

NEW ISSUE - BOOK-ENTRY ONLY

Ratings: Moody's: Aa2
Standard & Poor's: AA
Fitch: AA

In the opinion of Bond Counsel, assuming compliance by the Commonwealth with the Covenant and Tax Certificate (defined herein), under existing statutes and court decisions, interest on the Bonds is excluded from gross income of the owners thereof for federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"). In the further opinion of Bond Counsel, interest on the Bonds is not treated as a preference item for purposes of the alternative minimum tax imposed under the Code with respect to individuals and corporations, although such interest is included in "adjusted current earnings" in computing alternative minimum taxable income for purposes of the alternative minimum tax imposed by the Code on certain corporations. In the further opinion of Bond Counsel, 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 the Commonwealth's personal income tax and the Commonwealth's corporate net income tax. See "TAX MATTERS" herein.



\$200,000,000
Commonwealth of Pennsylvania
General Obligation Bonds
First Series of 2005

Dated: Date of Issuance and Delivery

Due: July 1, as shown below

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 January 1 and July 1, commencing January 1, 2006. U.S. Bank National Association, Pittsburgh, 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 Bonds are subject to redemption as set forth herein. See "THE BONDS - Optional Redemption."

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.

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 scheduled payment of principal of and interest on the Bonds maturing on July 1, 2022 through 2025, inclusive (indicated by an * below, the "Insured Bonds"), when due, will be guaranteed under an insurance policy to be issued concurrently with the delivery of the Insured Bonds by FINANCIAL SECURITY ASSURANCE INC.

MATURITY SCHEDULE

(Base CUSIP Number: 709141)

<u>Due</u> <u>July 1</u>	<u>Principal</u> <u>Amount</u>	<u>Interest</u> <u>Rate</u>	<u>Yield</u>	<u>CUSIP</u> <u>Number</u>	<u>Due</u> <u>July 1</u>	<u>Principal</u> <u>Amount</u>	<u>Interest</u> <u>Rate</u>	<u>Yield</u>	<u>CUSIP</u> <u>Number</u>
2006	\$ 6,120,000	5.00%	2.80%	Y90	2016	\$ 9,820,000	5.00%	3.66%	2B0
2007	6,370,000	5.00	2.75	Z24	2017	10,325,000	5.00	3.70	2C8
2008	6,650,000	5.00	2.92	Z32	2018	10,855,000	5.00	3.79	2D6
2009	6,955,000	5.00	3.00	Z40	2019	11,410,000	5.00	3.84	2E4
2010	7,285,000	5.00	3.05	Z57	2020	11,995,000	5.00	3.88	2F1
2011	7,650,000	5.00	3.18	Z65	2021	12,610,000	5.00	3.92	2G9
2012	8,040,000	5.00	3.29	Z73	2022	13,255,000*	4.15	4.13	2H7
2013	8,450,000	5.00	3.40	Z81	2023	13,935,000*	4.20	4.17	2J3
2014	8,885,000	5.00	3.49	Z99	2024	14,650,000*	4.20	4.18	2K0
2015	9,340,000	5.00	3.59	2A2	2025	15,400,000*	4.25	4.23	2L8

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 May 24, 2005, 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 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 Obermayer Rebmann Maxwell & Hippel LLP, of Philadelphia, Pennsylvania, Bond Counsel. The Commonwealth expects that the Bonds will be available in definitive form for delivery in New York, New York, on or about June 9, 2005.

Dated: May 24, 2005



THE ISSUING OFFICIALS

Governor*EDWARD G. RENDELL*
State Treasurer*ROBERT P. CASEY, JR.*
Auditor General *JACK WAGNER*

OFFICE OF THE BUDGET

Secretary*MICHAEL J. MASCH*

Attorney General of the Commonwealth of Pennsylvania:

Tom Corbett

Bond Counsel:

Obermayer Rebmann Maxwell & Hippel LLP
Philadelphia, Pennsylvania

Special Disclosure Counsel:

Hunton & Williams LLP
Richmond, Virginia

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.

Other than with respect to information concerning Financial Security Assurance Inc. ("Financial Security") contained in Appendix I specimen "Municipal Bond Insurance Policy" herein, none of the information in this Official Statement has been supplied or verified by Financial Security, and Financial Security makes no representation or warranty, express or implied, as to (i) the accuracy or completeness of such information; (ii) the validity of the Bonds; or (iii) the tax exempt status of the interest on the Bonds.

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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..... \$200,000,000 Commonwealth of Pennsylvania, General Obligation Bonds, First Series of 2005 (the "Bonds")

Dated Date Date of Issuance and Delivery

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 purpose:

<u>Purpose</u>	<u>Principal Amount</u>
Capital Facilities Projects	\$200,000,000

Redemption..... The Bonds maturing on or after July 1, 2016 are subject to optional redemption in whole or in part (and if in part, in part within one or more maturities) at any time on and after July 1, 2015 at a redemption price equal to the principal amount thereof, plus accrued interest to the date fixed for redemption

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 U.S. Bank National Association, Pittsburgh, Pennsylvania.

Legal Opinions Obermayer Rebmann Maxwell & Hippel LLP, Bond Counsel.
Tom Corbett, Attorney General of the Commonwealth of Pennsylvania.

Bond Ratings

Moody's Investors ServiceAa2

Standard & Poor's Rating Services, a division
of the McGraw-Hill Companies.....AA

Fitch Ratings.....AA

Official Statement
\$200,000,000
Commonwealth of Pennsylvania
General Obligation Bonds
First Series of 2005

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 \$200,000,000 aggregate principal amount of the Commonwealth's General Obligation Bonds, First Series of 2005 (the "Bonds"). The Bonds are being issued to finance various capital budget projects. 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 financial information should be considered as unaudited unless otherwise specifically identified. 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 the date of issuance and delivery, will bear interest initially from such date, at the rate per annum for each maturity as specified on the cover page hereof, will be payable semi-annually on each January 1 and July 1, commencing January 1, 2006, 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 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 U.S. Bank National Association, as Loan and Transfer Agent ("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 (whether or not a business 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 Bonds maturing in the years 2006 to 2015, inclusive, are not subject to redemption. The Bonds, or portions thereof in integral multiples of \$5,000, maturing on and after July 1, 2016, are subject to redemption at the option of the Commonwealth prior to scheduled maturity on or after July 1, 2015, 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 a redemption price equal to par (100% of stated principal amount) plus accrued interest to the date fixed for redemption.

As long as the Bonds are registered pursuant to a book-entry only system, notice of redemption will be given, as required by DTC's (or any successor depository's) procedures, 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 (5th) 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 Bonds will be made from the General 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 Section 7 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 Bonds are also authorized and issued pursuant to resolutions adopted by the Governor, the State Treasurer, and the Auditor General (the "Issuing Officials") on May 13, 2005, and May 24, 2005 (collectively, the "Resolutions").

Debt Limits

The Constitution (Article VIII, Section 7(a)) permits debt to be incurred (i) for purposes itemized in law and approved by voter referendum, (ii) without approval of the electorate for the rehabilitation of areas affected by man-made or natural disasters, and (iii) 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)
February 28, 2005
(In Millions)

Average Annual Tax Revenues Fiscal 2000-2004.....	\$ 25,091.0
Times 1.75.....	43,909.3
Less: Net Debt Outstanding ^(b)	<u>6,255.0</u>
Debt Issuable Within Limit.....	<u>\$ 37,654.3</u>

^(a) As certified by the Auditor General on March 1, 2005 (Appendix A).

^(b) After credit for refunded debt.

The capital debt authorizations for the various categories of capital facilities projects is shown in Table 2.

Table 2
Aggregate Capital Debt Authorization
(In Millions)

<u>Capital Facilities Projects Category</u>	<u>Debt Authorized</u>	<u>Issued^(a)</u>	<u>Authorized But Unissued</u>	<u>Pro Forma Remaining After Issuance Of the Bonds</u>
Buildings and Structures	\$ 18,240.8	\$ 6,476.5	\$ 11,764.3	\$ 11,664.3
Furniture and Equipment.....	737.8	381.5	356.2	356.2
Transportation Assistance	7,279.6	2,197.8	5,028.2	4,978.2
Redevelopment Assistance.....	15,829.5	1,484.0	14,245.5	14,195.5
Community Colleges.....	35.8	28.0	7.8	7.8
Highway and Highway Bridge.....	15,791.0	2,630.5	14,302.2	14,302.2
Advance Construction Interstate	450.0	450.0	0	0
Flood Control.....	322.1	42.8	278.3	278.3
Site Development.....	<u>150.0</u>	<u>150.0</u>	<u>0</u>	<u>0</u>
Total.....	<u>\$ 58,836.60</u>	<u>\$ 13,841.1</u>	<u>\$ 45,982.5</u>	<u>\$ 45,782.5</u>

^(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 year 2005 capital budget provided that such budget will be in effect until the fiscal year 2006 capital budget is enacted. The maximum amount of debt currently authorized by the fiscal year 2005 capital budget is as shown in Table 3 on the following page.

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Table 3
Fiscal Year 2005 Capital Budget Debt Limits ^(a)
(In Millions)

<u>Capital Facilities Projects Category</u>	<u>Limits</u>	<u>Issued to Date</u>	<u>Remaining Issuable Within Limit</u>	<u>Pro Forma Remaining After Issuance Of the Bonds</u>
Buildings and Structures	\$ 335.0	\$ 0.0	\$ 335.0	\$ 235.0.0
Transportation Assistance	150.0	100.0	50.0	0.0
Redevelopment Assistance	270.0	100.0	170.0	120.0
Flood Control	<u>1.0</u>	<u>1.0</u>	<u>0.0</u>	<u>0.0</u>
Total	<u>\$ 756.0</u>	<u>\$ 201.0</u>	<u>\$ 555.0</u>	<u>\$ 355.0</u>

^(a) The fiscal year 2005 capital budget debt limits became effective November 30, 2004, and will remain in force until the fiscal 2006 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 to provide for the construction, acquisition and major rehabilitation of capital facilities projects as described below under "Capital Facilities."

The proceeds received from the sale of the Bonds (including bond premium), after paying the costs of issuance, will be applied by the Commonwealth to pay the costs of the 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 Bonds will be deposited into the Capital Facilities Fund and applied to defray the costs of issuance of the Bonds and the financial costs of various capital facilities projects of the Commonwealth. Of the \$200,000,000 aggregate principal amount of the Bonds issued for capital facilities projects, (i) \$100,000,000 aggregate principal amount of the Bonds 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; (ii) \$50,000,000 aggregate principal amount of the Bonds is to be allocated to the Department of Transportation to fund transportation assistance projects; and (iii) \$50,000,000 aggregate principal amount of the Bonds is to be allocated to the Department of Community and Economic Development to fund redevelopment assistance 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 the Capital Facilities Fund will be retained in that fund and used for the purposes of the fund.

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.

<u>Name</u>	<u>Office</u>	<u>Term Expires</u>
Edward G. Rendell	Governor	January 16, 2007
Catherine Baker Knoll	Lieutenant Governor	January 16, 2007
Tom Corbett	Attorney General	January 20, 2009
Robert P. Casey, Jr.	State Treasurer	January 20, 2009
Jack Wagner	Auditor General	January 20, 2009

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

Commonwealth Employees

Employees are permitted to organize and bargain collectively. As of July 2003, 82.9 percent of the full-time salaried employees under the Governor's jurisdiction were covered by collective bargaining agreements or memoranda of understanding. Approximately 46.4 percent of state employees are represented by the American Federation of State, County and Municipal Employees ("AFSCME").

Approximately 64 percent of state employees, represented by the AFSCME, Pennsylvania Social Services Union and other unions, are covered by contracts effective July 1, 2003 and expiring on June 30, 2007. These contracts provide 6.5 percent salary increases over the four-year life of the contracts. Contracts extending through June 30, 2007 also have been negotiated in the past year with two other unions whose contracts expired in June 2004. One union received a 6.5 percent salary increase over the three-year period ending June 30, 2007; the second received an interest arbitration award providing for a 14 percent salary increase over the four-year period ending June 30, 2008. Employees represented by three other unions whose contracts expired in June 2004 continue to work while negotiations with the unions continue. Table 4 presents the number of approved and filled positions under the Governor's jurisdiction for the period 1999 through 2003.

Table 4
Filled Salaried Positions and Employees
Under the Governor's Jurisdiction^(a)
1999-2003

<u>As of July 1</u>	<u>Total Full and Part Time Filled Salaried Positions</u>	<u>Total Full Time Salaried Employees</u>	<u>Civil Service Salaried Positions</u>	<u>Civil Service As a % of Total Filled Salaried Positions</u>
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
2002	80,146	79,665	56,296	70.2
2003	78,691	78,691	54,817	69.7

^(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*.

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 2005 refers to the fiscal year ending June 30, 2005.) 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 operating 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, 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 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. 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 and the Budget Stabilization Reserve Fund that replaced the Tax Stabilization Reserve Fund following its abolishment in 2002 are special revenue funds designated to receive a statutorily determined portion of the budgetary basis fiscal year-end surplus of the General Fund. The Budget Stabilization Reserve Fund was established in July 2002 after the Tax Stabilization Reserve Fund was abolished and its balance transferred to the General Fund for the 2002 fiscal year budget. The Budget Stabilization Reserve Fund is to be used for emergencies threatening the health, safety or welfare of citizens or during downturns in the economy that result in significant unanticipated revenue shortfalls not able to be addressed through the normal budget process. 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 Budget Stabilization Reserve Fund (previously the Tax Stabilization Reserve Fund) has been reported as a fund balance reservation in the General Fund (governmental fund category) since fiscal year 1999. Prior to that fiscal year, the Tax Stabilization Reserve Fund was reported, on a GAAP basis, as a designation of the General Fund unreserved fund balance. See "Budget Stabilization Reserve Fund and Tax Stabilization Reserve Fund" below.

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. Two of the largest of such funds are the State Stores Fund and the State Lottery Fund. The State Stores Fund 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. The State Lottery Fund is also an Enterprise 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 and handicapped in Pennsylvania.

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 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 for its governmental funds 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 fund 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 fund financial reporting requires a modified accrual basis of accounting for governmental funds, while proprietary and fiduciary funds are reported on the accrual basis of accounting.

Fund 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 fund financial 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, sales, and personal income tax accruals, (ii) tax refunds payable and tax credits, and (iii) expenditures incurred but not yet posted as expenditures or 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 Basic Financial Statements are a component of the Commonwealth's Comprehensive Annual Financial Report ("CAFR"). The CAFRs for recent fiscal years, including the fiscal year ended June 30, 2004, have been filed with each Nationally Recognized Municipal Information Repository (a "NRMSIR") currently recognized by the Securities and Exchange Commission and are available from any NRMSIR and at 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. In February 2004, the Commonwealth restated its GAAP basis financial statements for the fiscal year ended June 30, 2002, for reasons discussed in "COMMONWEALTH FINANCIAL PERFORMANCE – Restatement of Financial Statements." The Commonwealth has filed both the restated financials and restated CAFR with each NRMSIR and has posted them at the Office of the Budget's web site. **Beginning with the CAFR for the fiscal year ended June 30, 2002 and continuing in subsequent CAFR's, the Commonwealth has incorporated several new accounting and reporting standards that affect the comparability of financial information for those fiscal years to GAAP basis financial information reported for fiscal years prior to the adoption of the new standards. See "New Governmental Accounting and Reporting Standards" below.**

New Governmental Accounting and Reporting Standards

Beginning with its GAAP basis financial statements for the fiscal year ended June 30, 2002, the Commonwealth adopted several new accounting and reporting standards established by the Governmental Accounting Standards Board in its Statements 33, 34, 35, 36, 37 and 38 (collectively, the "New Standards"). Among other things, these New Standards require presentation of government-wide and fund financial statements that constitute basic financial statements and replace general-purpose financial statements reported under former standards. Government-wide financial statements are intended to portray the government "as a whole" while fund financial statements provide fund-specific information. Government-wide financial statements are intended to describe the total cost of providing governmental services and disclose whether the Commonwealth's financial condition improved or weakened during the fiscal year. Other features of the new government-wide financial statements are the reporting of infrastructure assets and related depreciation. Previously, the Commonwealth did not report infrastructure values or accumulated depreciation related to general fixed assets. As part of implementing the New Standards, effective July 1, 2001, the Commonwealth reclassified and/or restated numerous fund balance amounts previously reported at June 30, 2001 and reported governmental activities net assets at June 30, 2001. Note B to the financial statements in the June 30, 2002 CAFR provides a detailed explanation of the nature and amount of such restatements. The New Standards also require providing supplementary information, including a Management's Discussion and Analysis of the financial statements.

Beginning with fiscal year 2002 the Commonwealth also changed how functional expenditure categories are defined. All of these changes may hamper the comparability of GAAP basis financial information for fiscal years ended June 30, 2002 and later to financial reports for years prior to the implementation of the New Standards.

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. The common investment pool operated by the State Treasurer for the investment of operating funds of the Commonwealth maintains a portion of its investments in equity securities. The legislative authorization to invest in equity securities has been extended until December 2006.

Budget Stabilization Reserve Fund and Tax Stabilization Reserve Fund

Legislation enacted with the adoption of the fiscal year 2003 budget abolished the Tax Stabilization Reserve Fund and transferred its balance of \$1.038 billion to the General Fund. That legislation also established a new reserve fund named the Budget Stabilization Reserve Fund and initially directed \$300 million of funding from the General Fund for deposit to the fund during fiscal year 2003. Subsequently, the General Assembly repealed the \$300 million transfer allowing that amount to remain in the General Fund to help offset anticipated revenue shortfalls to the fiscal year 2003 budget.

Balances in the Budget Stabilization Reserve Fund, the successor to 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. The Budget Stabilization Reserve Fund is intended to accumulate a balance equal to 6 percent of General Fund revenues. Beginning with fiscal year 2003, 25 percent of any fiscal year-end surplus is to be deposited into the Budget Stabilization Reserve Fund. When the Budget Stabilization Reserve Fund balance reaches or exceeds a level equal to 6 percent of General Fund revenues, the proportion of the General Fund's fiscal year-end balance to be transferred to the Budget Stabilization Reserve Fund is to be lowered from 25 percent to 10 percent. The General Assembly may appropriate additional amounts to this fund at any time. During fiscal year 2003, the General Assembly repealed a fiscal year 2003 \$300 million transfer from the General Fund to the Budget Stabilization Reserve Fund to retain that amount in the General Fund. This action, in addition to other budget actions taken during fiscal year 2003 (See "Fiscal Year 2003 Financial Results"), contributed to the achievement of a General Fund unappropriated surplus balance of \$279.1 million on June 30, 2003. As required by law, 25 percent of that amount, or \$69.8 million was transferred to the Budget Stabilization Reserve Fund. Following completion of the fiscal year 2004 budget, a General Fund