(In Millions)

Fiscal Year of Issue Ended June 30	Amount Issued For the Account of the General Fund	Amount Issued as a % of Actual General Fund Revenues
1997	$ 550	3 %
1998	225	1
1999	0	0
2000	0	0
2001	0	0

Bond Anticipation Notes. Pending the issuance of bonds, the Commonwealth may issue bond anticipation notes subject to the applicable statutory and constitutional limitations generally imposed on bonds. The term of such borrowings may not exceed three years. Issuing authority rests with the Issuing Officials. No bond anticipation notes are outstanding.

Projected Issuance of Long-Term Debt

Projected future issuance of new-money long-term bonds or bond anticipation notes through fiscal year 2006 as currently estimated based on current authorizations is shown in Table 19. Actual issuance of bonds will be affected by a number of economic and other factors and may vary significantly from this projection.

Table 19
Projected Bond Issuance and Principal Retirements
Fiscal Years 2002-2006
(In Millions)

	Fiscal Year Ending June 30				
	2002	2003	2004	2005	2006
Capital Facilities[a]					
Buildings and Structures	$ 590	$ 250	$ 190	$ 210	$ 220
Furniture and Equipment	30	40	60	22	20
Transportation Assistance	150	150	150	150	150
Redevelopment Assistance	178	260	180	80	35
Flood Control	4	6	15	13	1
Special Purpose:					
Pennvest — 1988 & 1992 Referenda	1	2	2	2	2
Local Criminal Justice	1	0	0	0	0
Disaster Relief	1	1	0	0	0
Total Projected Issuance	$ 955	$ 709	$ 597	$ 510	$ 430
Principal Retirement[b]	$ 479.4	$ 494.9	$ 508.6	$ 497.2	$ 520.4

Totals may not add due to rounding.
[a] Includes issuance for new projects and for projects previously authorized.
[b] On bonded debt outstanding and pro forma for projected.

OTHER STATE-RELATED OBLIGATIONS

Moral Obligations

Moral obligation financing is a financing arrangement in which designated officials of the Commonwealth, its departments or agencies agree, when necessary, to request the General Assembly to appropriate funds as may be required to make up any deficiency in a debt service reserve fund established to assure payment of obligations issued under such an arrangement. The General Assembly is not required to approve such appropriation requests.

Pennsylvania Housing Finance Agency ("PHFA"). The PHFA is a state-created agency that provides financing for housing for lower and moderate income families in the Commonwealth. The bonds, but not the notes, of the PHFA are partially secured by a capital reserve fund required to be maintained by the PHFA in an amount equal to the maximum annual debt service on its outstanding bonds in any succeeding calendar year. If there is a potential deficiency in the capital reserve fund or if funds are necessary to avoid default on interest, principal or sinking fund payments on bonds or notes of PHFA, the statute creating PHFA provides a mechanism for obtaining additional funds. That mechanism directs the Governor, upon notification from PHFA, to place in the budget of the Commonwealth for the next succeeding year an amount sufficient to make up any such deficiency or to avoid any such default. The budget as finally adopted by the General Assembly may or may not include the amount so placed therein by the Governor. PHFA is not permitted to borrow additional funds so long as any deficiency exists in the capital reserve fund.

According to PHFA, as of June 30, 2001, PHFA had $2,925.9 million of revenue bonds outstanding.

The Hospitals and Higher Education Facilities Authority of Philadelphia (the "Hospitals Authority"). The Hospitals Authority is a municipal authority organized by the City of Philadelphia (the "City") to, *inter alia,* acquire and prepare various sites for use as intermediate care facilities for the mentally retarded. In August 1986, the Hospitals Authority issued $20.4 million of bonds, which were refunded in 1993, by a $21.1 million bond issue of the Hospitals Authority (the "Hospitals Authority Bonds"), for such facilities for the City. The Hospitals Authority Bonds are secured by leases with the City payable only from project revenues and a debt service reserve fund. The Commonwealth's Department of Public Welfare ("DPW") has agreed with the Hospitals Authority to request in DPW's annual budget submission to the Governor, an amount of funds sufficient to alleviate any deficiency that may arise in the debt service reserve fund for the Hospitals Authority Bonds. The budget as finally adopted may or may not include the amount requested. If funds are paid to the Hospitals Authority, DPW will obtain certain rights in the property financed with the Hospitals Authority Bonds in return for such payment.

In response to a delay in the availability of billable beds and the revenues from these beds to pay debt service on the Hospitals Authority Bonds, PHFA agreed in June 1989, to provide a $2.2 million low-interest loan to the Hospitals Authority. The loan enabled the Hospitals Authority to make all debt service payments on the Hospitals Authority Bonds during 1990. Enough beds were completed in 1991 to provide sufficient revenues to the Hospitals Authority to meet its debt service payments and to begin repaying the loan from PHFA. According to the Hospitals Authority, as of June 30, 2001, $0.6 million of the loan principal was outstanding. DPW has agreed that the additional costs of the project arising from the PHFA loan will be reimbursed to the City by DPW through payments under provider agreements between the City and DPW, as reasonable costs of the project.

Lease Financing

The Commonwealth, through several of its departments and agencies, leases various real property and equipment. Some leases and their respective lease payments are, with the Commonwealth's approval, pledged as security for debt obligations issued by certain public authorities or other entities within the state. All lease payments payable by Commonwealth departments and agencies are subject to and dependent upon an annual spending authorization approved through the Commonwealth's annual budget process. The Commonwealth is not required by law to appropriate or otherwise provide moneys from which the lease payments are to be paid. The obligations to be paid from such lease payments are not bonded debt of the Commonwealth.

Table 20 on the following page contains summary information on obligations of significant amount secured by lease payments from leases with Commonwealth departments and agencies payable from the General Fund or other budgeted special funds.

Table 20
Obligations Secured By Commonwealth Lease Payments
(In Thousands)

Lessor	Purpose	Maximum Annual Lease Payment	Principal Amount Outstanding as of 6/30/2001	Final Maturity
Scranton-Lackawanna Health & Welfare Authority	Office Space	$ 488	$ 2,320	Apr. 15, 2007
Harristown Development Corporation	Office Space	6,307	60,785	May 1, 2016[e]
Erie County Prison Authority[a]	Prison Facility	11,571	103,745 [b]	Nov. 1, 2014
General Facilities Authority of Greene County	Land for Prison Facility	1,783	13,825 [b]	July 1, 2011
The Harrisburg Authority[a]	Prison Facility	10,927	0 [c]	- -[c]
Schuylkill County Redevelopment Authority[a]	Prison Facility	11,186	0 [c]	- -[c]
Northumberland County Authority[a]	Prison Facility	11,918	105,702 [b]	Oct. 15, 2014
Somerset County General Authority[a]	Prison Facility	12,145	0 [c]	- -[c]
Philadelphia Regional Port Authority	Port Facilities	5,151	54,445	Sept. 1, 2020
Government Services Corp.	Prison Facilities	62,242	594,520 [d]	July 1, 2015

[a] Refunded and defeased from Certificates of Participation, Series 1993 A, issued July 21, 1993.
[b] These amounts have been legally refunded and defeased by the Series 1993 A Certificates referenced in footnote (a) above and no longer constitute outstanding lease payment obligations of the Commonwealth.
[c] All outstanding bonds redeemed from Series 1993 A Certificate of Participation escrow.
[d] This amount represents the aggregate principal amount of the Series 1993 A Certificates referenced in footnote (a) above. The Series 1993 A Certificates were issued to refund and defease, from time to time, lease payment obligations of the Commonwealth previously issued in connection with the financing of the prison facilities listed above (Erie County Prison Authority, General Facilities Authority of Greene County, The Harrisburg Authority, Schuylkill County Redevelopment Authority, Northumberland County Authority and Somerset County Authority).
[e] Refunding bonds in the principal amount of $71,135,000 were issued by the Corporation in October 2001.

The Harristown Development Corporation and the Scranton-Lackawanna Health and Welfare Authority lease office space to the Commonwealth in the cities of Harrisburg and Scranton respectively. Certificates of participation in the principal amount of $71,135,000 were issued in October 2001, representing undivided rights in the lease payments by the Commonwealth to the Harristown Development Corporation for nearly one million square feet of office space occupied by Commonwealth departments and agencies since 1978. The Scranton-Lackawanna Health and Welfare Authority in October 1974 issued its lease revenue bonds in the principal amount of $5,750,000. Debt service on the bonds is paid from lease payments by Commonwealth departments and agencies for 150,000 square feet of office space in the City of Scranton.

In 1990, Act 1990-71 was enacted authorizing the Commonwealth to lease, as lessee, prison facilities to expeditiously help relieve overcrowded conditions in Commonwealth-owned correctional institutions. Under that Act and the Administrative Code, five separate correctional facilities were constructed under the terms of leases between the Commonwealth and the Erie County Prison Authority, the General Facilities Authority of Greene County, The Harrisburg Authority, the Northumberland County Authority, the Schuylkill County Redevelopment Authority, and the Somerset County General Authority. The facilities have been accepted by the Commonwealth and occupied. On July 21, 1993, $762,495,000 certificates of participation in lease payments of the Commonwealth of Pennsylvania were issued to provide the necessary funds to consolidate the financing for the five correctional facilities constructed by the various authorities. The consolidated financing provided funds to refund the bonds of the various authorities issued to originally finance the construction and to pay remaining costs of construction of the correctional facilities. The consolidated financing provided cost savings to the Commonwealth. The Commonwealth has also leased port facilities of the Philadelphia Regional Port Authority (“PRPA”) to encourage trade through the Port of Philadelphia. Lease revenue bonds of PRPA in the amount of

$65,990,000 were issued by that authority in January 1993. These bonds are payable from lease payments made by the Commonwealth from an annual appropriation authorizing payments to PRPA.

These lease obligations and agreements to lease various other facilities and equipment entered into by the Commonwealth are included in Note K to the General Purpose Financial Statements for the fiscal year ended June 30, 2001.

Pensions and Retirement Systems

The Commonwealth maintains contributory benefit pension plans covering all state employees, public school employees and employees of certain state-related organizations. State employees and employees of certain state-related organizations are members of the State Employees' Retirement System ("SERS"). Public school employees are members of the Public School Employees' Retirement System ("PSERS"). With certain exceptions, membership in the applicable retirement system is mandatory for covered employees.

SERS and PSERS are established by state law as independent administrative boards of the Commonwealth, each directed by a governing board, which exercises control and management of its system, including the investment of its assets. The board of the SERS consists of eleven members, six appointed by the Governor, two members each from the Senate and House of Representatives and the State Treasurer. The PSERS board has fifteen members including the Commonwealth's Secretary of Education, the State Treasurer, the executive secretary of the Pennsylvania School Boards Association, two members appointed by the Governor, six elected members (five from among PSERS members and one from among school board members in Pennsylvania) and two members each from the Senate and the House of Representatives.

The retirement plans of SERS and PSERS are contributory defined benefit plans for which the benefit payments to members and contribution rates by employees are specified in state law. Changes in benefit and contribution provisions for each retirement plan must be made by legislation. Under statutory provisions established in 1981, all legislative bills and amendments proposing to change a public employee pension or retirement plan are to be accompanied with an actuarial note prepared by an enrolled pension actuary providing an estimate of the cost and actuarial effect of the proposed change.

Table 21
Public School Employees' Retirement Fund
(In Millions)

Year Ended June 30	Employer Contributions	Employee Contributions	Net Investment Income	Total Deductions From Plan Net Assets[a]	Net Assets[b]
1997	$ 845	$ 559	$ 6,147	$ 1,886	$ 39,397
1998	731	578	6,196	2,045	44,857
1999	527	646	5,429	2,484	48,975
2000	413	680	5,765	2,411	53,422
2001	186	722	(3,844)	2,332	48,153

[a] Includes the PSERS administrative expenses.

[b] PSERS adopted GASB Statement No.'s 25 and 26 retrospectively to fiscal 1994. GASB Statement No. 25 requires the presentation of Plan Net Assets, which combines the cumulative residual effects of all System assets and current liabilities. System long-term actuarial liabilities are not presented on the System's basic financial statements, but instead are presented upon a supplementary schedule of funding progress. The presentations above include the effects of financial activity related to the administration of the PSERS healthcare insurance premium assistance program and Health Options Program. As required with the adoption of GASB Statement No. 26, separate financial presentation for these programs are made on PSERS financial statements.

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Table 22
State Employees' Retirement Fund
(In Millions)

Year Ended December 31	Employer Contributions	Employee Contributions	Net Investment Income[a]	Total Deductions From Plan Net Assets[b]	Plan Net Assets[c]
1996....................	$ 374	$ 210	$ 2,509	$ 943	$ 18,492
1997....................	324	213	3,320	1,037	21,312
1998....................	310	221	3,360	1,080	24,123
1999....................	225	271	4,723	1,248	28,093
2000....................	168	232	586	1,198	27,880

[a] Includes net appreciation (depreciation) in fair value of investments.
[b] Includes SERS administrative costs.
[c] Market value of investment assets. SERS adopted GASB Statement No. 25 retroactively as of January 1, 1995. GASB Statement No. 25 requires that investments be reported at their fair value. The 1995 net asset value has been restated in accordance with GASB Statement No. 25. Also includes securities lending collateral pool pursuant to GASB Statement No. 28.

The Commonwealth's retirement programs are jointly contributory between the employer and employee. The contribution rate for PSERS new members who enroll in the pension plan on or after January 1, 2002 is 7.50 percent of compensation. The contribution rate for current PSERS members who enrolled on or after July 22, 1983 and who elect participation in the revised benefit provisions of Act 9 of 2001 is 7.50 percent of compensation effective January 1, 2002. The contribution rate for current PSERS members who enrolled prior to July 22, 1983 and who elect participation in the provisions of Act 9 of 2001 is 6.50 percent of compensation, effective January 1, 2002. Contribution rates of 6.25 percent or 5.25 percent of compensation will apply to current members who do not elect to participate in the provisions of Act 9 of 2001, in accordance with their date of enrollment. SERS members, except for a limited number of members contributing under other plans, for the period of July 1, 1993 through December 31, 2001, contributed at a rate of 5 percent of their compensation amount. As of January 1, 2002, a new contribution rate of 6.25 percent went into effect for all class "AA" members under the provisions of Act 9 of 2001. Those eligible members who did not elect class "AA" as of December 31, 2001, will continue to contribute at the class "A" rate of 5 percent. Interest on each employee's accumulated contributions is credited annually at a 4 percent rate mandated by state statute. Accumulated contributions plus interest credited is refundable to covered employees upon termination of their employment.

The employer contribution is a rate that is based upon the actuarially determined normal cost, an accrued liability contribution funded over 10 years with level dollar funding, and a supplemental annuity contribution funded over 10 years with level dollar funding, in accordance with Act 9 of 2001. PSERS employer contribution also includes a rate for health care premium assistance.

As of December 31, 2001, the majority of class "A" members of SERS elected into the new class "AA", under Act 9 of 2001. Also under the Act 9 provisions, new members enrolled in the System after June 30, 2001 are class "AA". That classification provides a benefit formula of 2.5 percent times final average salary, times years of service, when certain eligibility requirements are met. The Governor recently signed pension enhancement legislation contained in Act 9 of 2001 that provides for new classes to be effective July 1, 2001. For the majority of SERS members, the new class provides a benefit formula of 2.5 percent times final average salary, times years of service. For the small number of employees who did not elect into class "AA", their benefit will remain at the class "A" level, which is 2 percent times final average salary, times year of service. For PSERS, the employer's contribution is shared by the Commonwealth and the school districts. In fiscal years prior to fiscal year 1996, the Commonwealth's contribution was appropriated annually from the General Fund to the Department of Education for payment directly to PSERS upon a quarterly billing. Starting in fiscal year 1996, in response to Act 29 of 1994, contributing employers were categorized into "school" entities and "non-school" entities. The Commonwealth's contribution for non-school entities is administered as in the pre-fiscal year 1996 method. For school entities, the Commonwealth remits its employer contribution portion to those school entities, which then remit the entire employer contributions (both school entity and Commonwealth portions) to PSERS. The Commonwealth's contribution continues to be appropriated annually from the General Fund to the Department of Education. The PSERS employer rate for fiscal year 2002 is 1.09 percent and for fiscal year 2003 is 5.64%. Contributions to the pension plans by the employer (including normal costs and payments to amortize prior service costs and medical premium assistance payments), employee contributions, interest earnings on the plans and benefit payments are shown in the following tables, which have been prepared by the staffs of SERS and PSERS.

Annual actuarial valuations are required by state law to determine the employer contribution rates necessary to accumulate sufficient assets and provide for payment of future benefits. The actuary's recommendations for employer contribution rates represent a funding plan for meeting current and future retirement obligations and are included in the enacted budget for the current fiscal year. The employer's contribution rate is computed to fully amortize the unfunded actuarial accrued liability of the respective plan as determined by its actuary. The unfunded accrued liability is a measure of the present value of benefits estimated to be due in the future for current employees given assumptions as to mortality, pay levels, retirement experience and employee turnover, less the present value of assets available to pay those benefits given assumptions of normal cost, supplemental annuity amortization, employer contribution levels and member contributions. The unfunded actuarial accrued liability for the most recent years with completed valuations based on the projected benefit method utilizing level percentage entry age and normal cost are shown in Table 23 below. Both SERS and PSERS currently use an investment rate of return assumption of 8.5 percent. Favorable investment returns have resulted in both funds making progress in lowering their unfunded actuarial accrued liabilities. In fact, SERS attained fully funded status in 1992 and PSERS in 1997.

Table 23
Unfunded Actuarial Accrued Liability
1996-2001
(In Millions)

Valuation Year Ended	SERS[a]	PSERS[b]
1996	$ (904)	$ 1,459
1997	(1,277)	(1,663)
1998	(2,313)	(3,833)
1999	(4,532)	(7,107)
2000	(6,392)	(9,470)
2001	N/A	(2,275)

[a] The fiscal year for SERS ends on December 31 of each year. The decrease in the unfunded amounts between 1996 and 2000 was the result of favorable market conditions experienced by the Fund.
[b] The fiscal year for PSERS ends on June 30 of each year. The net decrease in the unfunded actuarial accrued liability is due primarily to investment returns exceeding the actuarially assumed rate.

For financial reporting purposes, both SERS and PSERS have adopted the Governmental Accounting Standards Board's Statement No. 25. This Statement requires a specific method of accounting and financial reporting for defined benefit pension plans. Among other things, the Statement requires a comparison of employer contributions to "annual required contributions" (ARC). Independently audited financial statements for both SERS and PSERS, as of December 31, 2000 and June 30, 2001, respectively, provide this comparison for each of the six fiscal years then ended. For all years shown, for both SERS and PSERS, employer contributions were at least 100 percent of ARC.

GOVERNMENT AUTHORITIES AND OTHER ORGANIZATIONS

Certain state-created organizations have statutory authorization to issue debt for which state appropriations to pay debt service thereon are not required. The debt of these organizations is funded by assets of, or revenues derived from the various projects financed and is not a statutory or moral obligation of the Commonwealth. However, some of these organizations are indirectly dependent upon Commonwealth operating appropriations. In addition, the Commonwealth may choose to take action to financially assist these organizations. These organizations, their purposes and their outstanding debt, as computed by each organization, are as follows:

Delaware River Joint Toll Bridge Commission ("DRJTBC"). The DRJTBC, a public corporation of the Commonwealth and New Jersey, owns and operates bridges across the Delaware River. Debt service on bonds is paid from tolls and other revenues of the Commission. The DRJTBC had $48.5 million in bonds outstanding as of June 30, 2001.

Delaware River Port Authority ("DRPA"). The DRPA, a public corporation of the Commonwealth and New Jersey, operates several toll bridges over the Delaware River, and promotes the use of the Philadelphia-Camden port and promotes economic development in the port district. Debt service on bonds is paid from toll revenues and other revenues pledged by DRPA to repayment of bonds. The DRPA had $1,278.6 million in revenue bond debt outstanding on June 30, 2001.

Pennsylvania Economic Development Financing Authority ("PEDFA"). The PEDFA was created in 1987 to offer pooled bond and other bond issues for both taxable and tax-exempt bonds on behalf of local industrial and commercial development authorities for economic development projects. Bonds may be secured by loan repayments and all other revenues of the PEDFA. The PEDFA, as of June 30, 2001, had $1,272.0 million of debt outstanding.

Pennsylvania Energy Development Authority ("PEDA"). The PEDA was created in 1982 to finance energy research projects, demonstration projects promoting the production or conservation of energy and the promotion, utilization and transportation of Pennsylvania energy resources. The authority's funding is from appropriations and project revenues. Debt service on bonds is paid from project revenues and other revenues pledged by PEDA to repayment of bonds. The PEDA had $68.2 million in bonds outstanding as of June 30, 2001.

Pennsylvania Higher Education Assistance Agency ("PHEAA"). The PHEAA makes or guarantees student loans to students or parents, or to lending institutions or post-secondary institutions. Debt service on the bonds is paid by loan interest and repayments and other agency revenues. The PHEAA had $2,248.9 million in bonds outstanding as of June 30, 2001.

Pennsylvania Higher Educational Facilities Authority ("PHEFA"). The PHEFA is a public corporation of the Commonwealth established to finance college facilities. As of June 30, 2001, the PHEFA had $3,760.1 million in revenue bonds and notes outstanding payable from the lease rentals or loan repayments of the projects financed. Some of the lessees or borrowers, although private institutions, receive grants and subsidies from the Commonwealth.

Pennsylvania Industrial Development Authority ("PIDA"). The PIDA is a public corporation of the Commonwealth established for the purpose of financing economic development. The PIDA had $328.2 million in revenue bond debt outstanding on June 30, 2001, to which all of its revenues are pledged.

Pennsylvania Infrastructure Investment Authority ("Pennvest"). Pennvest was created in 1988 to provide low interest rate loans and grants for the purpose of constructing new and improving existing water supply and sewage disposal systems to protect the health and safety of the citizens of the Commonwealth and to promote economic development within the Commonwealth. Loans and grants are available to local governments and, in certain circumstances, to private companies. The Pennvest bonds are secured by principal repayments and interest payments on Pennvest loans. Pennvest had $183.3 million revenue bonds outstanding as of June 30, 2001.

Pennsylvania Turnpike Commission ("PTC"). The PTC operates the Pennsylvania Turnpike System ("System"). Its outstanding indebtedness, $1,703.3 million as of June 30, 2001, is payable from the net revenues of the System, primarily toll revenues and rentals from leases and concessions or from certain taxes dedicated to the System.

Philadelphia Regional Port Authority ("PRPA"). The PRPA was created in 1989 for the purpose of acquiring and operating port facilities in Bucks and Delaware Counties, and the City of Philadelphia. Debt service on the bonds is paid by a pledge of the authority's revenues, rentals and receipts. The PRPA had $56.2 million in bonds outstanding as of June 30, 2001.

State Public School Building Authority ("SPSBA"). The SPSBA finances public school projects and community colleges. Bonds issued by the SPSBA are supported by the lease rental payments or loan repayments made to the SPSBA by local school districts and the community colleges. A portion of the funds appropriated annually by the Commonwealth as aid to local school districts and community colleges may be used by them to pay a portion of such lease rental payments or loan repayments. The SPSBA had $438.4 million revenue bonds outstanding on June 30, 2001.

CITY OF PHILADELPHIA - PICA

The Pennsylvania Intergovernmental Cooperation Authority ("PICA") was created by Commonwealth legislation in 1991 to assist Philadelphia, the Commonwealth's largest city, in remedying its fiscal emergencies. PICA is designed to provide assistance through the issuance of funding debt and to make factual findings and recommendations to Philadelphia concerning its budgetary and fiscal affairs. This financial assistance has included grants used by the City for defeasance of certain city general obligation bonds, funding of capital projects and the liquidation of the cumulative general fund balance deficit of Philadelphia as of June 30, 1992, of $224.9 million. At this time, Philadelphia is operating under a five-year fiscal plan approved by PICA on May 15, 2001.

No further bonds are to be issued by PICA for the purpose of financing a capital project or deficit as the authority for such bond sales expired December 31, 1994. PICA's authority to issue debt for the purpose of financing a cash flow deficit expired on December 31, 1995. Its ability to refund existing outstanding debt is unrestricted. PICA had $901.9

million in special tax revenue bonds outstanding as of June 30, 2001. Neither the taxing power nor the credit of the Commonwealth is pledged to pay debt service on PICA's bonds.

LITIGATION

The Commonwealth's Office of Attorney General and Office of General Counsel have reviewed the status of pending litigation against the Commonwealth, its officers and employees, and have provided the following brief descriptions of applicable law of certain cases affecting the Commonwealth.

In 1978, the General Assembly approved a limited waiver of sovereign immunity. Damages for any loss are limited to $250,000 for each person and $1,000,000 for each accident. The Supreme Court of Pennsylvania has held that this limitation is constitutional. Approximately 3,500 suits against the Commonwealth remain open. Tort claim payments for the departments and agencies, other than the Department of Transportation, are paid from departmental and agency operating and program appropriations. Tort claim payments for the Department of Transportation are paid from an appropriation from the Motor License Fund. The Motor License Fund tort claim appropriation for fiscal 2001 is $20.0 million.

Powell v. Ridge

In March 1998, several residents of the City of Philadelphia on behalf of themselves and their school-aged children, along with the School District of Philadelphia, the Philadelphia Superintendent of Schools, the president of the Philadelphia Board of Education, the City of Philadelphia, the Mayor of Philadelphia, and several membership organizations interested in the Philadelphia public schools, brought suit in the United States District Court for the Eastern District of Pennsylvania against the Governor, the Secretary of Education, the chairman of the State Board of Education, and the State Treasurer. The plaintiffs claim that the Commonwealth's system for funding public schools has the effect of discriminating on the basis of race and violates Title VI of the Civil Rights Act of 1964.

The plaintiffs have asked the court to declare the funding system to be illegal, to enjoin the defendants from violating the regulation in the future and to award counsel fees and costs.

The District Court allowed two groups to intervene. The Philadelphia Federation of Teachers intervened on the side of the plaintiffs, while several leaders of the Pennsylvania General Assembly intervened on the side of the defendants. In addition, the U.S. Department of Justice intervened to defend against a claim made by the legislator intervenors that a statute waiving states' immunity under the Eleventh Amendment to the U.S. Constitution for Title VI claims is unconstitutional.

The District Court found that the plaintiffs had failed to state a claim under the Title VI regulation at issue or under 42 U.S.C. §1983 and dismissed the action in its entirety with prejudice. The plaintiffs appealed. In August 1999, the U.S. Court of Appeals for the Third Circuit reversed the District Court's dismissal of the action and remanded the case for further proceedings, including the filing of an answer. The defendants and legislator intervenors filed petitions for writ of certiorari with the U.S. Supreme Court. In December 1999, the Supreme Court denied the petitions.

In the District Court, the parties began the process of discovery. However, on June 23, 2000, by agreement of the parties, the District Court stayed all proceedings and placed the case in civil suspense until approximately June 8, 2001.

Since that time, the Governor of Pennsylvania and the Pennsylvania Secretary of Education together with the Mayor of Philadelphia entered into an agreement that resulted in the designation of the Philadelphia School District as distressed under the School Code. Prior to making that agreement the governmental plaintiffs and the defendants in *Powell* asked the District Court to stay all proceedings in the case until the end of October 2001. The non-governmental plaintiffs in *Powell* oppose the stay. The District Court has yet to rule on the motion for stay. In the meantime, no other activity has occurred in the District Court.

County of Allegheny v. Commonwealth of Pennsylvania

In December 1987, the Supreme Court of Pennsylvania held in *County of Allegheny v. Commonwealth of Pennsylvania*, that the statutory scheme for county funding of the judicial system is in conflict with the Pennsylvania Constitution. However, the Supreme Court of Pennsylvania stayed its judgment to afford the General Assembly an opportunity to enact appropriate funding legislation consistent with its opinion and ordered that the prior system of county funding shall remain in place until this is done.

The Court appointed retired Justice Frank J. Montemuro, Jr. as special master to devise and submit a plan for implementation. The *Interim Report of the Master* recommended a four phase transition to state funding of a unified judicial system, during each of which specified court employees would transfer into the state payroll system. Phase I recommended that the General Assembly provide for an administrative structure of local court administrators to be employed by the Administrative Office of Pennsylvania Courts, a state agency. Numbering approximately 165 people statewide, local court administrators are employees of the counties in which they work. On June 22, 1999, the Governor approved Act 1999-12 under which approximately 165 county-level court administrators became employees of the Commonwealth. Act 12 also triggered the release of appropriations that had been made for this purpose in 1998 and 1999.

The remainder of Justice Montemuro's recommendation for later phases remains pending before the Supreme Court of Pennsylvania.

PPG Industries, Inc. v. Commonwealth of Pennsylvania

By decision dated November 30, 2001, the Pennsylvania Supreme Court held that the manufacturing exemption to Pennsylvania's capital stock/franchise tax discriminates against interstate commerce in violation of the Commerce Clause of the United States Constitution. Accordingly, the Court ordered the manufacturing exemption severed from the capital stock/franchise tax. Further, the Court directed the Commonwealth must forthwith provide a retrospective remedy to taxpayers along the lines of those provided by the U.S. Supreme Court in McKesson v. Division of Alcoholic Beverages and Tobacco, Dept. of Business Regulation of Florida, 496 U.S. 18 (1990), i.e., (1) refunds for those taxpayers who were discriminated against by the unlawful exemption, (2) additional assessments against those who benefited by the unlawful exemption, or (3) some combination of the two so long as any remedy does not discriminate against interstate commerce. PPG filed with the court a petition for reconsideration of its November 30, 2001 Opinion and Order which is currently pending before the Court. The Department of Revenue has not yet announced what retrospective remedy will be implemented.

During the course of this litigation, the General Assembly enacted amendments to the Tax Reform Code of 1971, which presumptively cure the constitutional problem with the tax after January 1, 1999, but do not impact on the tax during the years involved in this litigation.

Unisys Corporation v. Commonwealth

Unisys challenges the statutory three-factor apportionment formula used for the apportionment of capital stock value in the franchise tax on constitutional and statutory (fairness) grounds. Unisys's argument is that because the valuation formula requires the use of consolidated net worth, instead of separate company net worth, and the inclusion of dividends paid by subsidiary corporations, the apportionment factors should also include the property, payroll and sales of the subsidiary corporations, not just those of the taxpayer.

The case was argued before the Commonwealth Court en banc, which issued its decision on March 8, 1999. The court sustained the statute from the constitutional challenge in favor of the Commonwealth. However, it ruled in favor of the taxpayer's fairness argument, which was based on 72 P.S. §7401(3) 2. (a)(18). There were two dissents.

The Commonwealth appealed this decision to the Pennsylvania Supreme Court and Unisys cross-appealed. Briefs were filed by both parties during 1999 and the Pennsylvania Supreme Court held oral argument in December 2000. The Court has yet to render a decision.

Northbrook Life Insurance Co., No. 1120 F&R 1996

This case is the lead case in potential litigation with the entire insurance industry that does business in Pennsylvania. Currently, the Commonwealth Court has docketed in excess of 40 cases representing 20 or more insurance companies. Dozens of additional cases are being held pending this litigation at the administrative boards.

The cases challenge the Department of Revenue's application of portions of the Life and Health Guarantee Association Act of 1982 (the Act). The Act establishes a funding mechanism to fulfill defaulted obligations of insurance companies under life and health insurance policies and annuities contracts to insured Pennsylvania residents. In accordance with this funding mechanism, other insurance companies are assessed to provide the funds due to Pennsylvania residents insured from insurance companies which have become insolvent or are otherwise in default to its insureds.

Because the assessed insurance companies are paying the insurance obligations of other companies, a provision was placed in the Act which allows assessed insurance companies to claim a credit against their gross premiums tax liability based on such assessments.

The assessments on each company are broken into various categories including life insurance assessments, health insurance assessments, and annuity assessments, based on the type and amount of business each company transacts in Pennsylvania.

Life and health insurance premiums have always been subject to the premiums tax and there is no dispute that companies may claim credit for life and health assessments. Annuity considerations, however, were taxed for approximately a three-year period, 1992-1995. Some annuity considerations were subject to tax, others were not. After several changes of direction, the Department of Revenue decided to allow credits for assessments paid on taxable annuity considerations. Credits were not allowed for assessments paid on non-taxable annuities.

There is no provision in the insurance law that restricts the credit to only the assessments paid on taxable annuities. Taxpayers want the credit for assessments paid on all annuities, both during the period that annuities were taxed and going forward.

Settlement negotiations continue and the matter is also being prepared for litigation. Estimates of refund potential vary widely, ranging from $50 million to $300 million.

RATINGS

Fitch Ratings ("Fitch") has assigned its municipal bond rating of "AA", Moody's Investors Service ("Moody's") has assigned its municipal bond rating of "Aa2", and Standard and Poor's Rating Services, a division of the McGraw-Hill Companies ("S&P") has assigned its municipal bond rating of to the Bonds. The Underwriter (as hereinafter defined) has contracted with Financial Guaranty Insurance Company to insure the payment of principal and interest for certain maturities of the Bonds identified with an asterisk (*) on the inside of the front cover hereof. Due to the insurance policy, these bonds may be assigned a rating other than the rating shown above by one or more of the rating firms listed above. The ratings reflect only the views of the rating agencies.

A rating of "AA" ranks in the second category of S&P's system of rating categories for municipal bonds. S&P offers the following explanation of the significance of its rating:

"An obligation rated 'AA' differs from the highest rated obligations only in small degree. The obligation's capacity to meet its financial commitment on the obligation is very strong.

A rating of "Aa2" ranks in the second category of Moody's system of nine rating categories for municipal bonds. Moody's offers the following explanation of the significance of its rating:

"Bonds that are rated Aa are judged to be of high quality by all standards. Together with the Aaa group they comprise what are generally known as high grade bonds. They are rated lower than the best bonds because margins of protection may not be as large as in Aaa securities or fluctuations of protective elements may be of greater amplitude or there may be other elements present that make the long-term risks appear somewhat larger than in Aaa securities. Moody's applies numerical modifiers 1, 2, and 3 in each generic rating classification from Aa through B. The modifier . . . the modifier 2 indicates a ranking in the mid-range of that generic rating category."

A rating of "AA" ranks in the second category of Fitch's system of rating categories for municipal bonds. Fitch offers the following explanation of the significance of its rating:

"AA rated bonds are considered to be investment grade and of very high credit quality. The obligor's ability to pay interest and repay principal is very strong, although not quite as strong as bonds rated AAA. Plus and minus signs are used with a rating symbol to indicated the relative position of a credit within the rating category."

The ratings are based upon current information furnished by the Commonwealth or obtained from other sources considered reliable by the rating agencies, which do not perform any audit in connection with any rating and may, on occasion, rely on unaudited financial information. Reference is made to the rating agencies' manuals for complete descriptions of their respective rating procedures and other rating categories, and to S&P's, Moody's and Fitch's discussions of the Commonwealth expected to be released in connection with their ratings.

A security rating is not a recommendation to buy, sell or hold securities. There is no assurance that such ratings will continue for any given period of time or that they will not be revised downward or withdrawn entirely if, in the opinion of the rating agencies, circumstances warrant such revision or withdrawal. Any such downward revision or withdrawal could have an adverse effect on the marketability or market price of the Bonds. The Commonwealth has not undertaken any responsibility after issuance of the Bonds to assure the maintenance of the ratings, to oppose any revision or withdrawal of the ratings by S&P, Moody's or Fitch to inform the holders of the Bonds of any such revision or withdrawal.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

The arithmetical accuracy of certain computations included in the schedules provided by Commerce Capital Markets, Inc. on behalf of the Commonwealth relating to (i) computation of forecasted receipts of principal and interest on the Escrow Obligations and the forecasted payments of principal and interest to redeem the Prior Bonds, and (ii) computation of the yields on the First Refunding Series of 2002 Bonds and the Escrow Obligations was examined by The Arbitrage Group. Such computations were based solely on assumptions and information supplied by Commerce Capital Markets, Inc. on behalf of the Commonwealth. The Arbitrage Group has restricted its procedures to examining the arithmetical accuracy of certain computations and has not made any study or evaluation of the assumptions and information on which the computations are based and, accordingly, has not expressed an opinion on the data used, the reasonableness of the assumptions, or the achievability of the forecasted outcome.

FEDERAL TAX EXEMPTION

Bond Counsel is expected to issue its opinion on the date of delivery of the Bonds that under existing law, the interest on and accruals of original issue discount with respect to the Bonds (a) are excluded from gross income for federal income tax purposes and (b) are not items of tax preference within the meaning of Section 57 of the Internal Revenue Code of 1986, as amended (the "Code") for purposes of the alternative minimum tax imposed by Section 55 of the Code on individuals and corporations: however, it should be noted, with respect to corporations (as defined for federal income tax purposes), such interest and accruals are taken into account in determining adjusted current earnings for the purpose of computing the alternative minimum tax imposed by Section 55 of the Code on such corporations. Accruals of the original issue discount with respect to a Bond allocable to an owner of a Bond under a constant yield method of accrual (a) are not included in gross income for federal income tax purposes, and (b) are added to such owner's tax basis in the Bond for the purpose of determining gain or loss for federal income tax purposes upon sale, exchange, redemption and other disposition of the Bond. The opinions set forth in the preceding two sentences are subject to the condition that the Commonwealth complies with all the requirements of the Code that must be satisfied subsequent to the issuance of the Bonds in order that interest on and accruals of original issue discount with respect to the Bonds be (or continue to be) excluded from gross income for federal income tax purposes. Failure to comply with such requirements could cause the interest on and accruals of original issue discount with respect to the Bonds to be included in gross income retroactively to the date of issuance of the Bonds. The Commonwealth has covenanted to comply with all such requirements.

Ownership of the Bonds may give rise to collateral federal income tax consequences to certain taxpayers, including, without limitation, financial institutions, property and casualty insurance companies, S corporations with Subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry the Bonds. Bond Counsel expresses no opinion as to any such collateral federal income tax consequences. Purchasers of Bonds should consult their own tax advisors as to such collateral federal income tax consequences. Ownership of the Bonds may give rise to collateral federal income tax consequences to certain taxpayers, including, without limitation, financial institutions, property and casualty insurance companies, S corporations with Subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry the Bonds. Bond Counsel expresses no opinion as to any such collateral federal income tax consequences. Purchasers of Bonds should consult their own tax advisors as to such collateral federal income tax consequences.

Original Issue Discount.

The initial public offering price of certain of the Bonds as shown on the cover page (the "OID Bonds") is less than the amount payable on such OID Bonds at maturity. The difference between the initial public offering price at which the OID Bonds were sold and the principal amount thereof constitutes original issue discount ("OID"). OID is apportioned among the original purchasers of the OID Bonds and subsequent holders thereof during their periods of ownership on a daily basis. Section 1288 of the Code is applicable to the OID Bonds and requires holders of the OID Bonds to accrue OID tax-exempt interest income on the basis of an economic constant interest rate method over the life of the OID Bonds, taking into account the semiannual compounding of accrued interest. Under this provision, for the purpose of determining gain or loss upon the disposition (including sale, redemption or payment at maturity) of any OID Bond, a holder of such OID Bond is entitled to increase his or her adjusted basis with respect to the OID Bond by the amount of OID which shall have accrued under the constant interest method as tax-exempt interest income during the period such OID Bond was held by the holder. Owners of OID Bonds should consult their tax advisors as to the determination for federal income tax purposes of interest accrued or accredited upon purchase, sale or redemption of such OID Bonds.

Original Issue Premium.

The initial public offering price of certain of the Bonds as shown on the cover page will include an original issue premium (the "OIP Bonds"). The original issue premium for an OIP Bond will be equal to the excess of a holder's tax basis in the OIP Bonds over the amount payable at maturity, or in the case of an OIP Bond subject to redemption, the amount payable on the redemption date. Under current law, the original issue premium for an OIP Bond must be amortized on an annual basis by the holder thereof. The amount of original issue premium amortized each year will not be deductible for federal income tax purposes. Further, Section 1016 of the Code requires that the amount of annual amortization for the OIP Bond reduce the holder's tax basis in such OIP Bond. This reduction in a holder's tax basis will affect the amount of capital gain or loss to be recognized by the holder when the OIP Bond is sold or redeemed. Holders of OIP Bonds should consult their tax advisors with respect to the determination and treatment of amortizable original issue premium for federal income tax purposes, and with respect to the state and local tax consequences of owning such OIP Bonds.

PENNSYLVANIA TAX EXEMPTION

Bond Counsel is expected to issue its opinion on the date of delivery of the Bonds that under existing law, the Bonds are exempt from personal property taxes in Pennsylvania and the interest on the Bonds are exempt from Pennsylvania personal income tax and corporate net income tax.

UNDERWRITING

After competitive bidding on February 13, 2002, the Bonds were awarded to Salomon Smith Barney, Inc. (the “Underwriters”) for a purchase price of $690,623,975.52 plus accrued interest to the date of settlement. The Underwriters have supplied the public offering yields of the Bonds shown on the front cover hereof. If all of the Bonds are resold to the public at such yields, the underwriter’s discount will approximate 0.418 percent of the aggregate principal amount of the Bonds. The Underwriters may change the public offering yields from time to time.

LEGALITY FOR INVESTMENT

Under the Pennsylvania Probate, Estates and Fiduciaries Code, the Bonds are authorized investments for fiduciaries, as defined in that code, within the Commonwealth of Pennsylvania. The Bonds are legal investments for Pennsylvania savings banks, banks, bank and trust companies, and insurance companies and are acceptable as security for deposits of funds of the Commonwealth. The Bonds are eligible for purchase, dealing in, underwriting and unlimited holding by national banking associations pursuant to regulations promulgated by the Comptroller of the Currency set forth in the Code of Federal Regulations, Title 12—Banks and Banking, Sections 1.3(c) and 1.4.

FINANCIAL ADVISOR

Commerce Capital Markets, Inc., Philadelphia, Pennsylvania, is serving as independent Financial Advisor to the Commonwealth with respect to the bonds. The Financial Advisor’s fees in connection with the issuance of the Bonds are expected to be paid from Bond proceeds.

LEGAL MATTERS

All legal matters incident to the authorization and issuance of the Bonds are subject to the approval of the Attorney General of the Commonwealth of Pennsylvania, The Honorable D. Michael Fisher, and of Klett Rooney Lieber & Schorling, A Professional Corporation, Pittsburgh, Pennsylvania, Bond Counsel. A copy of the opinion of Bond Counsel will be printed on or attached to each of the Bonds. Copies of the opinion of the Attorney General, together with additional copies of the opinion of Bond Counsel, will be available at the time of delivery of the Bonds. Proposed forms of these opinions are included as Appendices F and G.

Bond Counsel also represents the Commonwealth and certain of its agencies in unrelated matters. Hunton & Williams, Richmond, Virginia, serves as a special disclosure counsel to the Commonwealth in connection with its general obligation bonds.

ADDITIONAL INFORMATION

Periodic public reports relating to the financial condition of the Commonwealth are prepared by the Office of the Budget. These reports and additional information may be obtained upon request from the office of the Secretary of the Budget, Mr. Robert A. Bittenbender, Attn.: Mr. Arthur D. Heilman, 7th Floor, Bell Tower, 303 Walnut Street, Harrisburg, Pennsylvania 17101-1808, (Telephone (717) 783-3086). The annual Comprehensive Annual Financial Report ("CAFR"), a summary of the adopted fiscal 2002 budget and certain other information are available in the Budget and Financial Reports section of the Office of the Budget's web site on the World Wide Web, http://www.budget.state.pa.us.

CONTINUING DISCLOSURE

The Commonwealth will execute a written agreement (the "Continuing Disclosure Agreement") for the benefit of the beneficial owners of the Bonds in order to assist the Underwriters in meeting the requirements of Rule 15c2-12 (the "Rule") promulgated by the Securities and Exchange Commission. The Continuing Disclosure Agreement will require the Commonwealth to:

(i) File not later than 240 days following the end of each of the Commonwealth's fiscal years, Annual Financial Statements and Annual Operating Data, as defined below, with each then-existing Nationally Recognized Municipal Securities Information Repository ("NRMSIR") and if one is established and then in operation, with any State Information Depository ("SID") for the Commonwealth of Pennsylvania;

(ii) File in a timely manner to each NRMSIR (and any SID then existing) notice of certain specified events listed below; and

(iii) File with either each NRMSIR or the Municipal Securities Rulemaking Board (and with any SID then existing) notice of any failure of the Commonwealth to file the information required by (i) above.

Annual Financial Information. It is expected that the financial statements to be filed annually as provided by (i) above will be audited financial statements. The Continuing Disclosure Agreement, however, permits the filing of unaudited financial statements if audited financial statements are not available by the 240-day deadline, with audited financial statements to be filed as soon as they are available. The Annual Operating Data will be operating data of the type contained in this Official Statement in the following tables:

(i) Tables 6 through 11 under the heading "COMMONWEALTH FINANCIAL PERFORMANCE";

(ii) Tables 14 and 16 through 18 under the heading "OUTSTANDING INDEBTEDNESS OF THE COMMONWEALTH"; and

(iii) Tables 20 through 23 under the heading "OTHER STATE-RELATED OBLIGATIONS."

If any of the tables listed above reflect information that is no longer calculated and available or relevant because of changes in operations, the Commonwealth will provide notice of such change in the first annual filing of Annual Operating Data after such changes are undertaken. The format of the tables also may be altered.

Event Disclosure. The Continuing Disclosure Agreement requires the Commonwealth to provide timely notice to each NRMSIR (and any SID then existing) of the following events if such events are material with respect to the Bonds:

* principal and interest payment delinquencies;

* nonpayment related defaults;
* unscheduled draws on debt service reserves reflecting financial difficulties;
* unscheduled draws on credit enhancements reflecting financial difficulties;
* substitution of credit or liquidity providers, or their failure to perform;
* adverse tax opinions or events affecting the tax-exempt status of the Bonds;
* modifications to the rights of holders of the Bonds;
* Bond calls;
* defeasances;
* release, substitution, or sale of property securing repayment of the Bonds; and
* rating changes.

The eleven events listed above are specified by the Rule but some of them may not be relevant to the Bonds.

Limitations, Remedy and Amendments. The Continuing Disclosure Agreement requires the Commonwealth to provide only limited information at limited times, and such information may not include all information necessary to determine the value of the Bonds at any time. The Commonwealth may also make other information available on a voluntary basis, but it is not contractually obligated to do so. See “ADDITIONAL INFORMATION” herein for the availability of other information from the Commonwealth’s Office of the Budget.

The sole and exclusive remedy for any breach by the Commonwealth of its obligations under the Continuing Disclosure Agreement is an action to compel specific performance by the Commonwealth of its obligations. No assurance can be provided as to the outcome of any such proceeding. A breech by the Commonwealth of its obligations under the Continuing Disclosure Agreement does not constitute a default under the Bonds.

The Commonwealth reserves the right to amend the Continuing Disclosure Agreement consistent with the provisions of the Rule as then in effect.

The Commonwealth has never failed to comply in all material respects with any previous continuing disclosure undertaking.

NRMSIRs. As of the date of this Official Statement, the Securities and Exchange Commission has recognized the following NRMSIRs:

Bloomberg Municipal Repository
100 Business Park Drive
Skillman, NJ 08558
Phone: (609) 279-3225
Fax: (609) 279-5962

Standard & Poor’s J.J. Kenny Repository
55 Water Street
45th Floor
New York, NY 10041
Phone: (212) 438-4595
Fax: (212) 438-3975

DPC Data Inc.
One Executive Drive
Fort Lee, NJ 07024
Phone: (201) 346-0701
Fax: (201) 947-0107

FT Interactive Data
Attn: NRMSIR
100 William Street
New York, NY 10038
Phone (212) 771-6999
Fax: (212) 771-7390

A current list of all NRMSIRs can be obtained at any time from the Securities and Exchange Commission. The Commonwealth makes no representation as to the scope of services provided to the secondary market by any NRMSIR or as to the costs of any such services.

The execution of this Official Statement has been authorized in the Resolutions.

/s/ MARK S. SCHWEIKER
MARK S. SCHWEIKER, Governor

/s/ BARBARA HAFER
BARBARA HAFER, State Treasurer

/s/ ROBERT P. CASEY, JR.
ROBERT P. CASEY, JR., Auditor General

CERTIFICATE OF THE AUDITOR GENERAL
Pursuant to
ARTICLE VIII, SECTION 7(a)(4) and (c)
of the
CONSTITUTION OF PENNSYLVANIA
and the
Act of April 9, 1929, No. 176, as amended

To the Governor and the General Assembly:

I, Robert P. Casey, Jr., Auditor General of the Commonwealth of Pennsylvania, pursuant to the Pennsylvania Constitution Article VIII, (Section 7(a)(4) and (c)) and Section 1604-B of The Fiscal Code (Act of April 9, 1929, P.L. 343, No. 176, Article XVI-B: added June 21 1984, P.L. 407, No. 83, Section 2) certify as follows:

	The average annual tax revenues deposited in all funds in the five fiscal years ended preceding the date of August 31, 2001	$ 23,008,382,095
(i)	The amount of outstanding net debt as of the end of the preceding fiscal year	$ 4,567,293,488
(ii)	The amount of such net debt as of August 31, 2001	$ 4,554,304,562
(iii)	The difference between the limitation upon all net debt outstanding as provided in Article VIII, Section 7 (a) (4) of the Constitution of Pennsylvania and the amount of such net debt as of the date of August 31, 2001	$ 35,710,364,104
(iv)	The amount of such debt scheduled to be repaid during the remainder of the current fiscal year..	$ 351,926,287
(v)	The amount of debt authorized by law to be issued, but not yet incurred	$ 32,036,905,468
(vi)	The amount of outstanding obligations excluded from outstanding debt as self sustaining pursuant to Article VIII, Section 7(c)(1), (2) and (3) of the Constitution of Pennsylvania...................................	$ 3,043,494,738

IN TESTIMONY WHEREOF, I have set my hand and affixed the seal of the Auditor General, this 31st day of August 2001.

/s/Robert P. Casey, Jr.
ROBERT P. CASEY, JR.
Auditor General
Commonwealth of Pennsylvania

(Seal)

SELECTED DATA ON THE COMMONWEALTH OF PENNSYLVANIA

General

The Commonwealth of Pennsylvania is one of the most populous states, ranking sixth behind California, Texas, New York, Florida, and Illinois. Pennsylvania is an established state with a diversified economy. Pennsylvania had been historically identified as a heavy industry state. That reputation has changed over the last thirty years as the coal, steel and railroad industries declined. The Commonwealth's business environment readjusted with a more diversified economic base. This economic readjustment was a direct result of a long-term shift in jobs, investment, and workers away from the northeast part of the nation. Currently, the major sources of growth in Pennsylvania are in the service sector, including trade, medical, health services, education and financial institutions.

Pennsylvania's agricultural industries remain an important component of the Commonwealth's economic structure, accounting for more than $5.1 billion in crop and livestock products annually. In 2000, agribusiness and food related industries reached record export sales approaching $1 billion in economic activity. Over 59,000 farms form the backbone of the State's agricultural economy. Farmland in Pennsylvania includes over four million acres of harvested cropland and four million acres of pasture and farm woodlands - nearly one-third of the Commonwealth's total land area. Agricultural diversity in the Commonwealth is demonstrated by the fact that Pennsylvania ranks among the top ten states in the production of a variety of agricultural products.

Pennsylvania's natural resources include major deposits of coal, petroleum, and natural gas. Annually, about 80 million tons of anthracite and bituminous coal, 181 billion cubic feet of natural gas, and about 1.4 million barrels of oil are produced in Pennsylvania. Extensive public and private forests provide a vast source of material for the lumber, furniture, and paper products industries. Additionally, the Commonwealth derives a good water supply from underground sources, abundant rainfall, and a large number of rivers, streams, and lakes.

Human resources are plentiful in Pennsylvania. The workforce is estimated at 5.6 million people, ranking as the sixth largest labor pool in the nation. The high level of education embodied in the Commonwealth's work force fosters a wide variety of employment capabilities. Pennsylvania's basic and higher education statistics compare favorably with other states in the nation.

Pennsylvania is a Mid-Atlantic state within easy reach of the populous eastern seaboard and, as such, is a gateway to the Midwest. A comprehensive transportation grid enhances the Commonwealth's strategic geographic position. The Commonwealth's water systems afford the unique feature of triple port coverage, a deep-water port at Philadelphia, a Great Lakes port at Erie and an inland water port at Pittsburgh. Between rail and road, Pennsylvania is easily accessible for trade both inter and intra state commerce.

Population

The Commonwealth is highly urbanized. Of the Commonwealth's 2001 mid-year population estimate, 79 percent resided in the 15 Metropolitan Statistical Areas ("MSAs") of the Commonwealth. The largest MSAs in the Commonwealth are those that include the cities of Philadelphia and Pittsburgh, which together contain almost 44 percent of the State's total population. The population of Pennsylvania, the highest ever, 12.28 million people in 2001, according to the U.S. Bureau of the Census, represents a population growing slower than the nation with a higher portion than the nation or the region comprised of persons between 45 and 65 years of age. The following tables present the population trend from 1991 to 2001 and the age distribution of the population for 2000.

Population Trends
Pennsylvania, Middle Atlantic Region and the United States
1991-2001

	Total Population In Thousands			Total Population as a % of 1991 base		
As of July 1	PA	Middle Atlantic Region[(a)]	U.S.	PA	Middle Atlantic Region[(a)]	U.S.
1991.............	11,943	37,756	252,153	100 %	100 %	100 %
1992.............	11,981	37,890	255,029	100	101	101
1993.............	12,022	38,037	257,746	100	101	102
1994.............	12,042	38,117	260,327	101	101	103
1995.............	12,044	38,161	262,803	101	101	104
1996.............	12,038	38,191	265,228	101	101	105
1997.............	12,015	38,213	267,783	101	101	106
1998.............	12,002	38,257	270,248	100	101	107
1999.............	11,994	38,334	272,690	100	102	108,
2000.............	12,283	39,701	282,125	103	105	112
2001.............	12,287	39,783	284,797	103	105	113

(a) Middle Atlantic Region: Pennsylvania, New York, New Jersey
Source: U.S. Department of Commerce, Bureau of the Census, December 2001.

Population By Age Group — 2000
Pennsylvania, Middle Atlantic Region and the United States

Age	Pennsylvania	Middle Atlantic Region[(a)]	United States
Under 5 years	5.9 %	6.4 %	6.8 %
5-24 years........................	26.8	26.8	28.2
25-44 years......................	28.6	30.2	30.3
45-64 years......................	23.1	22.7	22.4
65 years and over............	15.6	13.9	12.3

(a) Middle Atlantic Region: Pennsylvania, New York, New Jersey.
Source: U.S. Department of Commerce, Bureau of the Census, December 2001

Employment

Non-agricultural employment in Pennsylvania over the ten years ending in 2000 increased at an average annual rate of 0.6 percent compared with a 0.7 percent rate for the Middle Atlantic region and 2.2 percent rate for the U.S. The following table shows employment trends from 1991 through 2000.

Non-Agricultural Establishment Employment Trends
Pennsylvania, Middle Atlantic Region and the United States
1991-2000

	Total Establishment Employment In Thousands			Total Establishment Employment as a % of 1991 base		
Calendar Year	PA	Middle Atlantic Region[(a)]	U.S.	PA	Middle Atlantic Region[(a)]	U.S.
1991.............	5,084	16,469	108,249	100 %	100 %	100 %
1992.............	5,076	16,264	108,601	99	99	100
1993.............	5,123	16,376	110,713	100	99	102
1994.............	5,192	16,577	114,163	102	100	105
1995.............	5,253	16,746	117,191	103	102	108
1996.............	5,306	16,884	119,608	104	103	110
1997.............	5,406	17,198	122,690	106	104	113
1998.............	5,495	17,533	125,865	108	106	116
1999.............	5,586	17,943	128,916	110	109	119
2000.............	5,698	18,327	131,759	112	111	122

(a) Middle Atlantic Region: Pennsylvania, New York, New Jersey.
Source: U.S. Department of Labor, Bureau of Labor Statistics.

Non-manufacturing employment in Pennsylvania has increased in recent years and reached 83.7 percent of total employment by 2000. Consequently, manufacturing employment constitutes a diminished share of total employment within the Commonwealth. Manufacturing, contributing 16.3 percent of 2000 non-agricultural employment, has fallen behind both the services sector and the trade sector as the largest single source of employment within the Commonwealth. In 2000, the services sector accounted for 32.9 percent of all non-agricultural employment while the trade sector accounted for 22.4 percent. The following table shows trends in employment by sector for Pennsylvania from 1996 through 2000.

Non-Agricultural Establishment Employment by Sector
Pennsylvania
1996-2000

(In Thousands)

	CALENDAR YEAR									
	1996		1997		1998		1999		2000	
	Employees	%	Employees	%	Employees	%	Employees	%	Employees	%
Manufacturing:										
Durable………………	532.7	10.0	540.5	10.0	547.2	10.0	547.2	9.8	537.4	9.4
Non-Durable…………	396.8	7.5	397.6	7.4	396.0	7.2	393.0	7.0	388.6	6.8
Total Manufacturing[d]……	929.6	17.5	938.1	17.4	943.2	17.2	940.2	16.8	926.0	16.3
Non-Manufacturing:										
Trade[a]………………	1,200.9	22.6	1,217.0	22.5	1,228.6	22.4	1,250.4	22.4	1,275.2	22.4
Finance[b]……………	308.7	5.8	312.8	5.8	319.0	5.8	323.7	5.8	326.3	5.7
Services……………..	1,651.4	31.1	1,714.6	31.7	1,768.7	32.2	1,812.7	32.5	1,872.4	32.9
Government…………	719.8	13.6	711.8	13.2	706.0	12.8	710.1	12.7	726.9	12.8
Utilities[c]…………….	273.6	5.2	278.9	5.2	287.2	5.2	292.8	5.2	301.1	5.3
Construction…………	202.8	3.8	213.0	3.9	221.3	4.0	235.7	4.2	251.1	4.4
Mining……………….	19.5	0.4	20.4	0.4	20.8	0.4	20.5	0.4	19.4	0.3
Total Non-Manufacturing[d]	4,376.7	82.5	4,468.5	82.4	4,551.6	82.8	4,645.9	83.2	4,772.4	83.7
Total Employees[d][e]	5,306.2	100.0	5,406.6	99.8	5,494.8	100.0	5,586.1	100.0	5,698.4	100.0

[a] Wholesale and retail trade.
[b] Finance, insurance and real estate.
[c] Includes transportation, communications, electric, gas and sanitary services.
[d] Discrepancies occur due to rounding.
[e] Does not include workers involved in labor-management disputes.
Source: PA Department of Labor and Industry

The following table presents the percentages of non-agricultural employment in various sectors in Pennsylvania and the United States in 2000.

Non-Agricultural Establishment Employment by Sector
Pennsylvania and the United States

	2000 Calendar Year	
	Pennsylvania	United States
Manufacturing	16.3 %	14.0 %
Trade[a]	22.4	23.0
Finance[b]	5.7	5.8
Services	32.9	30.7
Government	12.8	15.7
Utilities[c]	5.3	5.3
Construction...	4.4	5.1
Mining..	0.3	0.4
Total[d]	100.0 %	100.0 %

[a] Wholesale and retail trade.
[b] Finance, insurance and real estate.
[c] Includes transportation, communications, electric, gas and sanitary services.
[d] Discrepancies occur due to rounding.
Source: U.S. Department of Labor, Bureau of Labor Statistics.

Within the manufacturing sector of Pennsylvania's economy, which now accounts for less than one-sixth of total non-agricultural employment in Pennsylvania, the non-electrical machinery industries employed the largest number of workers. Employment in the non-electrical machinery industries was 10.7 percent of Pennsylvania manufacturing employment but only 1.7 percent of total Pennsylvania non-agricultural employment in 2000. The following table shows trends in manufacturing employment by industry for Pennsylvania from 1996 through 2000.

Manufacturing Establishment Employment by Industry
Pennsylvania
1996-2000
(In Thousands)

	CALENDAR YEAR									
	1996		1997		1998		1999		2000	
	Employees	%	Employees	%	Employees	%	Employees	%	Employees	%
Durable Goods:										
Primary Metals…………….	75.7	8.0	74.2	8.0	73.4	7.8	71.5	7.6	67.8	7.3
Fabricated Metals………….	84.9	9.0	84.9	9.1	86.6	9.2	88.0	9.3	89.6	9.7
Machinery (excluding electrical) ….	101.7	10.8	105.0	11.3	106.4	11.4	107.0	11.3	99.4	10.7
Electrical Equipment……….	74.9	8.0	75.0	8.1	76.2	8.1	78.6	8.3	80.9	8.7
Transportation Equipment….	53.1	5.6	50.4	5.4	51.9	5.5	53.4	5.7	49.4	5.3
Stone, Clay and Glass………	39.5	4.2	38.3	4.1	38.4	4.1	38.8	4.1	38.8	4.2
Other Durable Goods………	105.3	11.3	104.9	11.3	107.6	11.5	109.9	11.7	111.5	12.0
Total Durable Goods[a]…...	535.1	56.9	532.7	57.3	540.5	57.7	547.2	58.0	537.4	58.0
Non-Durable Goods:										
Apparel & Related Goods…	48.8	5.2	42.9	4.6	40.7	4.3	38.2	4.1	32.6	3.5
Food Products……………..	85.8	9.1	84.2	9.1	84.0	9.0	84.3	8.9	85.0	9.2
Chemical Products…………	65.0	6.9	66.9	7.2	68.8	7.3	70.2	7.4	72.3	7.8
Printing and Publishing……	82.3	8.6	81.8	8.8	81.7	8.7	82.3	8.7	80.5	8.7
Textile Products…………..	23.7	2.5	22.2	2.4	21.9	2.3	21.5	2.3	18.6	2.0
Paper Products…………….	37.7	4.0	36.3	3.9	36.8	3.9	36.0	3.8	35.3	3.8
Other Non-Durable Goods…	62.4	6.6	62.5	6.7	63.7	6.8	63.5	6.7	64.3	6.9
Total Non-Durable Goods[a]	405.7	42.9	396.8	42.7	397.6	42.5	396.0	42.0	388.6	42.0
Total Manufacturing Employees[a]…………..	940.7	100.0	929.6	100.0	936.4	100.0	943.2	100.0	926.0	100.0

[a] Discrepancies occur due to rounding

Source: U.S. Department of Labor, Bureau of Labor Statistics.

Unemployment

Pennsylvania's annual average unemployment rate was equivalent to the national average throughout the 1990's. Slower economic growth caused the unemployment rate in the Commonwealth to rise to 7.6 percent in 1992. The resumption of faster economic growth resulted in a decrease in the Commonwealth's annual unemployment rate to 4.2 percent in 2000. From 1996 through 2000, Pennsylvania's annual average unemployment rate was below the Middle Atlantic Region's average, but slightly higher than that of the United States. As of December 2001, the most recent month for which figures are available, Pennsylvania had a seasonally adjusted annual unemployment rate of 5.1 percent. The following table represents the annual non-adjusted unemployment rate in Pennsylvania, the Middle Atlantic Region, and the United States from 1992 through 2001.

Annual Average Unemployment Rate
Pennsylvania, Middle Atlantic Region and the United States
1992-2001

Calendar Year	Pennsylvania	Middle Atlantic Region[(a)]	United States
1992	7.6 %	8.1 %	7.5 %
1993	7.1	7.5	6.9
1994	6.2	6.7	6.1
1995	5.9	6.2	5.6
1996	5.3	5.9	5.4
1997	5.2	5.7	4.9
1998	4.6	4.9	4.5
1999	4.4	4.7	4.2
2000	4.2	4.2	4.0
2001	4.7	4.5	4.8

[(a)] Middle Atlantic Region: Pennsylvania, New York, New Jersey.
Source: U.S. Department of Labor, Bureau of Labor Statistics.

The following table presents the thirty largest non-governmental employers in Pennsylvania:

Commonwealth of Pennsylvania
Thirty Largest
Non-Governmental Employers
June 2001

Company	Rank	Company	Rank
Wal-Mart Associates	1	Giant Eagle Inc.	16
University of Pennsylvania	2	Acme Markets Inc.	17
Pennsylvania State University	3	Tenet Healthsystem Philadelphia	18
US Air Inc.	4	J.C. Penny Company Inc	19
United Parcel Service	5	Aramark Services Mgmt.	20
K-Mart	6	Lucent Technologies	21
Weis Markets	7	Vanguard Group Inc.	22
Mellon Financial Corp	8	Hershey Foods Inc	23
Sears Roebuck & Co	9	The Home Depot USA Inc	24
Verizon of PA.	10	University of Pittsburgh Medical Center	25
Giant Food Stores	11	Highmark Blue Cross/Blue Shield	26
University of Pittsburgh	12	Boscov Department Stores Inc	27
Merck & Co Inc	13	Southeastern PA Transportation	28
PNC Bank, NA	14	Temple University	29
May Department Stores Co.	15	Rite Aid of PA Inc	30

Source: Pennsylvania Department of Labor, Office of Employment Security.

Personal Income

Personal income in the Commonwealth for 2000 is $362.8 billion, an increase of 5.7 percent over the previous year. During the same period, national personal income increased at a rate of 7.2 percent. Based on the 2000 personal income estimates, per capita income for 2000 is at $29,533 in the Commonwealth compared to per capita income in the United States of $29,451. The following tables represent annual personal income data and per capita income from 1991 through 2000.

Personal Income
Pennsylvania, Mideast Region and the United States
1991-2000

	Total Personal Income Dollars in Millions			Total Personal Income As a % of 1991 base		
Year	PA	Region[a]	Mideast U.S.[b]	PA	Region[a]	Mideast U.S.
1991..........	$ 244,892	$ 1,018,680	$ 5,065,416	100 %	100 %	100 %
1992..........	258,186	1,074,930	5,376,622	105	106	106
1993..........	267,020	1,103,630	5,598,446	109	108	111
1994..........	275,336	1,140,466	5,878,362	112	112	116
1995..........	285,923	1,193,865	6,192,235	117	117	122
1996..........	299,001	1,255,345	6,538,103	122	123	129
1997..........	313,457	1,315,810	6,928,545	128	129	137
1998..........	330,731	1,399,933	7,418,754	135	137	146
1999..........	343,197	1,457,818	7,769,648	140	143	153
2000..........	362,989	1,556,329	8,351,512	148	153	165

[a] Mideast Region: Pennsylvania, New York, New Jersey, Maryland, District of Columbia, and Delaware.
[b] Sum of States.
Source: U.S. Department of Commerce, Bureau of Economic Analysis, December 2001.

Per Capita Income
Pennsylvania, Mideast Region and the United States
1991-2000

	Per Capita Income			As a % of U.S.	
Calendar Year	PA	Mideast Region[a]	U.S.	PA	Mideast Region[a]
1991..........	$ 20,453	$ 23,139	$ 20,039	102 %	115 %
1992..........	21,441	24,241	20,979	102	116
1993..........	22,043	24,705	21,557	102	115
1994..........	22,634	25,381	22,358	101	114
1995..........	23,441	26,441	23,272	101	114
1996..........	24,465	27,680	24,286	101	114
1997..........	25,630	28,887	25,427	101	114
1998..........	27,005	30,583	26,909	100	114
1999..........	27,971	31,660	27,859	100	114
2000..........	29,533	33,549	29,451	100	114

[a] Mideast Region: Pennsylvania, New York, New Jersey, Maryland, District of Columbia, and Delaware.
Source: U.S. Department of Commerce, Bureau of Economic Analysis, December 2001.

The following table presents growth rates in personal income and selected components of personal income for Pennsylvania, the Mideast Region and the United States from 1996 through 2000.

Annual Growth Rates
Personal Income and Selected Components of Personal Income
Pennsylvania, Mideast Region and the United States

Calendar Year	Pennsylvania	Mideast Region[a]	United States
Total Personal Income			
1996	4.5%	4.6%	5.6%
1997	4.8	4.8	4.2
1998	5.5	6.4	5.0
1999	3.8	4.1	3.5
2000	5.8	6.8	5.9
Manufacturing			
1996	2.6%	1.4%	8.1%
1997	2.9	2.2	6.3
1998	3.9	4.2	7.5
1999	2.9	2.2	6.7
2000	3.0	6.3	7.6
Trade[b]			
1996	2.5%	3.1%	4.7%
1997	6.0	6.0	6.5
1998	4.7	5.8	6.9
1999	5.3	5.8	6.6
2000	5.8	6.9	7.0
Finance[c]			
1996	8.9%	12.0%	9.2%
1997	8.4	8.3	10.5
1998	12.5	12.1	12.8
1999	6.9	8.6	9.1
2000	6.4	10.8	8.4
Services			
1996	4.9%	4.9%	6.5%
1997	6.4	6.5	7.5
1998	7.2	8.1	8.9
1999	5.9	6.7	7.8
2000	7.4	8.5	9.7
Utilities[d]			
1996	3.2%	3.9%	4.5%
1997	4.8	2.8	5.7
1998	6.1	5.6	7.0
1999	6.8	6.7	8.9
2000	4.4	5.9	6.8
Construction			
1996	4.2%	4.4%	7.5%
1997	3.9	5.0	5.6
1998	8.2	10.2	11.7
1999	10.7	10.8	10.8
2000	7.3	9.2	8.4
Mining			
1996	2.4 %	1.2%	3.9%
1997	9.8	10.7	11.0
1998	12.9	9.2	12.0
1999	6.5	2.2	-8.3
2000	0.1	2.5	10.4

[a] Mideast Region: Delaware, District of Columbia, Maryland, Pennsylvania, New York, and New Jersey.
[b] Wholesale and retail trade.
[c] Finance, insurance and real estate.
[d] Includes transportation, communications, electric, gas and sanitary services.
Source: U.S. Department of Commerce, Bureau of Economic Analysis, December 2001.

The Commonwealth's 2000 average hourly wage rate of $14.60 for manufacturing and production workers compares to the national average of $13.74 for 2000. The following table presents the average hourly wage rates for 1996 through 2000.

Average Hourly Wages
Production Workers on Manufacturing Payrolls
Pennsylvania and the United States
1996-2000

Calendar Year	PA	U.S.
1996	$ 13.40	$ 12.37
1997	13.78	12.77
1998	14.06	13.17
1999	14.18	13.49
2000	14.60	13.74

Source: U.S. Department of Labor, Bureau of Labor Statistics July 2001

Market and Assessed Valuation of Real Property

Annually, the State Tax Equalization Board (the "STEB") determines an aggregate market value of all taxable real property in the Commonwealth. The STEB determines the market value by applying assessment to sales ratio studies to assessment valuations supplied by local assessing officials. The market values certified by the STEB do not include property that is tax exempt but do include an adjustment correcting the data for preferential assessments granted to certain farm and forestlands.

The table below shows the assessed valuation as determined and certified by the counties and the market value and the assessed to market value ratio determined by the STEB for real property over the last ten years. Increases in valuations shown below result from reassessment valuations by the counties, changes in property tax rolls and increases in the real value of existing property. In computing the market values for uneven-numbered years, the STEB is statutorily restricted to certifying only those changes in market value that result from properties added to or removed from the assessment rolls. The STEB is permitted to adjust the market valuation to reflect any change in real estate values or other economic change in value only in even-numbered years. This restriction accounts for the two-year pattern of market value changes apparent in the data below.

Valuations of Taxable Real Property
1991-2000

Year	Market Value[(a)]	Assessed Valuation	Ratio of Assessed Valuation to Market Value[(a)]
1991	$ 272,787,055,200	$ 78,065,867,747	28.6
1992	303,758,132,800	81,167,832,245	26.7
1993	309,005,875,900	83,124,139,090	26.9
1994	333,872,670,300	98,004,141,038	29.4
1995	338,550,074,600	101,088,995,085	29.9
1996	359,993,651,000	102,107,687,304	28.4
1997	366,096,581,900	123,734,109,457	37.2
1998	388,146,465,800	204,581,152,222	52.7
1999	390,136,860,900	208,896,190,899	53.5
2000	420,041,123,600	241,060,798,812	57.4

[(a)] Value adjusted for difference between regular assessment and preferential assessment permitted on certain farm and forestlands.
Source: Annual Certifications by the State Tax Equalization Board July 2001.

APPENDIX C

COMMONWEALTH GOVERNMENT AND FISCAL ADMINISTRATION

The government of the Commonwealth is composed of three separate branches. A general organization chart of the Commonwealth's government is shown on the following page.

Legislative Branch

The legislative branch consists of the General Assembly and its staff. The General Assembly is bicameral, composed of the Senate and the House of Representatives. The 50 members of the Senate serve staggered four-year terms and the 203 Representatives serve identical two-year terms. The General Assembly meets in regular session biannually beginning on the first Tuesday of January following elections. Special sessions may be called by the Governor on petition of a majority of the members of each house or whenever the Governor determines that public interest so requires. Legislative leadership includes majority and minority leaders in each house, a President Pro Tempore of the Senate and a Speaker of the House of Representatives.

Executive Branch

The Executive Branch is headed by five elected officials and encompasses 19 departments and approximately 36 independent commissions, boards, authorities and agencies.

The five elected officials are the Governor, the Lieutenant Governor, the Attorney General, the State Treasurer and the Auditor General. The Governor and the Lieutenant Governor are elected on the same ballot and serve a four-year term. The Governor is eligible to succeed himself for one term. The Auditor General, the Attorney General and the State Treasurer are elected for four-year terms in an even-year election held between gubernatorial elections.

The Governor is the chief executive officer of the Commonwealth. All departments except those of the State Treasurer, the Attorney General and the Auditor General are under the direct jurisdiction of the Governor. The head of each of the remaining departments is a Secretary who is appointed by the Governor and confirmed by a majority vote of the Senate. Each Secretary serves at the Governor's pleasure and is a member of the Governor's Cabinet.

The Lieutenant Governor presides over the Senate and serves as Acting Governor during the disability of the Governor and becomes Governor in the case of the death, conviction or impeachment, failure to qualify or resignation of the Governor.

The Attorney General is the chief law enforcement officer of the Commonwealth and is responsible for upholding and defending the constitutionality of all statutes. He is also responsible for reviewing the form and legality of all proposed rules and regulations, deeds, leases and contracts to be executed by Commonwealth agencies. The Office of Attorney General is under the Attorney General's direct jurisdiction.

The State Treasurer is charged with receiving, depositing and investing all Commonwealth funds and is responsible for the pre-audit approval of all requisitions for the disbursements of monies in the State Treasury. The Treasury Department is under the State Treasurer's direct jurisdiction.

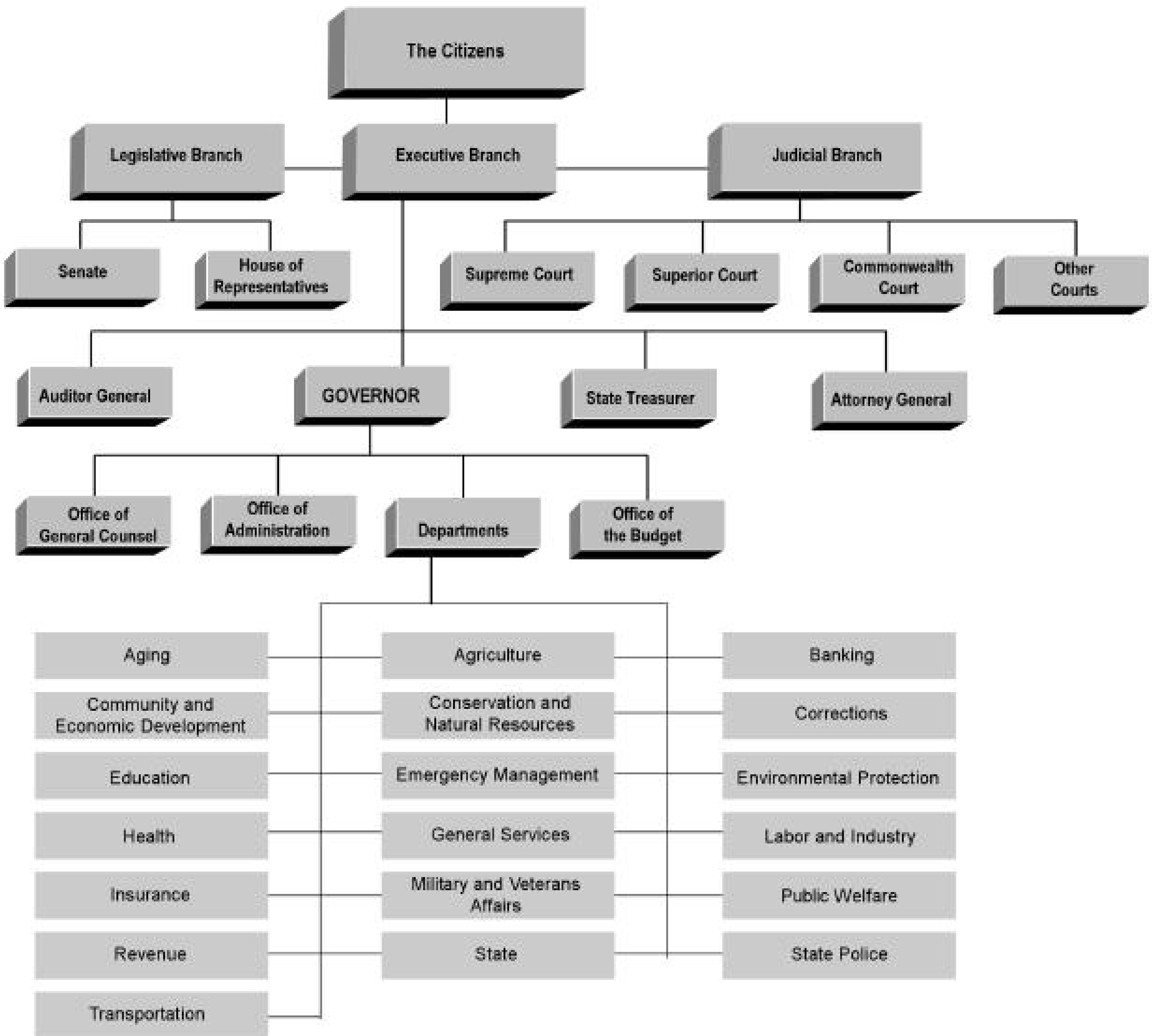
The Auditor General is charged with making audits of completed financial transactions. The Department of the Auditor General is under the Auditor General's direct jurisdiction.

Activities of state government are also conducted by various independent commissions, boards, authorities and agencies created by statute and not under the direct jurisdiction of the executive and legislative branches.

Judicial Branch

The judicial power of the Commonwealth is vested in a unified judicial system consisting of a Supreme Court and various other courts of original and appellate jurisdiction which are under the supervision and authority of the Supreme Court. All justices, judges and district justices are elected to office.

Commonwealth of Pennsylvania
Organization Chart



AGENCIES

Higher Education Assistance
Housing Finance
Interstate Agencies

AUTHORITIES

Energy Development
Higher Education Facilities
Industrial Development
Infrastructure Investment
Minority Business Development
Public School Building

BOARDS

Claims
Environmental Hearing
Finance and Revenue
Liquor Control
Milk Marketing
Municipal Retirement
Pardons
Probation and Parole
Public School Employes' Retirement
State Employees' Retirement
Tax Equalization

COMMISSIONS

Civil Service
Crime and Delinquency
Ethics
Fish and Boat
Game
Harness Racing
Historical and Museum
Horse Racing
Human Relations
Juvenile Court Judges
Public Employee Retirement
Public Television Network
Public Utility
Securities
Turnpike

Fiscal Organization

Each branch of the Commonwealth's government is responsible for its respective fiscal operations subject to restrictions embodied in the Constitution, the Administrative Code, and the Fiscal Code. Such restrictions are enforced and other central administrative functions are provided by five departments: the Office of the Budget ("OB") and the Office of Administration ("OA"), the Treasury Department, the Department of Revenue and the Department of the Auditor General. OB and OA are administrative offices within the Governor's offices. The Secretary of the Budget and the Secretary of Administration are appointed by the Governor and are responsible for the operations of their respective offices. The Department of Revenue is led by the Secretary of Revenue, who is appointed by the Governor subject to the advice of the Senate. The Treasury Department and the Department of the Auditor General are headed by the respective elected officials.

OB monitors the operation of the Commonwealth's departments, operates a central accounting system, compiles and publishes the Commonwealth's financial reports, assists in the preparation and publication of the budget, coordinates capital improvements and is responsible for the issuance of the Commonwealth's debt. OA is responsible for personnel policy and programs, management policy and organizational structure, data processing service, and electronic data processing policy and planning. The Treasury Department receives, invests and disburses all funds and maintains central cash records. The Department of Revenue administers the collection of most taxes. The Department of the Auditor General oversees the examination of the majority of financial transactions.

Commissions, authorities and agencies that are both independent by statute and financially self-supporting, operate autonomously although their capital projects and financing are reviewed by OB and included in the capital budget.

The Budgetary Process

The Commonwealth operates on a fiscal year beginning July 1 and ending June 30. For example, "fiscal year 2002" refers to the fiscal year ending on June 30, 2002.

The budget process commences in September, nine months prior to the beginning of the fiscal year, as departments formulate their initial budgets in response to Program Policy Guidelines issued by the Governor and hold preliminary hearings with OB and other members of the Governor's staff. By November 1, formal budget requests are submitted to OB by all government departments and other institutions requesting appropriations. OB, under the direction of the Secretary of the Budget, reviews the requests through November and December and may hold formal hearings.

The Department of Revenue, in conjunction with OB, prepares revenue estimates. In the preparation of such estimates, internal analysis, information from selected departments and econometric analysis are utilized. The Commonwealth subscribes to economic forecasts prepared by DRI?WEFA for national and Pennsylvania economic data that are used to estimate economically sensitive Commonwealth revenues. Other econometric forecasts are also consulted.

The Constitution requires that the Governor submit annually to the General Assembly a budget consisting of three parts:

(a) a balanced operating budget for the ensuing fiscal year setting forth proposed expenditures and estimated revenues from all sources and, if estimated revenues and available surplus are less than proposed expenditures, recommending specific additional sources of revenue sufficient to pay the deficiency;

(b) a capital budget for the ensuing fiscal year setting forth in detail proposed expenditures to be financed from the proceeds of obligations of the Commonwealth or of its agencies or authorities or from operating funds; and

(c) a financial plan for not less than the succeeding five fiscal years, which includes for each year (i) projected operating expenditures classified by department or agency and by program, and estimated revenues by major categories from existing and additional sources, and (ii) projected expenditures for capital projects specifically itemized by purpose and their proposed sources of financing.

All funds received by the Commonwealth are subject by statute to appropriation in specific amounts by the General Assembly or by executive authorizations by the Governor. The Governor's budget encompasses both annual appropriations and executive authorizations.

The Governor is required to submit the proposed budget as soon as possible after the organization of the General Assembly but not later than the first full week in February except in his first year of office. The Governor's submission begins with the Budget Message delivered in joint session. The budget in the form of a proposed bill is delivered to the appropriations committee of one of the houses. Hearings are held on the bills constituting the budget. In an iterative process, bills are reported from committee to floor and considered in and between houses.

The operating budget is considered in the form of the General Appropriations Bill and its supplements. The Bill is limited to appropriations for debt service, public schools and the executive, legislative and judicial branches. Its supplements cover appropriations from special revenue funds not included in the General Appropriations Bill and for such subjects as capital projects funded from current revenues. The operating budget also includes single subject bills covering appropriations made to any charitable or educational institutions not under the absolute control of the Commonwealth other than certain State-owned schools ("non-preferred appropriations").

The Constitution mandates that total operating budget appropriations made by the General Assembly may not exceed the sum of (a) the actual and estimated revenues in a given year, and (b) the surplus of the preceding year. The Constitution further specifies that a surplus of operating funds at the end of the fiscal year shall be appropriated. That is, if funds remain from the end of a fiscal year they must be appropriated for the ensuing year. Also, if a deficit occurs at year-end, funds must be provided for such a deficit.

Pursuant to the Administrative Code, the executive branch establishes the revenue estimates used in the budget. In practice, the revenue estimates used to balance the operating budget consist of the appropriate fund's available surplus and its estimated cash receipts for the fiscal year as well as net accruals. Appropriation lapses estimated to occur during the year or at year-end are not included; lapses are not available for re-appropriation until they occur.

Under this budgetary process a deficit can occur if revenues are less than those estimated in the budget and the shortfall is not offset by any unappropriated surplus or by appropriation lapses during or at the end of the year or by legislative action to increase revenues or reduce appropriation.

The Administrative Code was amended in 1978 to provide for stronger executive control of expenditures. All departments under the Governor's jurisdiction may be required to submit estimates of expenditures during the ensuing month, quarter or any other such period as requested by the Governor. These estimates are subject to the approval of the Secretary of the Budget. The Governor is empowered to request the State Treasurer to withhold funds from any such department not spending within such estimates. The Secretary of the Budget is empowered to set personnel levels for departments. Departments are required to provide personnel data monthly so that the Commonwealth's computerized data file on personnel levels can be maintained and used to monitor the Commonwealth's largest operating expense.

The proposed capital budget is considered in the form of the Capital Budget Bill and its supplements. The capital budget determines limits for the amount of debt that can be issued in that fiscal year for categories of capital projects, itemizes for funding all capital projects not previously itemized, authorizes the issuance of debt to finance these projects and appropriates the proceeds from the issuance of debt.

All appropriations require the majority vote of all members in each house except for non-preferred appropriations and appropriations from the Tax Stabilization Reserve Fund and from the Health Endowment Account portion of the Tobacco Settlement Fund which require passage by a two-thirds vote. During the legislative process, the General Assembly may add, change or delete any items in the budget proposed by the Governor. Once the bills constituting the budget have passed both houses and are returned to the Governor, he may either veto bills or item veto appropriations within bills. A gubernatorial veto can be overridden only by a two-thirds majority of all members of each house.

Accounting and Budgetary Controls

Every department of the executive branch that receives appropriations from the Commonwealth, with the exception of the Treasury Department and the Departments of the Auditor General and the Attorney General, has a comptroller appointed by and under the direct jurisdiction of the Governor. These agencies share a centralized encumbrance-based accounting system supervised by OB. Executive departments operating separate additional accounting systems include the Department of Transportation for the Motor License Fund, the Liquor Control Board for the State Stores Fund and the Department of Labor and Industry for the payment of unemployment compensation benefits. Officials within the Treasury Department, the Departments of the Auditor General and the Attorney General and the judicial and legislative branches administer individual operations under the jurisdiction of their respective areas.

Expenditure control occurs at two levels. The first is by appropriations and is enforced by the State Treasurer and individual comptrollers. The second is by allocations and allotments and is enforced by OB for all departments receiving appropriations, except for the legislative branch.

Departments receive authorization to spend and commit funds in the form of appropriations for a specific amount, purpose and time period. Funds appropriated to a single department may be in one or more appropriations as the General Assembly determines. When multiple appropriations to a department are enacted, separate appropriations are made for general operating expenses, special outlays and for specific programs or groupings thereof. The degree to which a department's total appropriations are itemized may vary, but control is exercised over both total and individual appropriations.

The Constitution requires that with the exceptions named, monies may be paid from the Treasury only if appropriated by law. Accordingly, when a voucher is submitted to the State Treasurer, a check will not be issued unless the amount is within the balance of the agency's total appropriation.

Departments are prevented by their comptrollers from incurring obligations in excess of their unexpended individual appropriations by an encumbrance system. Encumbrance control prevents spending beyond remaining individual appropriation balances. When a commitment or obligation is incurred, for example, when a contract or purchase order is signed, the required portion of the corresponding appropriation is reserved. This reserving of funds is called the encumbrance procedure. All obligations anticipating future disbursement of cash in the fiscal year require an encumbrance, with the exception of debt service payments. Since a debt service appropriation is used for no purpose other than debt service, an encumbrance is not necessary.

All individual appropriations are allocated by OB to departments by major object groups. For example, a department's appropriation for operating expenses may be broken down into such major object groups as personnel service, operating expenses and supplies, etc. Additionally, major object groups are subdivided into minor object groups. For example, personnel service would be broken down into salaries, benefits, overtime, etc. Department expenditures are monitored to insure that expenditures within an allocation do not exceed the designated totals. The departments, however, are free to adjust their expenditures between minor object groups as long as they do not exceed the major object group allocation. OB can monitor department expenditures against their allocations on a continuing basis as the records of departments under the Governor's jurisdiction can be accessed from the central system while those of most other departments and branches are provided monthly.

In addition to the preceding controls, another check is provided by the financial reporting process. All department records are reconciled by OB on a monthly basis with the Treasury Department's records of cash transactions and with the Department of Revenue's records of cash collections.

Audits

The Constitution requires that the financial affairs of any entity receiving appropriations and all department boards, commissions, agencies, instrumentalities, authorities and institutions of the Commonwealth be subject to audits made in accordance with generally accepted auditing standards. Any Commonwealth officer whose approval is necessary for any transaction may not be charged with the function of auditing that transaction after its occurrence.

The Department of the Auditor General has the responsibility for auditing all state-related financial transactions except its own, those of the legislative and judicial branches, and boards and commissions on which the Auditor General serves and those of certain funds. At least one audit must be made annually of the fiscal affairs of the executive branch. Audits of the Commonwealth General Purpose Financial Statements since fiscal 1985 have been performed jointly by the Department of the Auditor General and an independent public accounting firm.

The Treasury Department is required to pre-audit all requests for expenditures to insure that they are in accordance with law. In addition, OB conducts, as a matter of administrative policy, periodic audits of comptrollers under the Governor's jurisdiction and performance audits of state and federal programs.

APPENDIX D

INFORMATION REGARDING THE DEPOSITORY TRUST COMPANY AND ITS BOOK-ENTRY SYSTEM

The information that follows concerning The Depository Trust Company, New York, New York ("DTC") and the book-entry only system described below is based solely on information furnished by DTC and is not, and should not be construed as, a representation by the Commonwealth as to its accuracy, completeness or otherwise.

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued for each maturity of the Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds securities that its participants ("Direct Participants") deposit with DTC. DTC also facilitates the settlement among Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in Direct Participants' accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as securities brokers and dealers, banks, and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). The rules applicable to DTC and its Direct Participants are on file with the Securities and Exchange Commission.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. or such other name as requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Beneficial Owners of the Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners, or in the alternative, Beneficial Owners may wish to provide their names and addresses to the Loan and Transfer Agent and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the Bonds. Under its usual procedures, DTC will mail an Omnibus Proxy to the Commonwealth as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Bonds will be made to Cede & Co. or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Commonwealth or its agent, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Direct and Indirect Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Direct and Indirect Participants and not of DTC (nor its nominee), the Loan and Transfer Agent, or the Commonwealth, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Commonwealth or the Loan and Transfer Agent, disbursement of such payments to Direct Participants is the responsibility of DTC, and disbursement of such payments to the Beneficial Owners is the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the Commonwealth or the Loan and Transfer Agent. Under such circumstances, in the event that a successor securities depository is not obtained, Bond certificates are required to be printed and delivered.

The foregoing information concerning DTC and DTC's book-entry system has been obtained from information furnished by DTC. No representation or warranty is made by the Commonwealth as to the accuracy or completeness of such information.

The Commonwealth may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Bond certificates will be printed and delivered.

For so long as the Bonds are registered in the name of DTC, or its nominee Cede & Co., the Commonwealth and the Loan and Transfer Agent will treat Cede & Co. as the registered owner of the Bonds for all purposes, including payments, notices and voting.

Neither the Commonwealth nor the Loan and Transfer Agent shall have any responsibility or obligation to any Direct or Indirect Participant or Beneficial Owner with respect to (a) the accuracy of any records maintained by DTC or any Direct or Indirect Participant with respect to any beneficial ownership interest in any Bonds; (b) the payment by any Direct or Indirect Participant of any amount due to any Beneficial Owner in respect of the principal of, premium, if any, and interest on the Bonds; (c) the delivery or timeliness of delivery by any Direct or Indirect Participant of any notice to any Beneficial Owner of any notice with respect to the Bond, including, without limitation any notice of redemption; or (d) other action taken by DTC or Cede & Co., including the effectiveness of any action taken pursuant to an Omnibus Proxy.

SELECTED CONSTITUTIONAL PROVISIONS RELATING TO THE FINANCES OF THE COMMONWEALTH

Article VIII — TAXATION AND FINANCE

Commonwealth Indebtedness

Section 7. (a) No debt shall be incurred by or on behalf of the Commonwealth except by law and in accordance with the provisions of this section.

(1) Debt may be incurred without limit to suppress insurrection, rehabilitate areas affected by man-made or natural disaster, or to implement unissued authority approved by the electors prior to the adoption of this article.

(2) The Governor, State Treasurer and Auditor General, acting jointly, may (i) issue tax anticipation notes having a maturity within the fiscal year of issue and payable exclusively from revenues received in the same fiscal year, and (ii) incur debt for the purpose of refunding other debt, if such refunding debt matures within the term of the original debt.

(3) Debt may be incurred without limit for purposes specifically itemized in the law authorizing such debt, if the question whether the debt shall be incurred has been submitted to the electors and approved by a majority of those voting on the question.

(4) Debt may be incurred without the approval of the electors for capital projects specifically itemized in a capital budget if such debt will not cause the amount of all net debt outstanding to exceed one and three-quarters times the average of the annual tax revenues deposited in the previous five fiscal years as certified by the Auditor General. For the purposes of this subsection, debt outstanding shall not include debt incurred under clauses (1) and (2) (i), or debt incurred under clause (2) (ii) if the original debt would not be so considered, or debt incurred under subsection (3) unless the General Assembly shall so provide in the law authorizing such debt.

(b) All debt incurred for capital projects shall mature within a period not to exceed the estimated useful life of the projects as stated in the authorizing law, and when so stated shall be conclusive. All debt, except indebtedness permitted by clause (2) (i), shall be amortized in substantial and regular amounts, the first of which shall be due prior to the expiration of a period equal to one-tenth the term of the debt.

(c) As used in this section, debt shall mean the issued and outstanding obligations of the Commonwealth and shall include obligations of its agencies or authorities to the extent they are to be repaid from lease rentals or other charges payable directly or indirectly from revenues of the Commonwealth. Debt shall not include either (1) that portion of obligations to be repaid from charges made to the public for the use of the capital projects financed, as determined by the Auditor General, or (2) obligations to be repaid from lease rentals or other charges payable by a school district or other local taxing authority, or (3) obligations to be repaid by agencies or authorities created for the joint benefit of the Commonwealth and one or more other State governments.

(d) If sufficient funds are not appropriated for the timely payment of the interest upon and installments of principal of all debt, the State Treasurer shall set apart from the first revenues thereafter received applicable to the appropriate fund a sum sufficient to pay such interest and installments of principal, and shall so apply the money so set apart. The State Treasurer may be required to set aside and apply such revenues at the suit of any holder of Commonwealth obligations.

Commonwealth Credit Not to be Pledged

Section 8. The credit of the Commonwealth shall not be pledged or loaned to any individual, company, corporation or association nor shall the Commonwealth become a joint owner or stockholder in any company, corporation or association.

Municipal Debt Not to be Assumed by Commonwealth

Section 9. The Commonwealth shall not assume the debt, or any part thereof, of any county, city, borough, incorporated town, township or any similar general purpose unit of government unless such debt shall have been incurred to enable the Commonwealth to suppress insurrection or to assist the Commonwealth in the discharge of any portion of its present indebtedness.

Audit

Section 10. The financial affairs of any entity funded or financially aided by the Commonwealth, and all departments, boards, commissions, agencies, instrumentalities, authorities and institutions of the Commonwealth, shall be subject to audits made in accordance with generally accepted auditing standards.

Any Commonwealth officer whose approval is necessary for any transaction relative to the financial affairs of the Commonwealth shall not be charged with the function of auditing that transaction after its occurrence.

Gasoline Taxes and Motor License Fees Restricted

Section 11. (a) All proceeds from gasoline and other motor fuel excise taxes, motor vehicle registration fees and license taxes, operators' license fees and other excise taxes imposed on products used in motor transportation after providing therefrom for (a) cost of administration and collection, (b) payment of obligations incurred in the construction and reconstruction of public highways and bridges shall be appropriated by the General Assembly to agencies of the State or political subdivisions thereof; and used solely for construction, reconstruction, maintenance and repair of and safety on public highways and bridges and costs and expenses incident thereto, and for the payment of obligations incurred for such purposes, and shall not be diverted by transfer or otherwise to any other purpose, except that loans may be made by the State from the proceeds of such taxes and fees for a single period not exceeding eight months, but no such loan shall be made within the period of one year from any preceding loan, and every loan made in any fiscal year shall be repayable within one month after the beginning of the next fiscal year.

(b) All proceeds from aviation fuel excise taxes, after providing therefrom for the cost of administration and collection, shall be appropriated by the General Assembly to agencies of the State or political subdivisions thereof and used solely for: the purchase, construction, reconstruction, operation, and maintenance of airports and other air navigation facilities; aircraft accident investigation; the operation, maintenance and other costs of aircraft owned or leased by the Commonwealth; any other purpose reasonably related to air navigation including but not limited to the reimbursement of airport property owners for property tax expenditures; and costs and expenses incident thereto and for the payment of obligations incurred for such purposes, and shall not be diverted by transfer or otherwise to any other purpose.

Governor's Budgets and Financial Plan

Section 12. Annually, at the times set by law, the Governor shall submit to the General Assembly:

(a) A balanced operating budget for the ensuing fiscal year setting forth in detail (i) proposed expenditures classified by department or agency and by program and (ii) estimated revenues from all sources. If estimated revenues and available surplus are less than proposed expenditures, the Governor shall recommend specific additional sources of revenue sufficient to pay the deficiency and the estimated revenue to be derived from each source;

(b) A capital budget for the ensuing fiscal year setting forth in detail proposed expenditures to be financed from the proceeds of obligations of the Commonwealth or of its agencies or authorities or from operating funds; and

(c) A financial plan for not less than the next succeeding five fiscal years, which plan shall include for each such fiscal year:

(i) Projected operating expenditures classified by department or agency and by program, in reasonable detail, and estimated revenues, by major categories, from existing and additional sources, and

(ii) Projected expenditures for capital projects specifically itemized by purpose, and the proposed sources of financing each.

Appropriations

Section 13. (a) Operating budget appropriations made by the General Assembly shall not exceed the actual and estimated revenues and surplus available in the same fiscal year.

(b) The General Assembly shall adopt a capital budget for the ensuing fiscal year.

Surplus

Section 14. All surplus of operating funds at the end of the fiscal year shall be appropriated during the ensuing fiscal year by the General Assembly.

Project "70"

Section 15. In addition to the purposes stated in article eight, section seven of this Constitution, the Commonwealth may be authorized by law to create debt and to issue bonds to the amount of seventy million dollars ($70,000,000) for the acquisition of land for State parks, reservoirs and other conservation and recreation and historical preservation purposes and for participation by the Commonwealth with political subdivisions in the acquisition of land for parks, reservoirs and other conservation and recreation and historical preservation purposes, subject to such conditions and limitations as the General Assembly may prescribe.

Land and Water Conservation and Reclamation Fund

Section 16. In addition to the purposes stated in article eight, section seven of this Constitution, the Commonwealth may be authorized by law to create debt and issue bonds in the amount of five hundred million dollars ($500,000,000) for a Land and Water Conservation and Reclamation Fund to be used for the conservation and reclamation of land and water resources of the Commonwealth, including the elimination of acid mine drainage, sewage, and other pollution from the streams of the Commonwealth, the provision of State financial assistance to political subdivisions and municipal authorities of the Commonwealth of Pennsylvania for the construction of sewage treatment plants, the restoration of abandoned strip-mined areas, the control and extinguishment of surface and underground mine fires, the alleviation and prevention of subsidence resulting from mining operations, and the acquisition of additional lands and the reclamation and development of park and recreational lands acquired pursuant to the authority of Article VIII, section 15 of this Constitution, subject to such conditions and liabilities as the General Assembly may prescribe.

APPENDIX F

PROPOSED FORM OF OPINION OF THE ATTORNEY GENERAL OF THE COMMONWEALTH OF PENNSYLVANIA

, 2002

TO THE GOVERNOR, AUDITOR GENERAL
AND STATE TREASURER AS THE ISSUING
OFFICIALS OF THE COMMONWEALTH:

Re: Commonwealth of Pennsylvania General Obligation Bonds, First Series of 2002 and First Refunding Series of 2002

This opinion is furnished to you in connection with the issuance and sale by the Commonwealth of Pennsylvania (the "Commonwealth") on the date hereof of $650,635,000 aggregate principal amount of Commonwealth of Pennsylvania General Obligation Bonds, consisting of $300,000,000 aggregate principal amount of General Obligation bonds, First Series of 2002 (the "First Series Bonds") and $350,635,000 aggregate principal amount of General Obligation Bonds, First Refunding Series of 2002 (the "Refunding Series Bonds" and together with the First Series Bonds, the "Bonds"). The Bonds are dated February 1, 2002. The Bonds are issued as fully registered bonds without coupons in the denomination of $5,000 or any integral multiple thereof within a maturity and will bear interest from February 1, 2002, payable semi-annually on February 1 and August 1 of each year, commencing August 1, 2002, until the obligation with respect to the payment of such principal shall have been discharged. The First Series Bonds maturing on and after February 1, 2013, are subject to redemption at the option of the Commonwealth on and after February 1, 2012, as a whole or in part at any time, at the redemption prices stated in the Bonds.

The Bonds are authorized and issued pursuant to and in full compliance with the provisions, restrictions and limitations of Sections 7 and 16 of Article VIII of the Constitution; the laws of the Commonwealth, including the Capital Facilities Debt Enabling Act, Act No. 1999-1, approved February 9, 1999, as amended, annual capital budget bills and various bond authorization bills enacted by the General Assembly; the Agricultural Area Security Law, Act No. 1981-43, approved June 30, 1981, as amended; a constitutional referendum question approved by the voters of the Commonwealth on November 3, 1987; the Land and Water Conservation and Reclamation Act, Act No 1967-443, approved January 19, 1968, as amended; the Water Facilities Restoration Act, Act No. 1982-167, approved June 22, 1982; a constitutional referendum question approved by the voters of the Commonwealth on November 3, 1981; the Pennsylvania Infrastructure Investment Authority Act, Act No. 1988-16, approved March 1, 1988; constitutional referendum questions approved by the voters on April 28, 1988 and April 28, 1992; the Volunteer Fire Company, Ambulance Service and Rescue Squad Assistance Act, Act No. 1976-208, approved July 15, 1976, as amended, constitutional referendum questions approved by the voters of the Commonwealth on November 4, 1975, November 3, 1981, and November 6, 1990; the Pennsylvania Economic Revitalization Act, Act No. 1984-104, approved July 2, 1984; a constitutional referendum question approved by the voters of the Commonwealth on April 10, 1984; the Keystone Recreation, Park and Conservation Fund Act, Act No. 1993-50, approved July 2, 1993, a constitutional referendum question approved by the voters of the Commonwealth on November 2, 1993; the Prison Facilities Improvement Act, Act No. 1990-71, approved July 1, 1990; and a constitutional referendum question approved by the voters of the Commonwealth on November 6, 1990.

The Bonds are also authorized and issued pursuant to resolutions adopted by the Governor, the Auditor General, and the State Treasurer (the "Issuing Officials") on February 7, 2002, and February 13, 2002 (collectively, the "Resolutions").

The Resolutions, among other things, authorize the issuance and sale of the Bonds, and prescribe the forms thereof, the manner of bidding therefor and the forms of the bidding documents used in connection with the issuance and sale of the Bonds.

Certain of the Bonds have been issued to finance capital projects specifically itemized in a capital budget of the Commonwealth. Under Section 7(a)(4) of Article VIII of the Constitution, the Commonwealth may incur debt without the approval of the electors to finance such projects, if such debt will not cause the amount of all debt outstanding (as defined for the purposes of that Section) to exceed one and three-quarters times the average of the annual tax revenues deposited in all funds in the previous five fiscal years, as certified by the Auditor General.

I have examined Article VIII, Section 7 and Section 16 of the Constitution and the statutes referred to above, specimens of the Bonds, the Resolutions, and the other certificates delivered today at the Closing and such other matters and documents as I deemed necessary or appropriate.

I am of the opinion that:

1. Section 7 and Section 16 of Article VIII of the Constitution have been duly approved and adopted and have become part of the Constitution of Pennsylvania, and the statutes referred to above have been duly and properly enacted.

2. Pursuant to full and adequate legal power conferred upon them by the Constitution and the statutes referred to above, the Governor, the Auditor General and the State Treasurer have duly adopted the Resolutions and have validly taken all other necessary and proper action to issue and sell the Bonds, and the Bonds have been validly authorized, issued and sold pursuant to proper and appropriate action of such officials.

3. The Bonds are lawful, valid, direct and general obligations of the Commonwealth, and the full faith and credit of the Commonwealth is pledged for the payment of interest thereon as the same shall become due and for the payment of the principal thereof at maturity.

4. Under the provisions of Section 2901 of the Tax Reform Code of 1971, as amended, the Bonds and the interest thereon are exempt from taxation for state and local purposes within the Commonwealth, but this exemption does not extend to (a) gift, estate, succession or inheritance taxes or (b) any other taxes not levied or assessed directly on the Bonds or the interest thereon.

5. The Commonwealth has the power to provide for the payment of the principal of and interest on the First Series Bonds and on $ aggregate principal amount of the Refunding Series Bonds by levying unlimited ad valorem taxes upon all taxable property within the Commonwealth and excise taxes upon all taxable transactions within the Commonwealth, uniform on the same class of subjects, except gasoline and other motor fuel excise taxes, motor vehicle registration fees and license taxes, and operators' license fees and other excise taxes imposed on products used in motor transportation, and aviation fuel excise taxes, the proceeds of which are limited to certain special purposes by Section 11 of Article VIII of the Constitution.

6. The Commonwealth has the power to provide for the payment of the principal of and interest on $ aggregate principal amount of the Refunding Series Bonds by levying unlimited ad valorem taxes upon all taxable property within the Commonwealth and excise taxes upon all taxable transaction within the Commonwealth, uniform on the same class of subjects, excluding aviation fuel excise taxes, but including gasoline and other motor fuel excise taxes, and other excise taxes imposed on products used in motor transportation and by applying the motor vehicle registration fees, license taxes and operators' license fees to such payment.

7. If sufficient funds are not appropriated for timely payment of interest on and installments of principal of the Bonds, the Constitution requires the State Treasurer to set apart from the first revenues thereafter received applicable to the appropriate fund, a sum sufficient to pay such interest and installments of principal and to apply said sum to such purposes, and the State Treasurer may be required to set aside and apply such revenues at the suit of the holder of any of the Bonds.

Very truly yours,

D. Michael Fisher
Attorney General

KLETT ROONEY LIEBER & SCHORLING

A PROFESSIONAL CORPORATION

ONE OXFORD CENTRE, 40TH FLOOR
PITTSBURGH, PENNSYLVANIA 15219
TELEPHONE (412)392-2000
FACSIMILE (412) 392-2128

[FORM OF PROPOSED OPINION OF BOND COUNSEL]

February __, 2002

Re: Commonwealth of Pennsylvania General Obligation Bonds, First Series of 2002 and First Refunding Series of 2002

To: The Purchasers of the Above-Described Bonds

The Commonwealth of Pennsylvania (the "Commonwealth") has authorized the issuance of $650,635,000 aggregate principal amount of General Obligation Bonds, First Series of 2002 and First Refunding Series of 2002 (together, the "Bonds") in fully registered form, in denominations of $5,000 or any integral multiple thereof. The Bonds bear interest from February 1, 2002 at various annual rates payable initially on August 1, 2002 and semi-annually thereafter on February 1 and August 1 of each year. The Bonds mature in various amounts on February 1 of each year from 2003 to 2022, inclusive. The Bonds are subject to optional redemption prior to maturity as stated therein.

The Bonds will initially be registered in the name of Cede & Co., as nominee for The Depository Trust Company, New York, New York, which will act as depository for the Bonds. The Bonds will be issued and sold by means of a book-entry-only system as more fully set forth in the Official Statement prepared in connection with the Bonds (the "Official Statement").

The Bonds are authorized and issued pursuant to and in full compliance with the provisions, restrictions and limitations of Sections 7 and 16 of Article VIII of the Constitution; the laws of the Commonwealth, including the Capital Facilities Debt Enabling Act, Act No. 1999-1, approved February 9, 1999, as amended; annual capital budget bills and various bond authorization bills enacted by the General Assembly; the Agricultural Area Security Law, Act No. 1981-43, approved June 30, 1981, as amended; a constitutional referendum question approved by the voters of the Commonwealth on November 3, 1987; the Land and Water Conservation and Reclamation Act, Act No 1967-443, approved January 19, 1968, as amended; the Water Facilities Restoration Act, Act No. 1982-167, approved June 22, 1982; a constitutional referendum question approved by the voters of the Commonwealth on November 3, 1981; the Pennsylvania Infrastructure Investment Authority Act, Act No. 1988-16, approved March 1, 1988; constitutional referendum questions approved by the voters of the Commonwealth on April 28, 1988 and April 28, 1992; the Volunteer Fire Company, Ambulance Service and Rescue Squad Assistance Act, Act No. 1976-208, approved July 15, 1976, as amended; constitutional referendum questions approved by the voters of the Commonwealth on November 4, 1975, November 3, 1981, and November 6, 1990; the Pennsylvania Economic Revitalization Act, Act No. 1984-104, approved July 2, 1984; a constitutional referendum question approved by the voters of the Commonwealth on April 10, 1984; the Keystone Recreation, Park and Conservation Fund Act, Act No. 1993-50, approved July 2, 1993; a constitutional referendum question approved by the voters of the Commonwealth on November 2, 1993; the Prison Facilities Improvement Act, Act No. 1990-71, approved July 1, 1990; and a constitutional referendum question approved by the voters of the Commonwealth on November 6, 1990. The Bonds are also authorized and issued pursuant to resolutions adopted by the Governor, the State Treasurer, and the Auditor General (the “Issuing Officials”) on February 7, 2002 and February 13, 2002 (collectively, the “Resolutions”). The Resolutions, among other things, authorize the issuance and sale of the Bonds and prescribe the form thereof, the manner of bidding therefor and the forms of the bidding documents used in connection with the issuance and sale of the Bonds.

As Bond Counsel for the Commonwealth, we have examined the proceedings relating to the authorization and issuance of the Bonds including among other things: (a) certified copies of the Resolutions; (b) a certificate of the Auditor General as to tax revenues and outstanding debt; (c) an opinion of The Honorable D. Michael Fisher, Attorney General of the Commonwealth; and (d) certificates of the Commonwealth as to material factual matters, including a Tax Certificate of the Commonwealth executed pursuant to the federal income tax laws and regulations applicable to the Bonds, and certificates of the First Union National Bank, as Loan and Transfer Agent, with respect to the execution and authentication of the Bonds. In rendering our opinion, we have not undertaken to verify the factual matters set forth in such certificates by independent investigation and have assumed that the representations made by the Commonwealth in such certificates and in the other financing documents are true and correct as of the date hereof. In rendering this opinion, we have also assumed the genuineness of all signatures and the accuracy and completeness of all documents, records and other instruments examined, without undertaking to verify the same by independent investigation.

From our examination of the foregoing, we are of the opinion that, under existing law and as of the date hereof:

1. The Bonds are valid, binding and enforceable direct obligations of the Commonwealth (except as enforcement may be limited by the exercise of judicial discretion and by bankruptcy, insolvency, moratorium and other similar laws or equitable principles now or hereafter in effect affecting the rights and remedies of creditors generally), and the full faith and credit of the Commonwealth are pledged for the payment of interest thereon as the same shall become due and the payment of the principal thereof at maturity or prior redemption.

2. The principal amount of the Bonds is within all applicable debt and other limitations fixed by the Constitution and the laws of the Commonwealth.

3. The Bonds have been validly authorized, issued and sold pursuant to all necessary action of the Issuing Officials.

4. If sufficient funds are not appropriated for the timely payment of interest on and installments of principal of the Bonds, the Constitution requires the State Treasurer to set apart from the first revenues thereafter received applicable to the appropriate fund, a sum sufficient to pay such interest and installments of principal and to apply said sum to such purposes, and the State Treasurer may be required to set aside and apply such revenues at the suit of the holder of any of the Bonds.

5. Under existing law, the interest on and accruals of original issue discount with respect to the Bonds (a) are excluded from gross income for federal income tax purposes and (b) are not items of tax preference within the meaning of Section 57 of the Internal Revenue Code of 1986, as amended (the "Code"), for purposes of the alternative minimum tax imposed by Section 55 of the Code on individuals and corporations; however, with respect to corporations (as defined for federal income tax purposes), such interest and accruals are taken into account in determining adjusted current earnings for the purpose of computing the alternative minimum tax imposed by Section 55 of the Code on such corporations. Accruals of the original issue discount with respect to a Bond allocable to an owner of a Bond under a constant yield method of accrual (a) are not included in gross income for federal income tax purposes, and (b) are added to such owner's tax basis in the Bond for the purpose of determining gain or loss for federal income tax purposes upon sale, exchange, redemption and other disposition of the Bond. The opinions set forth in the preceding two sentences are subject to the condition that the Commonwealth complies with all the requirements of the Code that must be satisfied subsequent to the issuance of the Bonds in order that interest on and accruals of original issue discount with respect to the Bonds be (or continue to be) excluded from gross income for federal income tax purposes. Failure to comply with such requirements could cause the interest on and accruals of original issue discount with respect to the Bonds to be included in gross income retroactively to the date of issuance of the Bonds. The Commonwealth has covenanted to comply with all such requirements. We express no opinion regarding other federal tax consequences arising with respect to the Bonds.

6. Under the laws of the Commonwealth, as presently enacted and construed, the Bonds are exempt from personal property taxes in the Commonwealth and interest on the Bonds is exempt from Commonwealth personal income tax and corporate net income tax.

7. Under the Commonwealth Probate, Estates and Fiduciaries Code, the Bonds are authorized investments (as defined in that code) for fiduciaries and personal representatives within the Commonwealth.

8. The Bonds are legal investments for Commonwealth savings banks, banks, bank and trust companies, trust companies and life insurance companies and are acceptable as security for deposit of funds of the Commonwealth.

9. The Bonds are exempt from registration under the provisions of the Securities Act of 1933, as amended.

This opinion is rendered solely for the benefit of the addressee hereof in connection with the transactions associated with the issuance of the Bonds. The addressee may not rely on this opinion letter for any other purpose and no other person may rely on this opinion letter for any purpose without the express written consent of the undersigned.

This opinion letter is limited to the matters set forth herein. No opinion may be inferred or implied beyond the matters expressly stated herein, and our opinions expressed herein must be read in conjunction with the assumptions, limitations, exceptions and qualifications set forth herein. In particular, we express no opinion herein as to the accuracy, adequacy or completeness of the Official Statement, and make no representation that we have independently verified the contents of the Official Statement. This opinion is subject to future changes in applicable law and we do not undertake any obligation to update any of the opinions expressed in this letter. The law covered by the opinions expressed herein is limited to the laws of the Commonwealth of Pennsylvania and the federal law of the United States of America.

Very truly yours,

KLETT ROONEY LIEBER & SCHORLING
A Professional Corporation

APPENDIX H

THE FINANCIAL GUARANTY INSURANCE COMPANY INSURANCE POLICY

(As used herein, "Bonds" means the First Series of 2002 Bonds maturing February 1, 2012, 2020, 2021 and First Refunding Series of 2002 Bonds maturing on February 1, 2014 to which FGIC's policy applies)

Bond Insurance

Concurrently with the issuance of the Bonds, Financial Guaranty Insurance Company* ("Financial Guaranty") will issue its Municipal Bond New Issue Insurance Policy for the Bonds (the "Policy"). The Policy unconditionally guarantees the payment of that portion of the principal of and interest on the Bonds which has become due for payment, but shall be unpaid by reason of nonpayment by the Commonwealth (the "Issuer"). Financial Guaranty will make such payments to State Street Bank and Trust Company, N.A., or its successor as its agent (the "Fiscal Agent"), on the later of the date on which such principal and interest is due or on the business day next following the day on which Financial Guaranty shall have received telephonic or telegraphic notice, subsequently confirmed in writing, or written notice by registered or certified mail, from an owner of Bonds or the Paying Agent of the nonpayment of such amount by the Issuer. The Fiscal Agent will disburse such amount due on any Bond to its owner upon receipt by the Fiscal Agent of evidence satisfactory to the Fiscal Agent of the owner's right to receive payment of the principal and interest due for payment and evidence, including any appropriate instruments of assignment, that all of such owner's rights to payment of such principal and interest shall be vested in Financial Guaranty. The term "nonpayment" in respect of a Bond includes any payment of principal and interest made to an owner of a Bond which has been recovered from such owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction.

The Policy is non-cancellable and the premium will be fully paid at the time of delivery of the Bonds. The Policy covers failure to pay principal of the Bonds on their respective stated maturity dates or dates on which the same shall have been duly called for mandatory sinking fund redemption, and not on any other date on which the Bonds may have been otherwise called for redemption, accelerated or advanced in maturity, and covers the failure to pay an installment of interest on the stated date for its payment.

This Official Statement contains a section regarding the ratings assigned to the Bonds and reference should be made to such section for a discussion of such ratings and the basis for their assignment to the Bonds. Reference should be made to the description of the Commonwealth of Pennsylvania for a discussion of the ratings, if any, assigned to such entity's outstanding parity debt that is not secured by credit enhancement.

The Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

Financial Guaranty is a wholly-owned subsidiary of FGIC Corporation (the "Corporation"), a Delaware holding company. The Corporation is a subsidiary of General Electric Capital Corporation ("GE Capital"). Neither the Corporation nor GE Capital is obligated to pay the debts of or the claims against Financial Guaranty. Financial Guaranty is a monoline financial guaranty insurer domiciled in the State of New York and subject to regulation by the State of New York Insurance Department. As of September 30, 2001, the total capital and surplus of Financial Guaranty was approximately $1.033 billion. Financial Guaranty prepares financial statements on the basis of both statutory accounting principles and generally accepted accounting principles. Copies of such financial statements may be obtained by writing to Financial Guaranty at 125 Park Avenue, New York, New York 10017, Attention: Communications Department (telephone number: 212-312-3000) or to the New York State Insurance Department at 25 Beaver Street, New York, New York 10004-2319, Attention: Financial Condition Property/Casualty Bureau (telephone number: 212-480-5187).

Financial Guaranty Insurance
Company
125 Park Avenue
New York, NY 10017
(212) 312-3000
(800) 352-0001

A GE Capital Company

FGIC

Municipal Bond
New Issue Insurance Policy

Issuer:	**Policy Number:**
	Control Number: 0010001
Bonds:	**Premium:**

Financial Guaranty Insurance Company ("Financial Guaranty"), a New York stock insurance company, in consideration of the payment of the premium and subject to the terms of this Policy, hereby unconditionally and irrevocably agrees to pay to State Street Bank and Trust Company, N.A., or its successor, as its agent (the "Fiscal Agent"), for the benefit of Bondholders, that portion of the principal and interest on the above-described debt obligations (the "Bonds") which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

Financial Guaranty will make such payments to the Fiscal Agent on the date such principal or interest becomes Due for Payment or on the Business Day next following the day on which Financial Guaranty shall have received Notice of Nonpayment, whichever is later. The Fiscal Agent will disburse to the Bondholder the face amount of principal and interest which is then Due for Payment but is unpaid by reason of Nonpayment by the Issuer but only upon receipt by the Fiscal Agent, in form reasonably satisfactory to it, of (i) evidence of the Bondholder's right to receive payment of the principal or interest Due for Payment and (ii) evidence, including any appropriate instruments of assignment, that all of the Bondholder's rights to payment of such principal or interest Due for Payment shall thereupon vest in Financial Guaranty. Upon such disbursement, Financial Guaranty shall become the owner of the Bond, appurtenant coupon or right to payment of principal or interest on such Bond and shall be fully subrogated to all of the Bondholder's rights thereunder, including the Bondholder's right to payment thereof.

This Policy is non-cancellable for any reason. The premium on this Policy is not refundable for any reason, including the payment of the Bonds prior to their maturity. This Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Bond.

As used herein, the term "Bondholder" means, as to a particular Bond, the person other than the Issuer who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof. "Due for Payment" means, when referring to the principal of a Bond, the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity and means, when referring to interest on a Bond, the stated date

Municipal Bond
New Issue Insurance Policy

for payment of interest. “Nonpayment” in respect of a Bond means the failure of the Issuer to have provided sufficient funds to the paying agent for payment in full of all principal and interest Due for Payment on such Bond. “Notice” means telephonic or telegraphic notice, subsequently confirmed in writing, or written notice by registered or certified mail, from a Bondholder or a paying agent for the Bonds to Financial Guaranty. “Business Day” means any day other than a Saturday, Sunday or a day on which the Fiscal Agent is authorized by law to remain closed.

In Witness Whereof, Financial Guaranty has caused this Policy to be affixed with its corporate seal and to be signed by its duly authorized officer in facsimile to become effective and binding upon Financial Guaranty by virtue of the countersignature of its duly authorized representative.

President

Effective Date: **Authorized Representative**

State Street Bank and Trust Company, N.A., acknowledges that it has agreed to perform the duties of Fiscal Agent under this Policy.

Authorized Officer

Financial Guaranty Insurance Company
125 Park Avenue
New York, NY 10017
(212) 312-3000
(800) 352-0001

A GE Capital Company

Endorsement
To Financial Guaranty Insurance Company Insurance Policy

Policy Number: **Control Number:** 0010001

It is further understood that the term "Nonpayment" in respect of a Bond includes any payment of principal or interest made to a Bondholder by or on behalf of the issuer of such Bond which has been recovered from such Bondholder pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction.

NOTHING HEREIN SHALL BE CONSTRUED TO WAIVE, ALTER, REDUCE OR AMEND COVERAGE IN ANY OTHER SECTION OF THE POLICY. IF FOUND CONTRARY TO THE POLICY LANGUAGE, THE TERMS OF THIS ENDORSEMENT SUPERSEDE THE POLICY LANGUAGE.

In Witness Whereof, Financial Guaranty has caused this Endorsement to be affixed with its corporate seal and to be signed by its duly authorized officer in facsimile to become effective and binding upon Financial Guaranty by virtue of the countersignature of its duly authorized representative.

President

Effective Date: **Authorized Representative**

Acknowledged as of the Effective Date written above:

Authorized Officer
State Street Bank and Trust Company, N.A., as Fiscal Agent