SINGLE AUDIT REPORT

For Fiscal Year Ended June 30, 2001

Commonwealth of Pennsylvania
Tom Ridge, Governor

Prepared By:

Office of the Budget
Robert A. Bittenbender, Secretary

Comptroller Operations
Harvey C. Eckert, Deputy Secretary

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Commonwealth of Pennsylvania
Single Audit Report
For the Fiscal Year Ended June 30, 2001

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COMMONWEALTH OF PENNSYLVANIA
GOVERNOR'S OFFICE
HARRISBURG

ROBERT A. BITTENBENDER
SECRETARY
OFFICE OF THE BUDGET

To the United States Department of Health and Human Services:

It is my privilege to provide to you the Commonwealth of Pennsylvania's single audit report for the fiscal year ended June 30, 2001. This audit has been performed in accordance with auditing standards generally accepted in the United States and the standards for financial audits contained in *Government Auditing Standards* issued by the U.S. General Accounting Office, and satisfies the requirements of the U.S. Office of Management and Budget's Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. The required auditors' report on the Commonwealth's general purpose financial statements and supplementary schedule of expenditures of federal awards and the reports on compliance and internal controls are contained in this document.

GENERAL PURPOSE FINANCIAL STATEMENTS

The Commonwealth's general purpose financial statements are prepared in conformity with generally accepted accounting principles, as prescribed by the Governmental Accounting Standards Board and are the linchpin of the Commonwealth's Comprehensive Annual Financial Report (CAFR). I am pleased to report that the Commonwealth's CAFR for the fiscal year ended June 30, 2000 has received the Government Finance Officers Association's (GFOA's) Certificate of Achievement for Excellence in Financial Reporting. This represents the fifteenth consecutive year the Commonwealth of Pennsylvania has received this award. We are confident the Commonwealth's Comprehensive Annual Financial Report for the fiscal year ended June 30, 2001 conforms to GFOA standards, and we have submitted it to the GFOA to determine its eligibility for a Certificate of Achievement for Excellence in Financial Reporting.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

The accompanying Schedule of Expenditures of Federal Awards reflects $13.7 billion of federal expenditures by the Commonwealth during the fiscal year ended June 30, 2001. For purposes of the Commonwealth's single audit, a Type A federal program is any program with federal expenditures of at least $30 million. Of the $13.7 billion expended, 92 percent, or $12.6 billion, represents expenditures under federal programs audited as major programs. The Summary of Auditors' Results lists the Commonwealth's major federal programs for the fiscal year ended June 30, 2001. Most of the $13.7 billion in federal expenditures occurred in ten state agencies, as reflected in the following table:

AGENCY NAME	FEDERAL EXPENDITURES (in thousands)
Public Welfare	$8,184,879
Labor and Industry	2,330,051
Transportation	1,164,467
Education	1,074,679
Health	256,184
Community and Economic Development	128,975
Insurance	86,518
Aging	78,515
PA Infrastructure Investment Authority	78,401
Environmental Protection	65,575
Subtotal	13,448,244
Other Agencies	254,984
Grand Total	$13,703,228

FINDINGS AND RECOMMENDATIONS - CURRENT YEAR

The accompanying report for the fiscal year ended June 30, 2001 contains various comments and findings. Comments pertaining to the audit of the Commonwealth’s general purpose financial statements are detailed in the General Purpose Financial Statement Comments. Findings pertaining to the audit of the Commonwealth’s federal programs are detailed in the Federal Award Findings and Questioned Costs. The comments and findings contain detailed explanations of the compliance issues, questioned costs, the auditors' recommendations, and the agency responses. This report also includes the Commonwealth's corrective action plan for each comment and finding.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

The Summary Schedule of Prior Audit Findings as of December 31, 2001 reflects the current status of prior, unresolved findings and recommendations. A total of 65 findings remain unresolved from single audits for the years ended June 30, 1994 through June 30, 2000.

INDEPENDENT AUDIT

The Commonwealth's general purpose financial statement audit and the single audit were performed jointly by the Department of the Auditor General and the independent public accounting firm of Ernst & Young LLP. These audits were performed pursuant to the authority vested in the Auditor General and the Governor under Section 402 of the Fiscal Code of 1929, and in the Governor under Section 701 of the Administrative Code of 1929.

REPORTS OF OTHER INDEPENDENT AUDITORS

Other auditors performed the single audits of the Pennsylvania Higher Education Assistance Agency, the Pennsylvania Housing Finance Agency and the State System of Higher Education (component units of the Commonwealth). Federal programs administered by these agencies are not included in the Commonwealth's Schedule of Expenditures of Federal Awards. These agencies will send their single audit reports directly to the appropriate federal agencies.

ACKNOWLEDGMENTS

I wish to express my appreciation to the various Commonwealth agency staff whose time and dedicated effort made this audit possible and, at the same time, to reaffirm my commitment to maintain the highest standards of accountability in the Commonwealth's management of federal funds.

Sincerely,

Robert A. Bittenbender
Secretary
Office of the Budget

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Commonwealth of Pennsylvania

For its Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2000

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

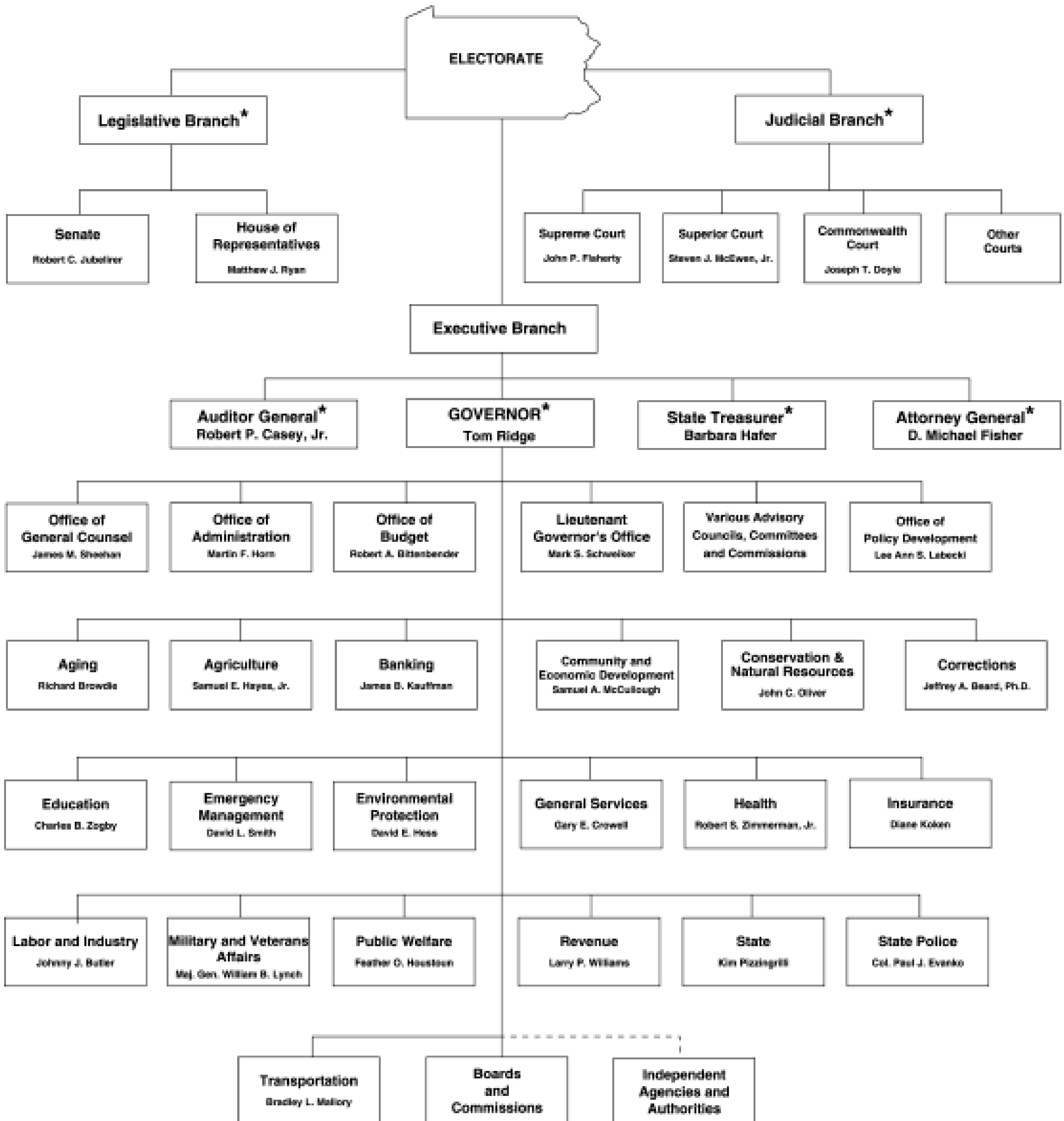
President

Executive Director

COMMONWEALTH OF PENNSYLVANIA

ORGANIZATION AND OFFICIALS CHART

JUNE 30, 2001



* Independently Elected

Legend of Abbreviations - June 30, 2001

The following legend presents descriptions of abbreviations that appear throughout the report:

ABBREVIATION	DESCRIPTION
ACDS	Automated Cost Distribution System
ACF	Administration for Children and Families
ADC	Average Daily Clearance
AIMS	Automated Interface Management System
AMIS	Activity Management Information System
BCCS	Bureau of Consolidated Computer Services
BCSE	Bureau of Child Support Enforcement
BCTS	Bureau of Commonwealth Telecommunications Services
BFM	Bureau of Financial Management
BOA	Bureau of Audits
CAO	County Assistance Office
CAP	Corrective Action Plan
CAROI	Cooperative Audit Resolution Oversight Initiative
CCDBG	Child Care and Development Block Grant
CCDF	Child Care and Development Fund
CDBG	Community Development Block Grant
CDS	Central Drawdown System
CFDA	Catalog of Federal Domestic Assistance
CFR	Code of Federal Regulations
CHDO	Community Housing Development Organization
CHIP	State Children’s Insurance Program
CIS	Client Information System
CMIA	Cash Management Improvement Act of 1990
CR	Change Request
CS	Central Services
CSR	Comprehensive Supervisory Review
CV	Correction Voucher
DCA	Department of Community Affairs
DCED	Department of Community and Economic Development
DEP	Department of Environmental Protection
DGS	Department of General Services
DOC	Department of Corrections
DOI	United States Department of the Interior
DOL	United States Department of Labor
DOT	United States Department of Transportation
DPW	Department of Public Welfare
EA	Expenditure Adjustment
EBT	Electronic Benefits Transfer
EEO	Equal Employment Opportunity
EPA	Environmental Protection Agency
ERP	Enterprise Resource Planning
FARS	Financial Accounting Reporting System
FEMA	Federal Emergency Management Agency
FFY	Federal Fiscal Year
FHWA	Federal Highway Administration
FMS	Financial Management Service
FNS	Food and Nutrition Service
FS	Food Stamps
FY	Fiscal Year
FYE	Fiscal Year Ended
GAAP	Generally Accepted Accounting Principles

Legend of Abbreviations - June 30, 2001

ABBREVIATION	DESCRIPTION
GPFS	General Purpose Financial Statements
HCFA	Health Care Financing Administration
HHS	United States Department of Health and Human Services
HOME	Home Investment Partnerships
HPC	Highway Planning and Construction
HUD	United States Department of Housing and Urban Development
ICS	Integrated Central System
IDIS	Integrated Disbursement and Information System
INS	Pennsylvania Department of Insurance
ITQ	Invitation to Qualify
IRS	Internal Revenue Service
JTPA	Job Training Partnership Act
LECS	Labor, Education and Community Services
L&I	Pennsylvania Department of Labor and Industry
MA	Medical Assistance Program
ME	Miscellaneous Encumbrance
MORIS	Maintenance Operations and Resources Information System
MOU	Memorandum of Understanding
OA	Office of Administration
OARCP	Office of Audit Resolution and Cost Policy
OB	Office of the Budget
OCYF	Office of Children Youth and Families
OIM	Office of Income Maintenance
OMB	Office of Management and Budget
OVR	Office of Vocational Rehabilitation
PADOT	Pennsylvania Department of Transportation
PDA	Pennsylvania Department of Aging
PDE	Pennsylvania Department of Education
PEMA	Pennsylvania Emergency Management Agency
PENNVEST	Pennsylvania Infrastructure Investment Authority
PHFA	Pennsylvania Housing Finance Agency
PHHS	Public Health and Human Services
PPR	Public Protection and Recreation
RC	Refund Correction
RCIA	Revenue Collected in Advance
RE	Refund of Expenditure
RESET	Road to Economic Self-Sufficiency through Employment and Training
RFP	Request for Proposal
RSA	Rehabilitation Services Administration
RSBS	Rehabilitation Services - Vocational Rehabilitation Grants to States
RSCM	Regulation of Surface Coal Mining
SEC	Securities and Exchange Commission
SCI	State Correctional Institution
SDA	Service Delivery Area
SEFA	Schedule of Expenditures of Federal Awards
SFYE	State Fiscal Year Ended
SSBG	Social Services Block Grant
TAA	Trade Adjustment Assistance - Workers
TANF	Temporary Assistance for Needy Families
TAPR	Trade Act Participation Report
TRA	Trade Readjustment Assistance
TREAS	Pennsylvania Treasury Department
TSR	Targeted Supervisory Review

Legend of Abbreviations - June 30, 2001

ABBREVIATION	DESCRIPTION
UI	Unemployment Insurance
USDA	United States Department of Agriculture
USDE	United States Department of Education
VT	Voucher Transmittal
WIA	Workforce Investment Act
WTW	Welfare to Work

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Department of the Auditor General
Commonwealth of Pennsylvania
Harrisburg, Pennsylvania 17120-0018

ERNST & YOUNG LLP

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Harrisburg, PA 17110-9359

Independent Auditors' Report on the General Purpose Financial Statements and Supplementary Schedule of Expenditures of Federal Awards

The Honorable Mark S. Schweiker, Governor
Commonwealth of Pennsylvania
Harrisburg, Pennsylvania

We have jointly audited the general purpose financial statements of the Commonwealth of Pennsylvania as of and for the fiscal year ended June 30, 2001, as listed in the accompanying table of contents. These general purpose financial statements are the responsibility of the Commonwealth's management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not jointly audit the financial statements of certain component units, which represent 80 percent of total assets of the Trust and Agency Funds, 100 percent of the revenues of the Pension Trust Fund, and 100 percent of the discretely presented component units. We also did not jointly audit the financial statements of one enterprise fund which represents 2 percent of total assets of the enterprise funds. The financial statements of these component units and enterprise fund were audited by other auditors, including Ernst & Young LLP acting separately, whose reports thereon have been furnished to us and our opinion expressed herein, insofar as it relates to the amounts included for those component units, is based solely on the reports of the other auditors. Ernst & Young LLP has audited separately 5 percent of total assets and 11 percent of operating revenues of the discretely presented component units.

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

In our opinion, based on our audit and the reports of other auditors, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the Commonwealth of Pennsylvania at June 30, 2001, and the results of its operations and the cash flows of its proprietary fund types for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 16, 2001 on our consideration of the Commonwealth of Pennsylvania's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was performed for the purpose of forming an opinion on the general purpose financial statements of the Commonwealth of Pennsylvania, taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U. S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the general purpose financial statements. The schedule of expenditures of federal awards is prepared on the bases of accounting described in Note B to the schedule of expenditures of federal awards and excludes the expenditures associated with federal award programs for the Pennsylvania Higher Education Assistance Agency, the Pennsylvania Housing Finance Agency, and the State System of Higher Education, component units that were audited in separate OMB Circular A-133 reports and submitted to the Federal Audit Clearinghouse. The information in the schedule of expenditures of federal awards has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the general purpose financial statements taken as a whole.

Robert P. Casey, Jr.   Ernst + Young LLP

November 16, 2001

COMBINED BALANCE SHEET
All Fund Types, Account Groups and Discretely Presented Component Units

June 30, 2001

COMMONWEALTH OF PENNSYLVANIA

(Expressed in Thousands)

	Governmental Fund Types				Proprietary Fund Types		Fiduciary Fund Type	Account Groups		Total (Memorandum Only)		Total
	General	Special Revenue	Debt Service	Capital Projects	Enterprise	Internal Service	Trust and Agency	General Fixed Assets	General Long-Term Obligations	Primary Government	Component Units	(Memorandum Only) Reporting Entity
ASSETS AND OTHER DEBITS												
Assets:												
Cash—Note D	$ 143,392	$ 47,445	$ 4	$ -	$ 16,690	$ 279	$ 11,974	$ -	$ -	$ 219,784	$ 127,805	$ 347,589
Cash with fiscal agents—Note D	-	-	-	-	524	-	2,905,317	-	-	2,905,841	330,496	3,236,337
Temporary investments—Note D	4,135,636	1,810,215	129,059	393,843	757,144	35,636	2,499,311	-	-	9,760,844	4,438,793	14,199,637
Long-term investments—Note D	1,482,112	325,376	-	-	1,422,527	-	30,436,241	-	-	33,666,256	52,299,107	85,965,363
Receivables, net:												
Taxes—Note G	1,024,550	168,907	-	-	-	-	293,068	-	-	1,486,525	-	1,486,525
Accounts	65,573	22,366	6,126	-	11,207	2	157,762	-	-	263,036	108,569	371,605
Accrued interest	17,975	10,161	48	1,519	17,021	118	146,427	-	-	193,269	101,945	295,214
Notes and loans—Note G	13,503	56,264	-	-	232,260	-	6,728	-	-	308,755	7,251,975	7,560,730
Lease rentals—Note G	-	-	1,642	-	-	-	-	-	-	1,642	4,126,578	4,128,220
Pension contributions	-	-	-	-	-	-	-	-	-	-	202,052	202,052
Investment proceeds	-	-	-	-	-	-	170,341	-	-	170,341	712,808	883,149
Other	-	9,065	-	-	26	235	49	-	-	9,375	282,112	291,487
Due from other funds—Note H	40,123	42,643	28	16,413	1,913	45,029	40,551	-	-	186,700	235,607	422,307
Due from primary government—Note H	-	-	-	-	-	-	-	-	-	-	6,780	6,780
Due from component units—Note H	5,460	123	23,835	-	-	517	2,912	-	-	32,847	145	32,992
Due from political subdivisions	31	255	-	-	-	-	5,415	-	-	5,701	-	5,701
Due from other governments—Note B	1,202,041	210,353	-	-	12	334	17,918	-	-	1,430,658	10,479	1,441,137
Advances to other funds—Note H	52,808	3,000	-	-	-	-	-	-	-	55,808	-	55,808
Inventory	-	-	-	-	148,613	13,549	-	-	-	162,162	15,204	177,366
Fixed assets—Note E	-	-	-	-	98,888	95,287	-	5,399,294	-	5,593,469	6,000,289	11,593,758
Less: accumulated depreciation	-	-	-	-	(70,992)	(47,897)	-	-	-	(118,889)	(2,553,589)	(2,672,478)
Other assets	-	-	-	-	904	15	467,642	-	-	468,561	168,767	637,328
Other Debits:												
Amounts available for:												
Retirement of general obligation bonds	-	-	-	-	-	-	-	-	152,085	152,085	-	152,085
Retirement of other bonds	-	-	-	-	-	-	-	-	-	-	88,092	88,092
Other general long-term obligations	-	-	-	-	-	-	-	-	35,548	35,548	939	36,487
Amounts to be provided for the retirement of												
General obligation bonds	-	-	-	-	-	-	-	-	5,392,996	5,392,996	-	5,392,996
Other bonds	-	-	-	-	-	-	-	-	-	-	4,109,619	4,109,619
Other general long-term obligations	-	-	-	-	-	-	-	-	2,425,640	2,425,640	-	2,425,640
TOTAL ASSETS AND OTHER DEBITS	$ 8,183,204	$ 2,706,173	$ 160,742	$ 411,775	$ 2,636,737	$ 143,104	$ 37,161,656	$ 5,399,294	$ 8,006,269	$ 64,808,954	$ 78,064,572	$ 142,873,526

(Continued)

- See notes to financial statements. -

COMBINED BALANCE SHEET

All Fund Types, Account Groups and Discretely Presented Component Units (continued) June 30, 2001

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Governmental Fund Types				Proprietary Fund Types		Fiduciary Fund Type	Account Groups		Total (Memorandum Only)		Total (Memorandum Only)
	General	Special Revenue	Debt Service	Capital Projects	Enterprise	Internal Service	Trust and Agency	General Fixed Assets	General Long-Term Obligations	Primary Government	Component Units	Reporting Entity
LIABILITIES, EQUITY AND OTHER CREDITS												
Liabilities:												
Accounts payable and accrued liabilities	$ 1,981,583	$ 836,963	$ -	$ 159,603	$ 127,537	$ 22,987	$ 219,432	$ -	$ -	$ 3,348,105	$ 470,055	$ 3,818,160
Investment purchases payable	-	-	-	-	-	-	782,190	-	-	782,190	2,584,218	3,366,408
Tax refunds payable	547,203	649	-	-	-	-	4,681	-	-	552,533	-	552,533
Tuition benefits payable-Note F	-	-	-	-	221,126	-	-	-	-	221,126	-	221,126
Securities lending obligations	281,506	49,808	-	-	371,678	-	1,071,337	-	-	1,774,329	2,519,806	4,294,135
Due to other funds—Note H	114,611	39,679	-	131	21,347	358	19,483	-	-	195,609	235,607	431,216
Due to primary government—Note H	-	-	-	-	-	-	-	-	-	-	32,746	32,746
Due to component units—Note H	51	8,660	-	-	-	-	-	-	-	8,711	145	8,856
Due to political subdivisions	643,377	26,159	-	-	-	-	-	-	-	669,536	-	669,536
Due to other governments	40,719	18,201	-	58,027	490	42	248,958	-	-	366,437	257,366	623,803
Deferred revenue	87,439	24,399	7,768	-	21,716	4	-	-	-	141,326	4,158,445	4,299,771
Notes payable—Note J	-	-	-	-	-	-	-	-	-	-	904,592	904,592
Demand revenue bonds payable—Note J	-	-	-	-	-	-	-	-	-	-	1,711,000	1,711,000
Advances from other funds—Note H	-	12,508	-	-	5,137	38,000	-	-	-	55,645	-	55,645
Other liabilities	1,720	-	897	-	2,666	-	1,230,381	-	-	1,235,664	1,216,748	2,452,412
Insurance loss liability—Note F	-	-	-	-	1,054,252	-	-	-	-	1,054,252	-	1,054,252
General obligation bonds payable—Note K	-	-	-	-	-	-	-	-	5,545,081	5,545,081	-	5,545,081
Bonds payable—Note K	-	-	-	-	-	-	-	-	-	-	4,214,372	4,214,372
Revenue bonds payable—Note K	-	-	-	-	-	-	-	-	-	-	5,795,032	5,795,032
Capital lease and other general long-term obligations—Note K	-	-	-	-	-	-	-	-	2,461,188	2,461,188	401,740	2,862,928
TOTAL LIABILITIES	3,698,209	1,017,026	8,665	217,761	1,825,949	61,391	3,576,462	-	8,006,269	18,411,732	24,501,872	42,913,604
Equity and Other Credits:												
Contributed Capital—Note C	-	-	-	-	312,749	9,187	-	-	-	321,936	1,861,504	2,183,440
Investment in fixed assets	-	-	-	-	-	-	-	5,399,294	-	5,399,294	368,545	5,767,839
Retained earnings:												
Reserved—Note C	-	-	-	-	7,484	-	-	-	-	7,484	1,428,736	1,436,220
Unreserved	-	-	-	-	490,555	72,526	-	-	-	563,081	969,633	1,532,714
Fund balance:												
Reserved for:												
Encumbrances	426,956	440,783	-	779,927	-	-	2,927	-	-	1,650,593	41,143	1,691,736
Advances—Note C	52,808	3,000	-	-	-	-	-	-	-	55,808	-	55,808
Pension and postemployment healthcare benefits	-	-	-	-	-	-	27,880,468	-	-	27,880,468	48,153,194	76,033,662
Loans receivable	-	56,264	-	-	-	-	-	-	-	56,264	37,709	93,973
Tax stabilization	1,093,213	-	-	-	-	-	-	-	-	1,093,213	-	1,093,213
Deferred compensation	-	-	-	-	-	-	959,096	-	-	959,096	-	959,096
INVEST Program participants	-	-	-	-	-	-	1,087,420	-	-	1,087,420	-	1,087,420
Endowment and similar funds	-	-	-	-	-	-	-	-	-	-	18,379	18,379
Restricted fund balance	-	-	-	-	-	-	-	-	-	-	54,709	54,709
Other—Note C	308,125	35,739	-	2,311	-	-	-	-	-	346,175	199,318	545,493
Unreserved:												
Designated for:												
Capital projects	-	-	-	79,867	-	-	-	-	-	79,867	451,764	531,631
Debt service:												
Retirement of general obligation bonds	-	-	152,085	-	-	-	-	-	-	152,085	88,092	240,177
Highways	-	182,670	-	-	-	-	-	-	-	182,670	-	182,670
Other—Note C	1,079,047	264	-	-	-	-	-	-	-	1,079,311	4,782	1,084,093
Undesignated (deficit)—Note C	1,524,846	970,427	(8)	(668,091)	-	-	3,655,283	-	-	5,482,457	(114,808)	5,367,649
TOTAL EQUITY AND OTHER CREDITS	4,484,995	1,689,147	152,077	194,014	810,788	81,713	33,585,194	5,399,294	-	46,397,222	53,562,700	99,959,922
TOTAL LIABILITIES, EQUITY AND OTHER CREDITS	$ 8,183,204	$ 2,706,173	$ 160,742	$ 411,775	$ 2,636,737	$ 143,104	$ 37,161,656	$ 5,399,294	$ 8,006,269	$ 64,808,954	$ 78,064,572	$ 142,873,526

- See notes to financial statements. -

COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

All Governmental Fund Types, Expendable Trust Funds and Discretely Presented Component Units

For the Fiscal Year Ended June 30, 2001

COMMONWEALTH OF PENNSYLVANIA

(Expressed in Thousands)

	Governmental Fund Types				Fiduciary Fund Type	Total (Memorandum Only)		Total (Memorandum Only)
	General	Special Revenue	Debt Service	Capital Projects	Expendable Trust	Primary Government	Component Units	Reporting Entity
REVENUES:								
Taxes	$ 19,297,659	$ 1,887,157	$ -	$ 47,380	$ 6,335	$ 21,238,531	$ -	$ 21,238,531
Unemployment taxes	-	-	-	-	1,383,214	1,383,214	-	1,383,214
Licenses and fees	202,591	969,781	-	-	64,807	1,237,179	9,487	1,246,666
Intergovernmental	10,588,526	1,497,846	-	-	68,228	12,154,600	49,146	12,203,746
Charges for sales and services	2,108,677	202,842	-	77,017	-	2,388,536	2,338	2,390,874
Investment income	181,235	90,239	8,761	26,967	157,976	465,178	30,207	495,385
Lottery revenues	-	1,788,333	-	-	-	1,788,333	-	1,788,333
Lease rental principal and interest	-	-	1,544	-	-	1,544	323,227	324,771
Other	489,827	48,122	159	178	107,492	645,778	36,719	682,497
TOTAL REVENUES	32,868,515	6,484,320	10,464	151,542	1,788,052	41,302,893	451,124	41,754,017
EXPENDITURES:								
Current:								
General government	1,613,383	1,676,264	-	2,541	37,792	3,329,980	-	3,329,980
Protection of persons and property	3,026,625	15,319	-	2,130	28,131	3,072,205	9,829	3,082,034
Public health and welfare	16,645,180	838,135	-	-	1,721,532	19,204,847	-	19,204,847
Public education	8,667,618	1,901	-	7,765	-	8,677,284	5,466	8,682,750
Conservation of natural resources	155,468	365,764	-	47,525	-	568,757	-	568,757
Economic development and assistance	522,073	6,413	-	216,657	-	745,143	40,417	785,560
Transportation	401,621	3,526,772	-	136,731	-	4,065,124	-	4,065,124
Capital outlay	117,354	46,712	-	491,182	-	655,248	670,722	1,325,970
Debt service:								
Principal retirement	-	-	477,001	-	-	477,001	120,983	597,984
Interest and fiscal charges	-	-	281,250	340	-	281,590	199,243	480,833
TOTAL EXPENDITURES	31,149,322	6,477,280	758,251	904,871	1,787,455	41,077,179	1,046,660	42,123,839
REVENUES OVER (UNDER) EXPENDITURES	1,719,193	7,040	(747,787)	(753,329)	597	225,714	(595,536)	(369,822)
OTHER FINANCING SOURCES (USES):								
Bond proceeds	-	3,108	-	660,811	-	663,919	511,674	1,175,593
Refunding bond proceeds	-	-	-	-	-	-	109,533	109,533
Operating transfers in—Note H	75,491	532,051	490,156	-	-	1,097,698	491,994	1,589,692
Operating transfers out—Note H	(582,822)	(473,710)	(1)	-	-	(1,056,533)	(491,994)	(1,548,527)
Operating transfers from primary government—Note H	-	-	-	-	-	-	39,100	39,100
Operating transfers to component units—Note H	(877,609)	-	-	-	-	(877,609)	-	(877,609)
Payment to refunded bond escrow agent	-	-	-	-	-	-	(78,145)	(78,145)
Capital lease and installment purchase obligations	2,789	3,818	-	-	-	6,607	-	6,607
NET OTHER FINANCING SOURCES (USES)	(1,382,151)	65,267	490,155	660,811	-	(165,918)	582,162	416,244
REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURES AND OTHER USES	337,042	72,307	(257,632)	(92,518)	597	59,796	(13,374)	46,422
FUND BALANCES JULY 1, 2000	4,263,641	1,676,594	409,709	286,532	4,616,709	11,253,185	589,170	11,842,355
RESIDUAL EQUITY TRANSFERS—NOTE H	(115,688)	(59,754)	-	-	-	(175,442)	-	(175,442)
FUND BALANCES JUNE 30, 2001	$ 4,484,995	$ 1,689,147	$ 152,077	$ 194,014	$ 4,617,306	$ 11,137,539	$ 575,796	$ 11,713,335

— See notes to financial statements. —

COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN UNRESERVED/UNDESIGNATED FUND BALANCES- BUDGET AND ACTUAL (BUDGETARY BASIS)

General and Budgeted Special Revenue Funds

For the Fiscal Year Ended June 30, 2001

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	General Fund			Budgeted Special Revenue Funds		
	Budget	**Actual**	**Variance Favorable (Unfavorable)**	**Budget**	**Actual**	**Variance Favorable (Unfavorable)**
REVENUES:						
State Programs:						
Taxes, net of refunds	$ 18,952,100	$ 18,972,002	$ 19,902	$ 1,104,588	$ 1,114,388	$ 9,800
Lottery receipts	-	-	-	898,111	858,531	(39,580)
Liquor store profits transfer	50,000	50,000	-	-	-	-
Licenses and fees	81,300	86,581	5,281	828,474	810,259	(18,215)
Investment income	154,347	226,432	72,085	75,821	64,069	(11,752)
Unclaimed property, net of claim payments	38,000	49,912	11,912	-	-	-
Fines, penalties and interest	27,300	33,082	5,782	30,338	30,038	(300)
Departmental services	1,962,909	1,962,909	-	52,828	52,828	-
Miscellaneous	58,453	24,736	(33,717)	20,238	17,121	(3,117)
TOTAL STATE PROGRAMS	21,324,409	21,405,654	81,245	3,010,398	2,947,234	(63,164)
Federal Programs	11,500,666	10,479,746	(1,020,920)	879,570	1,027,183	147,613
TOTAL REVENUES	32,825,075	31,885,400	(939,675)	3,889,968	3,974,417	84,449
EXPENDITURES:						
State Programs:						
General government	1,130,417	1,119,646	10,771	357,106	333,905	23,201
Protection of persons and property	3,000,510	2,931,922	68,588	330,508	320,397	10,111
Public health and welfare	7,903,463	7,884,684	18,779	764,050	727,970	36,080
Public education	8,458,765	8,451,977	6,788	1,639	1,077	562
Conservation of natural resources	162,123	161,229	894	1,000	1,000	-
Debt service	384,079	382,924	1,155	81,283	81,282	1
Economic development and assistance	505,711	503,594	2,117	178	178	-
Transportation	398,513	388,629	9,884	1,568,818	1,557,685	11,133
TOTAL STATE PROGRAMS	21,943,581	21,824,605	118,976	3,104,582	3,023,494	81,088
Federal Programs	11,500,666	10,479,746	1,020,920	879,570	1,027,183	(147,613)
TOTAL EXPENDITURES	33,444,247	32,304,351	1,139,896	3,984,152	4,050,677	(66,525)
REVENUES UNDER EXPENDITURES	(619,172)	(418,951)	200,221	(94,184)	(76,260)	17,924
OTHER FINANCING SOURCES:						
Prior-year lapses	143,882	143,882	-	26,575	26,575	-
Increase in budgeted revenues	81,245	-	(81,245)	-	-	-
NET OTHER FINANCING SOURCES	225,127	143,882	(81,245)	26,575	26,575	-
REVENUES AND OTHER SOURCES UNDER EXPENDITURES—NOTE M	(394,045)	(275,069)	118,976	(67,609)	(49,685)	17,924
UNRESERVED/UNDESIGNATED FUND BALANCES (BUDGETARY BASIS) JULY 1, 2000	610,536	610,536	-	558,095	558,095	-
UNRESERVED/UNDESIGNATED FUND BALANCES (BUDGETARY BASIS) JUNE 30, 2001	$ 216,491	$ 335,467	$ 118,976	$ 490,486	$ 508,410	$ 17,924

— See notes to financial statements. —

COMBINED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS

All Proprietary Fund Types and Discretely Presented Component Units

For the Fiscal Year Ended June 30, 2001

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Proprietary Fund Types		Total (Memorandum Only)		Total (Memorandum Only)
	Enterprise	Internal Service	Primary Government	Component Units	Reporting Entity
OPERATING REVENUES:					
Sales and services	$ 1,063,643	$ 406,457	$ 1,470,100	$ 540,989	$ 2,011,089
Investment income	141,333	-	141,333	98,310	239,643
Interest on notes and loans	7,241	-	7,241	463,459	470,700
Other	274	374	648	171,825	172,473
TOTAL OPERATING REVENUES	1,212,491	406,831	1,619,322	1,274,583	2,893,905
OPERATING EXPENSES:					
Cost of sales and services	1,035,060	391,258	1,426,318	782,404	2,208,722
Interest expense	5,910	-	5,910	389,530	395,440
Depreciation	5,311	10,675	15,986	167,949	183,935
Provision for uncollectible accounts	4,897	-	4,897	28,965	33,862
Other	165	-	165	150,930	151,095
TOTAL OPERATING EXPENSES	1,051,343	401,933	1,453,276	1,519,778	2,973,054
OPERATING INCOME (LOSS)	161,148	4,898	166,046	(245,195)	(79,149)
NONOPERATING REVENUES (EXPENSES):					
Investment income	6,983	1,941	8,924	67,474	76,398
Interest expense	-	-	-	(55,696)	(55,696)
Oil company franchise tax	-	-	-	44,379	44,379
Grants and capital contribution revenues	-	-	-	146,992	146,992
Grants and capital contribution expenses	-	-	-	(7,588)	(7,588)
Other revenues	771	716	1,487	-	1,487
Other expenses	(132)	(3,810)	(3,942)	-	(3,942)
NONOPERATING REVENUES (EXPENSES), NET.	7,622	(1,153)	6,469	195,561	202,030
INCOME (LOSS) BEFORE OPERATING TRANSFERS AND EXTRAORDINARY ITEMS	168,770	3,745	172,515	(49,634)	122,881
OPERATING TRANSFERS:					
Operating transfers out—Note H	(52,165)	-	(52,165)	-	(52,165)
Operating transfers from primary government—Note H	-	-	-	366,688	366,688
OPERATING TRANSFERS, NET	(52,165)	-	(52,165)	366,688	314,523
INCOME BEFORE EXTRAORDINARY ITEMS	116,605	3,745	120,350	317,054	437,404
Extraordinary loss on early extinguishment of debt	-	-	-	(558)	(558)
NET INCOME	116,605	3,745	120,350	316,496	436,846
RETAINED EARNINGS, JULY 1, 2000	381,434	68,781	450,215	2,081,873	2,532,088
RETAINED EARNINGS, JUNE 30, 2001	$ 498,039	$ 72,526	$ 570,565	$ 2,398,369	$ 2,968,934

— See notes to financial statements. —

COMBINED STATEMENT OF CASH FLOWS
All Proprietary Fund Types and
Discretely Presented Component Units

For the Fiscal Year Ended June 30, 2001

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Proprietary Funds		Total (Memorandum Only)		Total (Memorandum Only)
	Enterprise	Internal Service	Primary Government	Component Units	Reporting Entity
CASH FLOWS FROM OPERATING ACTIVITIES:					
Operating income (loss)	$ 161,148	$ 4,898	$ 166,046	$ (245,195)	$ (79,149)
Adjustments to reconcile operating income (loss) to net cash provided by (used for) operating activities:					
Depreciation	5,311	10,675	15,986	167,949	183,935
Provision for uncollectible accounts	4,897	-	4,897	28,965	33,862
Nonoperating revenues	771	716	1,487	146,992	148,479
Nonoperating expenses	-	(681)	(681)	(7,588)	(8,269)
Reclassification of investment income	(141,333)	-	(141,333)	(98,310)	(239,643)
Changes in assets and liabilities:					
Receivables	(37,288)	80	(37,208)	(281,863)	(319,071)
Due from other funds	1,436	(22,619)	(21,183)	-	(21,183)
Due from primary government	-	-	-	490	490
Due from component units	-	1,359	1,359	21	1,380
Due from other governments	(12)	(84)	(96)	10,967	10,871
Inventory	(15,889)	(731)	(16,620)	(3,899)	(20,519)
Other current assets	(202)	7	(195)	2,090	1,895
Accounts payable and accrued liabilities	20,317	240	20,557	(24,750)	(4,193)
Due to other funds	(65,049)	(22)	(65,071)	-	(65,071)
Due to primary government	-	-	-	(620)	(620)
Due to component units	-	-	-	(21)	(21)
Due to other governments	21	(17)	4	(16,642)	(16,638)
Deferred revenue	1,095	4	1,099	(31,041)	(29,942)
Reverse repurchase agreement obligations	(5,668)	-	(5,668)	-	(5,668)
Insurance loss liability	(83,207)	-	(83,207)	-	(83,207)
Tuition benefits payable	50,775	-	50,775	-	50,775
Securities lending obligations	(108,880)	-	(108,880)	-	(108,880)
Other current liabilities	(1,001)	-	(1,001)	(4,802)	(5,803)
TOTAL ADJUSTMENTS	(373,906)	(11,073)	(384,979)	(112,062)	(497,041)
NET CASH USED FOR OPERATING ACTIVITIES	(212,758)	(6,175)	(218,933)	(357,257)	(576,190)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:					
Borrowings (repayments) under advances from other funds	(119)	29,000	28,881	-	28,881
Proceeds from issuance of debt obligations	-	-	-	662,370	662,370
Principal paid on debt obligations	-	-	-	(337,969)	(337,969)
Operating transfers from primary government	-	-	-	366,688	366,688
Operating transfers out	(52,165)	-	(52,165)	-	(52,165)
Increase in contributed capital	5,102	-	5,102	13,000	18,102
Decrease in contributed capital	(24)	-	(24)	-	(24)
NET CASH PROVIDED BY (USED FOR) NONCAPITAL FINANCING ACTIVITIES	(47,206)	29,000	(18,206)	704,089	685,883
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:					
Proceeds from issuance of debt obligations	-	-	-	435,070	435,070
Principal paid on debt obligations	-	-	-	(48,686)	(48,686)
Interest paid on debt obligations	-	-	-	(55,696)	(55,696)
Increases in contributed capital	19,000	-	19,000	39,920	58,920
Acquisition and construction of capital assets	(7,690)	(17,220)	(24,910)	(448,832)	(473,742)
Oil company franchise tax	-	-	-	44,379	44,379
NET CASH PROVIDED BY (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES	11,310	(17,220)	(5,910)	(33,845)	(39,755)
CASH FLOWS FROM INVESTING ACTIVITIES:					
Purchase of investments	(13,278,009)	(264,789)	(13,542,798)	(7,403,337)	(20,946,135)
Proceeds from sale and maturities of investments	13,401,535	257,171	13,658,706	6,937,676	20,596,382
Investment income	127,045	1,888	128,933	163,522	292,455
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES	250,571	(5,730)	244,841	(302,139)	(57,298)
NET INCREASE (DECREASE) IN CASH	1,917	(125)	1,792	10,848	12,640
CASH, JULY 1, 2000	15,297	404	15,701	89,529	105,230
CASH, JUNE 30, 2001	$ 17,214	$ 279	$ 17,493	$ 100,377	$ 117,870

There were no material investing, capital or financing activities which did not result in cash receipts or cash payments during the fiscal year.

— See notes to financial statements. —

COMBINED STATEMENT OF CHANGES IN PLAN NET ASSETS

Pension Trust Funds - Component Units

For the Fiscal Year Ended June 30, 2001

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Blended	Discretely Presented			
	State Employees' Retirement System (December 31, 2000)	Public School Employees' Retirement System			
			Postemployment Healthcare		
	Pension	Pension	Premium Assistance	Health Options Program	Total
ADDITIONS:					
Pension contributions:					
Employee	$ 231,667	$ 579,850	$ -	$ 141,875	$ 721,725
Employer	168,002	158,193	27,523	-	185,716
Total contributions	399,669	738,043	27,523	141,875	907,441
Investment income:					-
Net appreciation (depreciation) in fair value of investments	(50,602)	(5,137,879)	260	-	(5,137,619)
Interest, dividend, rental and other income	766,911	1,409,966	2,274	1,724	1,413,964
Total investment activity income	716,309	(3,727,913)	2,534	1,724	(3,723,655)
Investment expenses	(140,526)	(143,663)	(22)	-	(143,685)
Net income from investing activities	575,783	(3,871,576)	2,512	1,724	(3,867,340)
Securities lending activities:					
Income	87,874	147,852	-	-	147,852
Expenses	(77,945)	(124,225)	-	-	(124,225)
Net securities lending activities income	9,929	23,627	-	-	23,627
Total net investment income	585,712	(3,847,949)	2,512	1,724	(3,843,713)
TOTAL ADDITIONS	985,381	(3,109,906)	30,035	143,599	(2,936,272)
DEDUCTIONS:					
Benefit payments	1,166,897	2,090,290	33,894	139,912	2,264,096
Refunds of contributions	9,888	22,369	-	-	22,369
Administrative expenses	21,309	31,335	997	2,522	34,854
Net account transfers	-	10,867	-	-	10,867
TOTAL DEDUCTIONS	1,198,094	2,154,861	34,891	142,434	2,332,186
NET INCREASE (DECREASE)	(212,713)	(5,264,767)	(4,856)	1,165	(5,268,458)
Fund balance reserved for pension and postemployment healthcare benefits:					
JULY 1, 2000	28,093,181	53,361,722	51,228	8,702	53,421,652
JUNE 30, 2001	$ 27,880,468	$ 48,096,955	$ 46,372	$ 9,867	$ 48,153,194

— See notes to financial statements. —

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	INVEST Program For Local Governments
Investment income	$ 61,676
Less: participant administrative expenses	573
Net increase in net assets resulting from operations	61,103
Net investment income distributions to participants	(61,103)
Share transactions (at net asset value of $1.00 per share):	
Shares purchased	3,094,263
Shares issued in lieu of cash distributions	50,384
Shares redeemed	(3,036,975)
Net increase in net assets from share transactions	107,672
Net increase in net assets	107,672
FUND BALANCE RESERVED FOR INVEST PROGRAM PARTICIPANTS JANUARY 1, 2000	979,748
FUND BALANCE RESERVED FOR INVEST PROGRAM PARTICIPANTS DECEMBER 31, 2000	$ 1,087,420

— See notes to financial statements. —

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Governmental Funds	Proprietary Funds	Fiduciary Funds	College and University Funds	Total (Memorandum Only) Component Units
ASSETS AND OTHER DEBITS					
Assets:					
Cash—Note D	$ 41	$ 92,338	$ 6,595	$ 28,831	$ 127,805
Cash with fiscal agents—Note D	322,457	8,039	-	-	330,496
Temporary investments—Note D	141,074	2,316,687	1,701,490	279,542	4,438,793
Long-term investments—Note D	136,991	940,702	50,816,899	404,515	52,299,107
Receivables, net:					
Accounts	91	24,436	34,018	50,024	108,569
Accrued interest	3,462	98,483	-	-	101,945
Notes and loans—Note G	2,612	7,214,705	-	34,658	7,251,975
Lease rental—Note G	4,109,369	17,209	-	-	4,126,578
Pension contributions	-	-	202,052	-	202,052
Investment proceeds	-	-	712,808	-	712,808
Other	-	17	279,341	2,754	282,112
Due from other funds—Note H	706	-	-	234,901	235,607
Due from primary government—Note H	-	6,461	319	-	6,780
Due from component units—Note H	-	145	-	-	145
Due from other governments—Note B	4,719	5,742	18	-	10,479
Inventory	-	10,215	-	4,989	15,204
Fixed assets—Note E	-	4,811,465	11,556	1,177,268	6,000,289
Less: accumulated depreciation	-	(2,161,343)	(7,472)	(384,774)	(2,553,589)
Other assets	10	142,685	231	25,841	168,767
Other Debits:					
Amounts available for retirement of other bonds	88,092	-	-	-	88,092
Amounts available for other general long-term obligations	939	-	-	-	939
Amounts to be provided for the retirement of other bonds	4,109,619	-	-	-	4,109,619
TOTAL ASSETS AND OTHER DEBITS	$ 8,920,182	$ 13,527,986	$ 53,757,855	$ 1,858,549	$ 78,064,572
LIABILITIES, EQUITY AND OTHER CREDITS					
Liabilities:					
Accounts payable and accrued liabilities	$ 5,674	$ 230,671	$ 98,460	$ 135,250	$ 470,055
Investment purchases payable	-	-	2,584,218	-	2,584,218
Securities lending agreement obligations	-	-	2,519,806	-	2,519,806
Due to other funds—Note H	706	-	-	234,901	235,607
Due to primary government—Note H	-	29,435	2,166	1,145	32,746
Due to component units—Note H	-	145	-	-	145
Due to other governments	28	257,338	-	-	257,366
Deferred revenue	4,131,629	229	1,048	25,539	4,158,445
Notes payable—Note J	6,199	898,393	-	-	904,592
Demand revenue bonds payable—Note J	-	1,711,000	-	-	1,711,000
Other liabilities	1,498	345,870	398,963	470,417	1,216,748
Bonds payable—Note K	4,198,402	-	-	15,970	4,214,372
Revenue bonds payable—Note K	-	5,795,032	-	-	5,795,032
Capital lease and other general long-term obligations—Note K	250	-	-	401,490	401,740
TOTAL LIABILITIES	8,344,386	9,268,113	5,604,661	1,284,712	24,501,872
Equity and Other Credits:					-
Contributed capital—Note C	-	1,861,504	-	-	1,861,504
Investment in fixed assets	-	-	-	368,545	368,545
Retained earnings:					
Reserved—Note C	-	1,428,736	-	-	1,428,736
Unreserved	-	969,633	-	-	969,633
Fund balance:					
Reserved for:					
Encumbrances	1,049	-	-	40,094	41,143
Pension and postemployment healthcare benefits	-	-	48,153,194	-	48,153,194
Loans receivable	-	-	-	37,709	37,709
Endowment and similar funds	-	-	-	18,379	18,379
Restricted fund balance	192	-	-	54,517	54,709
Other—Note C	2,741	-	-	196,577	199,318
Unreserved:					
Designated for:					
Capital projects	451,764	-	-	-	451,764
Debt service:					
Retirement of other bonds	88,092	-	-	-	88,092
Other—Note C	4,782	-	-	-	4,782
Undesignated (deficit)—Note C	27,176	-	-	(141,984)	(114,808)
TOTAL EQUITY AND OTHER CREDITS	575,796	4,259,873	48,153,194	573,837	53,562,700
TOTAL LIABILITIES, EQUITY AND OTHER CREDITS	$ 8,920,182	$ 13,527,986	$ 53,757,855	$ 1,858,549	$ 78,064,572

— See notes to financial statements. —

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	State Public School Building Authority	Philadelphia Shipyard Development Corporation (December 31, 2000)	Ben Franklin/ IRC Partnership	Insurance Fraud Prevention Authority	Pennsylvania Higher Educational Facilities Authority	Total
ASSETS AND OTHER DEBITS						
Assets:						
Cash—Note D	$ 41	$ -	$ -	$ -	$ -	$ 41
Cash with fiscal agents-Note D	-	-	-	273	322,184	322,457
Temporary investments—Note D	96,883	19,044	6,749	3,921	14,477	141,074
Long-term investments—Note D	25,694	-	-	-	111,297	136,991
Receivables, net:						
Accounts	-	-	-	91	-	91
Accrued interest	686	159	28	-	2,589	3,462
Notes and loans—Note G	2,612	-	-	-	-	2,612
Lease rental—Note G	437,412	-	-	-	3,671,957	4,109,369
Due from other funds—Note H	-	706	-	-	-	706
Due from other governments	-	4,610	-	109	-	4,719
Other assets	-	-	-	10	-	10
Other Debits:						
Amounts available for:						
Retirement of other bonds	-	-	-	-	88,092	88,092
Other general long-term obligations	939	-	-	-	-	939
Amounts to be provided for the retirement of other bonds	437,662	-	-	-	3,671,957	4,109,619
TOTAL ASSETS AND OTHER DEBITS	$ 1,001,929	$ 24,519	$ 6,777	$ 4,404	$ 7,882,553	$ 8,920,182
LIABILITIES AND FUND BALANCES						
Liabilities:						
Accounts payable and accrued liabilities	$ 819	$ 1,249	$ 3,486	$ 120	$ -	$ 5,674
Due to other funds	-	706	-	-	-	706
Due to other governments	-	-	28	-	-	28
Deferred revenue	437,412	22,260	-	-	3,671,957	4,131,629
Notes payable	6,199	-	-	-	-	6,199
Other liabilities	267	-	-	-	1,231	1,498
Bonds payable—Note K	438,352	-	-	-	3,760,050	4,198,402
Capital lease and other general long-term obligations	250	-	-	-	-	250
TOTAL LIABILITIES	883,299	24,215	3,514	120	7,433,238	8,344,386
Fund Balance:						
Reserved for:						
Encumbrances	-	-	1,049	-	-	1,049
Restricted fund balance	192	-	-	-	-	192
Other—Note C	-	-	-	-	2,741	2,741
Unreserved:						
Designated for:						
Capital projects	93,282	-	-	-	358,482	451,764
Debt service:						
Retirement of other bonds	-	-	-	-	88,092	88,092
Other—Note C	939	-	-	3,843	-	4,782
Undesignated	24,217	304	2,214	441	-	27,176
TOTAL FUND BALANCES	118,630	304	3,263	4,284	449,315	575,796
TOTAL LIABILITIES AND FUND BALANCES	$ 1,001,929	$ 24,519	$ 6,777	$ 4,404	$ 7,882,553	$ 8,920,182

— See notes to financial statements. —

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

Governmental Funds - Discretely Presented Component Units

For the Fiscal Year Ended June 30, 2001

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	State Public School Building Authority	Philadelphia Shipyard Development Corporation (December 31, 2000)	Ben Franklin/ IRC Partnership	Insurance Fraud Prevention Authority	Pennsylvania Higher Educational Facilities Authority	Total
REVENUES:						
Licenses and fees	$ -	$ -	$ -	$ 9,487	$ -	$ 9,487
Intergovernmental	-	49,146	-	-	-	49,146
Charges for sales and services	1,220	-	-	81	1,037	2,338
Investment income	8,667	1,322	574	504	19,140	30,207
Lease rental principal and interest	66,429	-	-	-	256,798	323,227
Other	3,450	-	-	-	33,269	36,719
TOTAL REVENUES	79,766	50,468	574	10,072	310,244	451,124
EXPENDITURES:						
Protection of persons and property	-	-	-	9,829	-	9,829
Public education	4,251	-	-	-	1,215	5,466
Economic development and assistance	-	-	40,417	-	-	40,417
Capital outlay	70,322	79,718	-	-	520,682	670,722
Debt service:						
Principal retirement	26,460	-	-	-	94,523	120,983
Interest and fiscal charges	22,239	-	-	-	177,004	199,243
TOTAL EXPENDITURES	123,272	79,718	40,417	9,829	793,424	1,046,660
REVENUES OVER (UNDER) EXPENDITURES	(43,506)	(29,250)	(39,843)	243	(483,180)	(595,536)
OTHER FINANCING SOURCES (USES):						
Bond and loan proceeds	48,156	28,281	-	-	435,237	511,674
Refunding bond proceeds	21,515	-	-	-	88,018	109,533
Operating transfers in—Note H	68,021	-	-	-	423,973	491,994
Operating transfers out—Note H	(68,021)	-	-	-	(423,973)	(491,994)
Operating transfer from primary government—Note H	-	-	39,100	-	-	39,100
Payment to refunded bond escrow agent	(40,127)	-	-	-	(38,018)	(78,145)
NET OTHER FINANCING SOURCES	29,544	28,281	39,100	-	485,237	582,162
REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURES AND OTHER USES	(13,962)	(969)	(743)	243	2,057	(13,374)
FUND BALANCES, JULY 1, 2000	132,592	1,273	4,006	4,041	447,258	589,170
FUND BALANCES, JUNE 30, 2001	$ 118,630	$ 304	$ 3,263	$ 4,284	$ 449,315	$ 575,796

— See notes to financial statements. —

COMBINING BALANCE SHEET
Proprietary Funds - Discretely Presented Component Units *June 30, 2001*

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Pennsylvania Turnpike Commission (May 31, 2001)	Pennsylvania Industrial Development Authority	Pennsylvania Housing Finance Agency	Pennsylvania Higher Education Assistance Agency	Pennsylvania Infrastructure Investment Authority	Total
ASSETS						
Cash—Note D	$ 67,802	$ -	$ 23,092	$ 1,440	$ 4	$ 92,338
Cash with fiscal agents—Note D	-	1,038	-	6,421	580	8,039
Temporary investments—Note D	376,440	232,453	806,152	504,964	396,678	2,316,687
Long-term investments—Note D	496,072	34,952	130,167	279,511	-	940,702
Receivables, net:						
Accounts	14,454	-	-	9,982	-	24,436
Accrued interest	6,883	3,447	-	84,934	3,219	98,483
Notes and loans—Note G	-	577,875	2,794,714	2,668,934	1,173,182	7,214,705
Lease rentals—Note G	-	17,209	-	-	-	17,209
Other	-	17	-	-	-	17
Due from primary government—Note H	6,461	-	-	-	-	6,461
Due from component units—Note H	-	-	17	-	128	145
Due from other governments—Note B	-	-	-	5,730	12	5,742
Inventory	10,215	-	-	-	-	10,215
Fixed assets—Note E	4,665,740	-	8,877	136,369	479	4,811,465
Less: accumulated depreciation	(2,100,682)	-	(3,384)	(56,929)	(348)	(2,161,343)
Other assets	29,853	10,026	17,266	67,673	17,867	142,685
TOTAL ASSETS	$ 3,573,238	$ 877,017	$ 3,776,901	$ 3,709,029	$ 1,591,801	$ 13,527,986
LIABILITIES AND EQUITY						
Liabilities:						
Accounts payable and accrued liabilities	$ 107,482	$ 451	$ 50,658	$ 68,692	$ 3,388	$ 230,671
Due to primary government—Note H	3,979	-	3	95	25,358	29,435
Due to component units—Note H	-	-	128	-	17	145
Due to other governments	-	-	-	257,330	8	257,338
Deferred revenue	-	229	-	-	-	229
Notes payable—Note J	-	-	41,101	857,292	-	898,393
Demand revenue bonds payable—Note J	-	-	-	1,711,000	-	1,711,000
Other liabilities	16,899	10,023	268,118	50,830	-	345,870
Revenue bonds payable—Note K	1,908,924	332,168	2,853,783	537,925	162,232	5,795,032
TOTAL LIABILITIES	2,037,284	342,871	3,213,791	3,483,164	191,003	9,268,113
Equity:						
Contributed capital—Note C	330,192	360,840	1,960	-	1,168,512	1,861,504
Retained earnings:						
Reserved—Note C	1,205,762	-	113,794	109,180	-	1,428,736
Unreserved	-	173,306	447,356	116,685	232,286	969,633
TOTAL EQUITY	1,535,954	534,146	563,110	225,865	1,400,798	4,259,873
TOTAL LIABILITIES AND EQUITY	$ 3,573,238	$ 877,017	$ 3,776,901	$ 3,709,029	$ 1,591,801	$ 13,527,986

— See notes to financial statements. —

COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS

Proprietary Funds - Discretely Presented Component Units *For the Fiscal Year Ended June 30, 2001*

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Pennsylvania Turnpike Commission (May 31, 2001)	Pennsylvania Industrial Development Authority	Pennsylvania Housing Finance Agency	Pennsylvania Higher Education Assistance Agency	Pennsylvania Infrastructure Investment Authority	Total
OPERATING REVENUES:						
Sales and services	$ 365,900	$ -	$ 24,850	$ 142,545	$ 7,694	$ 540,989
Investment income	-	17,241	44,334	16,204	20,531	98,310
Interest on notes and loans	-	20,725	191,423	231,632	19,679	463,459
Other	12,741	841	157,989	254	-	171,825
TOTAL OPERATING REVENUES	378,641	38,807	418,596	390,635	47,904	1,274,583
OPERATING EXPENSES:						
Cost of sales and services	212,365	3,102	24,398	533,970	8,569	782,404
Interest expense	-	19,487	181,764	177,741	10,538	389,530
Depreciation	156,180	-	78	11,635	56	167,949
Provision for uncollectible accounts	-	1,391	27,462	-	112	28,965
Other	-	-	150,930	-	-	150,930
TOTAL OPERATING EXPENSES	368,545	23,980	384,632	723,346	19,275	1,519,778
OPERATING INCOME (LOSS)	10,096	14,827	33,964	(332,711)	28,629	(245,195)
NONOPERATING REVENUES (EXPENSES):						
Investment income	67,474	-	-	-	-	67,474
Interest expense	(55,696)	-	-	-	-	(55,696)
Oil company franchise tax	44,379	-	-	-	-	44,379
Grants and capital contribution revenues	-	-	-	35,626	111,366	146,992
Grants and capital contribution expenses	-	-	-	(1,913)	(5,675)	(7,588)
NONOPERATING REVENUES, NET	56,157	-	-	33,713	105,691	195,561
INCOME (LOSS) BEFORE OPERATING TRANSFERS AND EXTRAORDINARY ITEMS	66,253	14,827	33,964	(298,998)	134,320	(49,634)
OPERATING TRANSFERS:						
Operating transfers from primary government— Note H	-	-	-	366,688	-	366,688
INCOME BEFORE EXTRAORDINARY ITEMS	66,253	14,827	33,964	67,690	134,320	317,054
Extraordinary loss on early extinguishment of debt	-	-	(558)	-	-	(558)
NET INCOME	66,253	14,827	33,406	67,690	134,320	316,496
RETAINED EARNINGS, JULY 1, 2000	1,139,509	158,479	527,744	158,175	97,966	2,081,873
RETAINED EARNINGS, JUNE 30, 2001	$ 1,205,762	$ 173,306	$ 561,150	$ 225,865	$ 232,286	$ 2,398,369

— See notes to financial statements. —

COMBINING STATEMENT OF CASH FLOWS
Proprietary Funds - Discretely Presented Component Units

For the Fiscal Year Ended June 30, 2001

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Pennsylvania Turnpike Commission (May 31, 2001)	Pennsylvania Industrial Development Authority	Pennsylvania Housing Finance Agency	Pennsylvania Higher Education Assistance Agency	Pennsylvania Infrastructure Investment Authority	Total
CASH FLOWS FROM OPERATING ACTIVITIES:						
Operating income (loss)	$ 10,096	$ 14,827	$ 33,964	$ (332,711)	$ 28,629	$ (245,195)
Adjustments to reconcile operating income (loss) to net cash provided by (used for) operating activities:						
Depreciation	156,180	-	78	11,635	56	167,949
Provision for uncollectible accounts	-	1,391	27,462	-	112	28,965
Nonoperating revenues	-	-	-	35,626	111,366	146,992
Nonoperating expenses	-	-	-	(1,913)	(5,675)	(7,588)
Reclassification of investment income	-	(17,241)	(44,334)	(16,204)	(20,531)	(98,310)
Changes in assets and liabilities:			-		-	
Receivables	(1,485)	8,332	30,856	(274,257)	(45,309)	(281,863)
Due from primary government	(10)	500	-	-	-	490
Due from component units	-	-	75	-	(54)	21
Due from other governments	-	-	-	10,891	76	10,967
Inventory	(3,899)	-	-	-	-	(3,899)
Other current assets	(1,496)	255	(1,691)	4,532	490	2,090
Accounts payable and accrued liabilities	(13,484)	(1)	(979)	(9,683)	(603)	(24,750)
Due to primary government	(8)	-	(10)	51	(653)	(620)
Due to component units	-	-	54	-	(75)	(21)
Due to other governments	-	-	-	(16,646)	4	(16,642)
Deferred revenue	-	150	-	(31,191)	-	(31,041)
Other current liabilities	(6,758)	(370)	3,426	(1,100)	-	(4,802)
TOTAL ADJUSTMENTS	129,040	(6,984)	14,937	(288,259)	39,204	(112,062)
NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES	139,136	7,843	48,901	(620,970)	67,833	(357,257)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:						
Proceeds from issuance of debt obligations	-	-	34,972	627,398	-	662,370
Principal paid on debt obligations	-	(23,156)	(18,333)	(296,480)	-	(337,969)
Operating transfers from primary government	-	-	-	366,688	-	366,688
Increase in contributed capital	-	13,000	-	-	-	13,000
NET CASH PROVIDED BY (USED FOR) NONCAPITAL FINANCING ACTIVITIES	-	(10,156)	16,639	697,606	-	704,089
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:						
Proceeds from issuance of debt obligations	435,070	-	-	-	-	435,070
Principal paid on debt obligations	(35,245)	-	-	-	(13,441)	(48,686)
Interest paid on debt obligations	(55,696)	-	-	-	-	(55,696)
Increase in contributed capital	39,920	-	-	-	-	39,920
Acquisition and construction of capital assets	(433,443)	-	(738)	(14,600)	(51)	(448,832)
Oil company franchise tax	44,379	-	-	-	-	44,379
NET CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES	(5,015)	-	(738)	(14,600)	(13,492)	(33,845)
CASH FLOWS FROM INVESTING ACTIVITIES:						
Purchase of investments	(848,763)	(36,494)	(749,662)	(5,506,825)	(261,593)	(7,403,337)
Proceeds from sale and maturities of investments	639,326	21,525	652,929	5,434,960	188,936	6,937,676
Investment income	67,474	17,241	44,334	16,204	18,269	163,522
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES	(141,963)	2,272	(52,399)	(55,661)	(54,388)	(302,139)
NET INCREASE (DECREASE) IN CASH	(7,842)	(41)	12,403	6,375	(47)	10,848
CASH, JULY 1, 2000	75,644	1,079	10,689	1,486	631	89,529
CASH, JUNE 30, 2001	$ 67,802	$ 1,038	$ 23,092	$ 7,861	$ 584	$ 100,377

There were no material investing, capital or financing activities which did not result in cash receipts or cash payments during the fiscal year.

— See notes to financial statements. —

COMMONWEALTH OF PENNSYLVANIA

(Expressed in Thousands)

	Pension Trust Fund	Agency Funds		
	Public School Employees' Retirement System	Pennsylvania Life and Health Insurance Guaranty Association (December 31, 2000)	Pennsylvania Property and Casualty Insurance Guaranty Association (December 31, 2000)	Total
ASSETS				
Cash—Note D	$ -	$ 1,534	$ 5,061	$ 6,595
Temporary investments—Note D	1,382,683	226,346	92,461	1,701,490
Long-term investments—Note D	50,816,899	-	-	50,816,899
Receivables, net:				
Accounts	-	-	34,018	34,018
Pension contributions	202,052	-	-	202,052
Investment proceeds	712,808	-	-	712,808
Other	239,096	-	40,245	279,341
Due from primary government—Note H	319	-	-	319
Due from other governments	18	-	-	18
Fixed assets—Note E	11,354	-	202	11,556
Less: accumulated depreciation	(7,385)	-	(87)	(7,472)
Other assets	-	-	231	231
TOTAL ASSETS	$ 53,357,844	$ 227,880	$ 172,131	$ 53,757,855
LIABILITIES AND FUND BALANCE				
Liabilities:				
Accounts payable and accrued liabilities	$ 98,460	$ -	$ -	$ 98,460
Investment purchases payable	2,584,218	-	-	2,584,218
Securities lending agreement obligations	2,519,806	-	-	2,519,806
Due to primary government—Note H	2,166	-	-	2,166
Deferred revenue	-	-	1,048	1,048
Other liabilities	-	227,880	171,083	398,963
TOTAL LIABILITIES	5,204,650	227,880	172,131	5,604,661
Fund Balance:				
Reserved for:				
Pension and postemployment healthcare benefits	48,153,194	-	-	48,153,194
TOTAL FUND BALANCE	48,153,194	-	-	48,153,194
TOTAL LIABILITIES AND FUND BALANCE	$ 53,357,844	$ 227,880	$ 172,131	$ 53,757,855

— See notes to financial statements. —

COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
Agency Funds - Discretely Presented Component Units *For the Fiscal Year Ended December 31, 2000*

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Balance January 1, 2000	Additions	Deductions	Balance December 31, 2000
PENNSYLVANIA LIFE AND HEALTH INSURANCE GUARANTY ASSOCIATION				
ASSETS				
Cash	$ 1,493	$ 19,043	$ 19,002	$ 1,534
Temporary investments	214,411	11,935	-	226,346
TOTAL ASSETS	$ 215,904	$ 30,978	$ 19,002	$ 227,880
LIABILITIES				
Other liabilities	$ 215,904	$ 11,976	$ -	$ 227,880
TOTAL LIABILITIES	$ 215,904	$ 11,976	$ -	$ 227,880
PENNSYLVANIA PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION				
ASSETS				
Cash	$ 2,553	$ 78,618	$ 76,110	$ 5,061
Temporary investments	47,974	44,487	-	92,461
Receivables, net:				
Accounts	200	66,534	32,716	34,018
Other	113,092	48,253	121,100	40,245
Other assets	258	115	27	346
TOTAL ASSETS	$ 164,077	$ 238,007	$ 229,953	$ 172,131
LIABILITIES				
Deferred revenues	$ 1,056	$ -	$ 8	$ 1,048
Other liabilities	163,021	155,669	147,607	171,083
TOTAL LIABILITIES	$ 164,077	$ 155,669	$ 147,615	$ 172,131
TOTAL				
ASSETS				
Cash	$ 4,046	$ 97,661	$ 95,112	$ 6,595
Temporary investments	262,385	56,422	-	318,807
Receivables, net:				
Accounts	200	66,534	32,716	34,018
Other	113,092	48,253	121,100	40,245
Other assets	258	115	27	346
TOTAL ASSETS	$ 379,981	$ 268,985	$ 248,955	$ 400,011
LIABILITIES				
Deferred revenues	$ 1,056	$ -	$ 8	$ 1,048
Other liabilities	378,925	167,645	147,607	398,963
TOTAL LIABILITIES	$ 379,981	$ 167,645	$ 147,615	$ 400,011

— See notes to financial statements. —

COMBINING BALANCE SHEET

College and University Funds - Discretely Presented Component Unit

June 30, 2001

COMMONWEALTH OF PENNSYLVANIA

(Expressed in Thousands)

	Current Funds: Unrestricted	Current Funds: Restricted	Loan Funds	Endowment and Similar Funds	Plant Funds: Unexpended	Plant Funds: Renewal and Replacement	Plant Funds: Retirement of Indebtedness	Plant Funds: Investment in Plant	Agency Funds	Component Units	Total
ASSETS:											
Cash—Note D	$ 12,711	$ -	$ -	$ -	$ -	$ 10	$ 1,513	$ -	$ -	$ 14,597	$ 28,831
Temporary investments—Note D	242,244	2	-	17	8,983	3,485	10,247	-	-	14,564	279,542
Long-term investments—Note D	209,997	616	-	17,854	-	1	165,074	-	-	10,973	404,515
Receivables, net:											
Accounts	20,183	22,511	-	-	-	4,549	23	-	156	2,602	50,024
Notes and loans—Note G	-	-	34,658	-	-	-	-	-	-	-	34,658
Other	-	-	-	-	2,754	-	-	-	-	-	2,754
Due from other funds—Note H	-	22,711	3,168	484	60,095	124,815	7,885	-	9,571	6,172	234,901
Inventory	4,989	-	-	-	-	-	-	-	-	-	4,989
Fixed assets—Note E	-	-	-	-	-	-	-	1,144,538	-	32,730	1,177,268
Less: accumulated depreciation	-	-	-	-	-	-	-	(384,774)	-	-	(384,774)
Other assets	7,960	66	-	27	270	1,825	5,913	-	-	9,780	25,841
TOTAL ASSETS	$ 498,084	$ 45,906	$ 37,826	$ 18,382	$ 72,102	$ 134,685	$ 190,655	$ 759,764	$ 9,727	$ 91,418	$ 1,858,549
LIABILITIES AND FUND EQUITY											
Liabilities:											
Accounts payable and accrued liabilities	$ 85,121	$ 13,878	$ 117	$ 3	$ 11,151	$ 12,204	$ 992	$ 952	$ 385	$ 10,447	$ 135,250
Due to other funds—Note H	231,080	-	-	-	-	-	-	3,767	54	-	234,901
Due to primary government—Note H	1,145	-	-	-	-	-	-	-	-	-	1,145
Bonds payable	-	-	-	-	-	-	-	-	-	15,970	15,970
Deferred revenue	25,539	-	-	-	-	-	-	-	-	-	25,539
Other liabilities	433,545	-	-	-	-	-	-	550	9,288	27,034	470,417
Capital lease obligations—Note K	-	-	-	-	6,569	2,447	6,524	385,950	-	-	401,490
TOTAL LIABILITIES	776,430	13,878	117	3	17,720	14,651	7,516	391,219	9,727	53,451	1,284,712
Fund Equity:											
Investment in fixed assets	-	-	-	-	-	-	-	368,545	-	-	368,545
Fund balance:											
Reserved for:											
Encumbrances	13,221	1,498	-	-	15,757	8,009	-	-	-	1,609	40,094
Loans receivable	-	-	37,709	-	-	-	-	-	-	-	37,709
Endowment and similar funds	-	-	-	18,379	-	-	-	-	-	-	18,379
Restricted fund balance	-	30,530	-	-	-	23,385	602	-	-	-	54,517
Other—Note C	141,978	-	-	-	7,626	33,111	1,227	-	-	12,635	196,577
Unreserved:											
Undesignated (deficit)—Note C	(433,545)	-	-	-	30,999	55,529	181,310	-	-	23,723	(141,984)
TOTAL FUND EQUITY (DEFICIT)	(278,346)	32,028	37,709	18,379	54,382	120,034	183,139	368,545	-	37,967	573,837
TOTAL LIABILITIES AND FUND EQUITY	$ 498,084	$ 45,906	$ 37,826	$ 18,382	$ 72,102	$ 134,685	$ 190,655	$ 759,764	$ 9,727	$ 91,418	$ 1,858,549

- See notes to financial statements. -

COMBINED STATEMENT OF CHANGES IN FUND BALANCES
College and University Funds - Discretely Presented Component Unit

For the Fiscal Year Ended June 30, 2001

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Current Funds				Plant Funds					
	Unrestricted	Restricted	Loan Funds	Endowment and Similar Funds	Unexpended	Renewal and Replacement	Retirement of Indebtedness	Investment in Plant	Component Units	Total
REVENUES AND OTHER ADDITIONS:										
Unrestricted current funds	$ 717,615	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 717,615
Gifts and bequests	-	4,687	-	835	2,610	1,098	1,209	508	-	10,947
Grants and contracts	-	184,893	184	-	226	291	736	-	-	186,330
Federal advances	-	-	1,059	-	-	-	-	-	-	1,059
Endowment income	-	732	-	-	-	-	-	-	-	732
Investment income	-	1,078	153	121	1,264	8,403	2,298	-	1,026	14,343
Net increase (decrease) in the fair value of investments	-	(33)	-	(1,436)	11	3	18,414	-	6	16,965
Interest on loans receivable	-	-	784	-	-	-	-	-	-	784
Expended for plant facilities—net of disposals (including $25,177 charged to current funds expenditures)	-	-	-	-	-	-	-	123,748	-	123,748
Retirement of indebtedness	-	-	-	-	6	169	83	19,991	-	20,249
Other	-	613	68	35	211	7,778	2,373	1,040	48,717	60,835
TOTAL REVENUES AND OTHER ADDITIONS	717,615	191,970	2,248	(445)	4,328	17,742	25,113	145,287	49,749	1,153,607
EXPENDITURES AND OTHER DEDUCTIONS:										
Educational and general	930,866	188,652	-	-	-	-	-	-	3,415	1,122,933
Auxiliary enterprises	138,511	247	-	-	-	-	-	-	-	138,758
Loan cancellations	-	-	492	-	-	-	-	-	-	492
Administrative and collection costs	-	-	438	-	-	-	-	-	311	749
Expended for plant facilities	-	-	-	-	26,496	43,555	172	42,432	705	113,360
Depreciation on plant facilities	-	-	-	-	-	-	-	56,150	1,317	57,467
Retirement of indebtedness	-	-	-	-	-	-	20,249	-	-	20,249
Interest on indebtedness	-	-	-	-	-	-	22,438	-	322	22,760
Other	-	2,637	84	-	831	-	479	4,884	42,704	51,619
TOTAL EXPENDITURES AND OTHER DEDUCTIONS	1,069,377	191,536	1,014	-	27,327	43,555	43,338	103,466	48,774	1,528,387
TRANSFERS AND ALLOCATIONS AMONG FUNDS— ADDITIONS (DEDUCTIONS):										
Mandatory:										
Principal and interest	(21,599)	-	-	-	(65)	(1,554)	23,218	-	-	-
Other	(392)	(48)	170	48	71	151	-	-	-	-
Nonmandatory:										
Operating transfers from Primary Government—Note H	453,652	8,250	-	-	687	8,983	-	249	-	471,821
Other	(65,960)	-	-	(10)	27,343	33,790	5,333	-	(496)	-
TRANSFERS AND ALLOCATIONS, NET	365,701	8,202	170	38	28,036	41,370	28,551	249	(496)	471,821
NET INCREASE (DECREASE) FOR THE YEAR	13,939	8,636	1,404	(407)	5,037	15,557	10,326	42,070	479	97,041
FUND BALANCES (DEFICIT), JULY 1, 2000	(292,285)	23,392	36,305	18,786	49,345	104,477	172,813	326,475	37,488	476,796
FUND BALANCES (DEFICIT), JUNE 30, 2001—NOTE C	$ (278,346)	$ 32,028	$ 37,709	$ 18,379	$ 54,382	$ 120,034	$ 183,139	$ 368,545	$ 37,967	$ 573,837

- See notes to financial statements. -

COMBINED STATEMENT OF CURRENT FUNDS REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

College and University Funds—Discretely Presented Component Unit

For the Fiscal Year Ended June 30, 2001

COMMONWEALTH OF PENNSYLVANIA

(Expressed in Thousands)

	Unrestricted	Restricted	Total
REVENUES:			
Tuition and fees	$ 487,336	$ -	$ 487,336
Government grants and contracts:			
State and local	1,080	95,853	96,933
Federal	2,580	83,535	86,115
Private gifts, grants and contracts	4,227	10,156	14,383
Investment income	25,336	898	26,234
Increase (decrease) in the fair value of investments	7,961	(32)	7,929
Endowment income	112	733	845
Activities of educational departments	10,055	-	10,055
Other sources	13,344	827	14,171
Auxiliary enterprises	165,584	-	165,584
TOTAL REVENUES	717,615	191,970	909,585
EXPENDITURES AND MANDATORY TRANSFERS:			
EXPENDITURES:			
Educational and general:			
Instruction	468,930	6,223	475,153
Research	1,451	2,493	3,944
Public service	9,059	25,459	34,518
Academic support	102,216	7,274	109,490
Student services	89,272	6,223	95,495
Operations and maintenance of plant	97,187	836	98,023
General institutional support	150,949	5,838	156,787
Student aid	11,802	134,306	146,108
TOTAL EDUCATIONAL AND GENERAL	930,866	188,652	1,119,518
Auxiliary enterprises	138,511	247	138,758
TOTAL EXPENDITURES	1,069,377	188,899	1,258,276
MANDATORY TRANSFERS:			
Renewal and replacement	69	-	69
Retirement of indebtness	9,483	-	9,483
Loan funds matching grants	170	-	170
Unexpended plant funds	70	-	70
Other	53,301	48	53,349
TOTAL MANDATORY TRANSFERS	63,093	48	63,141
TOTAL EXPENDITURES AND MANDATORY TRANSFERS	1,132,470	188,947	1,321,417
OPERATING TRANSFERS, OTHER TRANSFERS AND DEDUCTIONS:			
Operating transfers from Primary Government—Note H	453,652	8,250	461,902
Other transfers	(24,858)	-	(24,858)
Deductions	-	(2,637)	(2,637)
OPERATING TRANSFERS, OTHER TRANSFERS AND DEDUCTIONS, NET	428,794	5,613	434,407
NET INCREASE IN FUND BALANCES	$ 13,939	$ 8,636	$ 22,575

— See notes to financial statements. —

INDEX TO NOTES

NOTE A - FINANCIAL REPORTING ENTITY

Primary Government

For financial reporting purposes, the Commonwealth of Pennsylvania is a primary government (PG). The PG includes all publicly elected members of the executive, legislative and judicial branches of the Commonwealth. The PG also includes all Commonwealth departments, agencies, boards and organizations that are not legally separate.

Component Units

In addition to the PG, the financial reporting entity includes blended and discretely presented component units. Component units include all legally separate organizations for which the PG is financially accountable, and other organizations for which the nature and significance of their relationship with the PG are such that exclusion would cause the financial statements to be misleading or incomplete. The criteria used to define financial accountability include appointment of a voting majority of an organization's governing body and (1) the ability of the PG to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the PG. Fiscal dependency is also considered. The following organizations are included in the financial reporting entity as component units:

Blended Component Unit

State Employees' Retirement System (SERS) (Fiduciary Fund Type) — The SERS is a public employee retirement system that covers Commonwealth employees. The PG appoints all voting board members and, on a very limited basis, imposes its will on the SERS. The PG uses the SERS to provide pension benefits to PG employees. The PG makes essentially all employer contributions to the SERS; PG employees make almost all of the employee contributions to the SERS (virtually all PG employees are required to join the SERS). The PG is responsible for all of the SERS pension obligations. The SERS is a blended component unit because it provides services and benefits almost exclusively to the PG.

Discretely Presented Component Units

State Public School Building Authority (SPSBA) and Pennsylvania Higher Educational Facilities Authority (HEFA) (Governmental Fund Types) - The SPSBA and the HEFA issue limited obligation revenue bonds, the proceeds of which are used to finance the construction of facilities for school districts and public and private colleges and universities. These bonds are repaid solely from lease rental payments from the schools. Upon completion of the lease payment requirements (and satisfaction of bondholders), the title to the constructed or acquired assets vests with the schools.

The PG appoints all nine voting members of the SPSBA and the HEFA governing boards; nine high-ranking members of the PG serve as ex-officio members of each board. As a result, the PG is able to impose its will. The PG Department of Education approves the SPSBA and the HEFA projects (which indicates imposition of will and fiscal dependency). Although neither the PG nor the Authorities are obligated for debt service payments (beyond lease rental payments from schools), the PG may take certain actions to satisfy the SPSBA and the HEFA bondholders.

Ben Franklin/IRC Partnership (Partnership) (Governmental Fund Type) — The Partnership assists business through interaction of technology development, modernization and training programs. Industrial resource centers and technology centers, established through the Partnership, also increase the competitiveness of businesses. Operations of the Partnership are funded by state appropriations and private contributions; the Partnership may not issue debt. The Partnership works closely with the Department of Community and Economic Development (DCED). The PG appoints all fifteen voting members of the governing board. All Partnership expenditures must be appropriated annually by the General Assembly.

Insurance Fraud Prevention Authority (IFPA) (Governmental Fund Type) - The IFPA assists in the prevention, discovery, investigation and prosecution of insurance fraud. The IFPA is funded through assessments paid by the insurance industry and through certain criminal and civil fines, penalties and awards.

The PG appoints six of seven voting members of the IFPA governing board; the Attorney General serves ex-officio as one of these six members. A significant portion of IFPA expenditures funds the Section on Insurance Fraud in the Office of Attorney General; this indicates a financial benefit/burden. The IFPA is not fiscally dependent on the PG.

NOTE A - FINANCIAL REPORTING ENTITY (continued)

***Philadelphia Shipyard Development Corporation (PSDC) (Governmental Fund Type)* -** The PSDC was created as a nonprofit corporation to assist the PG and other governmental entities in financing a shipbuilding facility at the former Philadelphia Naval Shipyard. The PSDC obtains funding from the PG and a variety of other governmental sources to fund development, construction and job recruitment and training costs.

The PG appoints three of five voting board members and provides a significant portion of funding for the PSDC.

Pennsylvania Higher Education Assistance Agency (PHEAA) (Proprietary Fund Type) - The PHEAA makes grants and loans to students to help fund the cost of higher education. Lending institutions and post-secondary schools are involved in the loan program. The PG funds the PHEAA grant program; the PHEAA issues revenue bonds to fund the student loan program. Revenue bonds are repaid from student loan repayments. The PHEAA also services student loan portfolios for lending institutions.

The PG appoints all voting board members but does not significantly impose its will on the PHEAA. A significant PG financial burden exists through subsidizing the grant program; also, although the PG is not obligated for the PHEAA revenue bonds, the PG could take certain actions to satisfy bondholders. The PHEAA is fiscally dependent, as the Governor must approve the issuance of its debt.

Pennsylvania Housing Finance Agency (PHFA) (Proprietary Fund Type) - The PHFA makes loans to eligible individuals and organizations to purchase or construct housing. The loans benefit low and moderate-income individuals and families.

The PG appoints all voting board members; four of the fourteen members may be removed at will. The Governor is required to request an appropriation from the General Assembly for the PHFA whenever a deficiency exists in the capital reserve account or if additional funds are needed to avoid a default on the PHFA debt. This represents a PG moral obligation for the PHFA debt. The Governor must approve the issuance of the PHFA debt.

Pennsylvania Industrial Development Authority (PIDA) (Proprietary Fund Type) - The PIDA collaborates with local industrial development corporations to make loans which help preserve or expand the work force, assist targeted economic areas or assist specific companies. Loans are made at lower-than-market interest rates; the interest rates are based on local unemployment and other economic conditions. The PIDA issues revenue bonds to finance the loan program. Loan repayments are used for debt service payments. The PIDA operates closely with the DCED.

The PG appoints all voting board members and is able to impose its will on the PIDA. The PG has provided contributed capital; “excess” PIDA funds are transferred to the General Fund. The PG is not obligated for the PIDA debt, but the PG could take certain actions to satisfy bondholders.

Pennsylvania Infrastructure Investment Authority (PENNVEST) (Proprietary Fund Type) - PENNVEST makes grants and low-interest loans to local governments and authorities, businesses and nonprofit organizations for the construction, improvement, repair or rehabilitation of drinking and waste water systems. The PENNVEST obtains funds through Commonwealth general obligation bond proceeds (approved by referendum), revenue bonds, the Federal government and contributed amounts from Commonwealth funds. Loan repayments finance the PENNVEST debt service costs. PENNVEST operates closely with the Department of Environmental Protection.

The PG appoints all voting board members; there are limitations on three of the thirteen appointments. By issuing general obligation debt and providing the proceeds to the PENNVEST as contributed capital, the PG creates a significant financial burden. The PG is not obligated for the PENNVEST debt, but the PG could take certain actions to satisfy bondholders. Upon dissolution, the assets of the PENNVEST revert to the Commonwealth.

Pennsylvania Turnpike Commission (PTC) (Proprietary Fund Type) - The PTC was created to construct, maintain and operate a turnpike system in the Commonwealth. Activities are financed through user tolls and the issuance of revenue bonds. Debt service payments are funded through user tolls. The PTC works closely with the Department of Transportation.

The PG appoints all voting members. When all the PTC bondholders have been satisfied, the PTC assets revert to the Department of Transportation. The Governor must approve the issuance of all PTC debt. The PG is not obligated for PTC debt, but the PG could take certain actions to satisfy bondholders.

NOTE A - FINANCIAL REPORTING ENTITY (continued)

Pennsylvania Life and Health Insurance Guaranty Association (PLHIGA) (Fiduciary Fund Type) - The PLHIGA was created to protect insurance policy owners, insured persons, beneficiaries annuitants, payees and assignees of direct non-group life, health, annuity and supplemental policies or contracts from potential insurer failure due to the impairment or insolvency of the insurer. The PLHIGA guarantees the payment of insurance benefits and continuation of coverage by assessing member insurers. The PLHIGA is also authorized to assist the Pennsylvania Insurance Commissioner in the prevention and detection of insurer impairments or insolvencies.

The PG has appointment approval authority for all governing board members and the Insurance Commissioner has broad authority to impose will on the PLHIGA. There is a minor financial burden on the PG.

Pennsylvania Property and Casualty Insurance Guaranty Association (PPCIGA) (Fiduciary Fund Type) - The PPCIGA was created to provide for the payment of insured property and casualty policy claim losses and to avoid losses to claimants or policyholders as a result of insurer insolvency. The PPCIGA guarantees the payment of insurance benefits and continuation of coverage by assessing member insurers.

The PG has appointment approval authority for all governing board members and the Insurance Commissioner has broad authority to impose will on the PPCIGA. There is a minor financial burden on the PG.

Public School Employees' Retirement System (PSERS) (Fiduciary Fund Type) - The PSERS was created to administer and provide pension benefits to public school employees in Pennsylvania. The PSERS covers almost all such employees. Covered elementary and secondary school employers make employer contributions with the PG reimbursing each employer at least half their required annual contribution. Employer contributions for covered employees of higher education institutions and state-owned schools are shared equally by covered employers and the PG; all covered public school employees also make contributions.

The PG appoints eight of fifteen voting board members; the seven other members are appointed by active or retired public school employees or are appointed by public school boards. In addition to making significant contributions to the PSERS, the PG guarantees the payment of all annuities and other pension benefits. This represents a compelling PG financial burden.

State System of Higher Education (SSHE) (College and University Funds) - The SSHE was created to provide instruction for postsecondary students. The SSHE is composed of fourteen universities and an administrative headquarters. Resources are provided by student tuition, grants and PG subsidies.

The PG appoints all voting board members. Five of the sixteen appointments must be trustees of universities; three must be students. The PG provides significant operating and capital subsidies to the SSHE. The PG is not obligated for the SSHE debt, but the PG could take certain actions to satisfy bondholders.

Pennsylvania Economic Development Financing Authority (PEDFA) - The PEDFA was created to lend money primarily to businesses to promote economic development in the Commonwealth. The PEDFA issues revenue bonds to fund specific projects only and repayments are derived solely from project revenues. The debt is considered non-recourse, as the Authority is not obligated to bondholders beyond amounts received by the Authority from the funded projects. Financial statement information for the PEDFA is not reported because its only activity involves conduit debt.

The PG appoints all sixteen board members; five members are ex-officio. The PG is not obligated for the PEDFA debt, but the PG could take certain actions to satisfy bondholders. Upon dissolution, the assets of PEDFA revert to the Commonwealth.

Pennsylvania Energy Development Authority (PEDA)—The PEDA was created to promote the development of energy sources within the Commonwealth. The PEDA issued revenue bonds and lent the proceeds to fund three specific projects. Loan repayments are derived solely from project revenues. The debt is considered non-recourse, as the PEDA is not obligated to bondholders beyond amounts received from the funded projects. The PEDA has not issued any debt since 1990. Financial statement information for the PEDA is not reported because its only activity involves conduit debt.

NOTE A - FINANCIAL REPORTING ENTITY (continued)

The PG appoints all nineteen board members; six members are ex-officio. The Governor must approve the issuance of Authority debt. The PG is not obligated for the PEDA debt, but the PG could take certain actions to satisfy bondholders.

Historically, the **Philadelphia Parking Authority** (Authority) has been included in the City of Philadelphia's (City) financial reporting entity. Prior to June 30, 2001 the General Assembly passed Senate Bill 780 which provides, in part, for the Commonwealth to appoint a voting majority of the Authority's governing board. The new law provides for an increase from five to eleven board members; the Commonwealth appointed six new members by June 30, 2001. Over the next five years, existing members' (appointed by the City) terms are to expire and neither the Commonwealth nor the City are to appoint replacements for the five current members. Beginning June 1, 2006 the board is to consist of six members. Subsequent to June 30, 2001 the Authority and the City have pursued several legal actions contesting, among other things, the constitutionality of the new law. As of June 30, 2001 the Commonwealth has not included the Authority in its financial reporting entity.

Financial Reports

The Commonwealth sponsors the INVEST Program for Local Governments, an external investment pool, which is reported as an Investment Trust Fund. Audited financial statements for the INVEST Program and for component units are available by writing to the Deputy Secretary for Comptroller Operations, Room 207 Finance Building, Harrisburg, PA 17120.

Related Organizations

The Commonwealth created the Pennsylvania Municipal Retirement System (PMRS). The PG appoints all eleven governing board members but is not financially accountable, as there is no imposition of will, no financial benefit/burden, nor fiscal dependency associated with the PMRS. Local governments are the only participants in the PMRS. Participation is voluntary and there are variations among different municipal pension plans. Local participating governments are financially responsible only for their own plan obligations. The Commonwealth provides accounting services to the PMRS on a cost reimbursement basis.

The Commonwealth also created the Automotive Theft Prevention Authority (ATPA). The PG appoints all seven governing board members but is not financially accountable due to a lack of imposition of will and no financial benefit/burden. The ATPA is not fiscally dependent on the PG. The operation of the ATPA is funded by an annual assessment paid by companies providing automobile insurance in the Commonwealth. The PG processes cash receipts and disbursements for the ATPA.

Joint Venture

The Commonwealth, through its Office of Administration, created the Pennsylvania Employees Benefit Trust Fund (PEBTF) using a contractual agreement with various Commonwealth employee labor unions. The PEBTF establishes and provides Commonwealth employee health and welfare benefits. A governing board administers the PEBTF, one-half of whose members are each appointed by the Commonwealth and the various unions. Neither the Commonwealth nor the unions control the governing board or the PEBTF; administration is jointly and equally shared. The Commonwealth unilaterally pays for the cost of providing benefits. Contribution amounts are based on the terms contained in collective bargaining agreements. Employee unions are not financially responsible for making contributions. Neither the Commonwealth nor the employee unions have an equity interest or any ongoing financial interest in the PEBTF. Aside from its obligation to make periodic, established contributions, the Commonwealth is not responsible for any obligations of the PEBTF.

Excluded Organizations

School districts, local governments and counties are considered separate, stand-alone primary governments since they are governed by popularly elected officials. Secondary vocational-technical schools, intermediate units and community colleges were considered as potential component units, but have been excluded from the financial reporting entity. These schools may receive significant PG operating and/or capital subsidies, but the PG does not appoint a voting majority of governing board members, nor does the PG impose its will on these organizations. Although various Commonwealth laws affect or strongly influence these organizations, the PG does not control day-to-day operating decisions. These organizations are not fiscally dependent. The PG appoints a portion, but not a voting majority, of the governing boards at the following four universities (commonly referred to as state related): Pennsylvania State University, University of Pittsburgh, Lincoln University and Temple University. The PG provides significant subsidies; however, given the absence of PG appointment of a governing board voting majority and the lack of fiscal dependency, these universities are excluded from the financial reporting entity.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Fund Accounting: In governmental accounting, a fund is defined as an independent fiscal and accounting entity, with a self-balancing set of accounts, recording cash and/or other resources together with all related liabilities and equities which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with the fund's special regulations, restrictions or limitations. In the Commonwealth, funds are established by legislative enactment or in certain cases by administrative action.

The Commonwealth has established the following fund categories, fund types and account groups for the primary government:

Governmental Funds

General Fund—Accounts for all financial resources except those required to be accounted for in another fund. The General Fund is the Commonwealth's major operating fund.

Special Revenue Funds—Account for the proceeds of specific revenue sources (other than expendable trusts or major capital projects) that are legally restricted to expenditure for specified purposes.

Debt Service Funds—Account for the accumulation of resources, principally transfers from other funds, for the payment of general long-term debt principal and interest.

Capital Projects Funds—Account for financial resources to be used for the acquisition or construction of major capital facilities, including those provided to political subdivisions and other public organizations (other than those financed by Proprietary or Fiduciary Funds).

Proprietary Funds

Enterprise Funds—Account for operations that are financed and operated in a manner similar to private business enterprises. Costs of providing goods and services to the general public on a continuing basis, including depreciation, are financed or recovered primarily through user charges. The State Workmen's Insurance Fund is included for its fiscal year ended December 31, 2000 and the State Stores Fund for its fiscal year ended June 26, 2001.

Internal Service Funds—Account for the financing of goods or services provided by one department or agency to other departments or agencies of the Commonwealth, or to other governmental units, on a cost-reimbursement basis.

Fiduciary Funds

Trust and Agency Funds—Account for assets held by the Commonwealth in a trustee capacity or as an agent for individuals, private organizations, other governmental units and/or other funds. These include Expendable Trust Funds, a Pension Trust Fund, an Investment Trust Fund and Agency Funds. The State Employees' Retirement System, a Pension Trust Fund, the Deferred Compensation Fund, an Expendable Trust Fund, and the INVEST Program for Local Governments, an Investment Trust Fund, are included for their fiscal years ended December 31, 2000.

Account Groups

General Fixed Assets Account Group—Accounts for all general fixed assets acquired or constructed for use by the Commonwealth in the conduct of its activities, except those accounted for in Proprietary Funds, Pension Trust Funds, and College and University Funds.

General Long-Term Obligations Account Group—Accounts for all long-term obligations of the Commonwealth, except those accounted for in Proprietary Funds and College and University Funds.

Discretely presented component units include Governmental Funds, Proprietary Funds, Fiduciary Funds and College and University Funds that are legally separate from the Commonwealth but are considered part of the reporting entity. The Philadelphia Shipyard Development Corporation, the Pennsylvania Life and Health Insurance Guaranty Association and the Pennsylvania Property and Casualty Insurance Guaranty Association are included for their fiscal years ended December 31, 2000. The College and University Funds are reported as follows:

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

College and University Funds

Account for the operations of the Office of the Chancellor and the 14 state-owned universities, which comprise the State System of Higher Education, in accordance with the accounting guidance and reporting practices outlined in the American Institute of Certified Public Accountants Industry Audit Guide, *Audits of Colleges and Universities,* and other applicable guidance. Accordingly, the College and University Funds are an aggregation of the following funds:

Current Funds—Unrestricted and University Designated—Account for economic resources of the institution which are expendable for any purpose in performing the primary objectives of the universities and have not been designated by the governing body for any other purpose.

Current Funds—Restricted—Account for resources received from donors or other outside agencies that are restricted by them for specific operating purposes.

Loan Funds—Account for resources available for loans to students, faculty or staff.

Endowment and Similar Funds—Consist of endowment funds, term endowment funds and quasi-endowment funds.

Endowment Funds—Account for resources which the donor has stipulated, as a condition of the gift instrument, that the principal amount would be maintained inviolate and in perpetuity for investment. Investment earnings may be added to the principal or expended for restricted or unrestricted purposes, based on the donor's stipulation.

Term Endowment Funds—Account for resources, all or a part of the principal of which may be expended upon the passage of time or the occurrence of a particular event.

Quasi-Endowment Funds—Account for resources that the governing board of an institution, rather than an outside source, has determined will be retained and invested. Since this is an internal designation, the Board of Governors has the right to expend the principal of these funds at any time.

Plant Funds—Account for (a) resources available to acquire or repair institutional properties and to service debt incurred to acquire such properties and (b) the cost of fixed assets and the source from which the cost is funded.

Agency Funds—Account for resources held by the institution acting in the capacity of an agent for distribution to designated beneficiaries.

Component Units—Account for certain legally separate affiliated organizations for which the Board is financially accountable.

Measurement Focus and Basis of Accounting (GAAP): The general, special revenue, debt service, capital projects funds (Governmental Fund Types) and expendable trust funds are reported using the current financial resources measurement focus and modified accrual basis of accounting. Assets and liabilities of agency funds are reported using the modified accrual basis of accounting. Under this measurement focus, only current assets and current liabilities are normally included on the balance sheet. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets. Unreserved fund balance represents a measure of available spendable resources. Under the modified accrual basis of accounting, revenues of governmental and expendable trust funds are recognized in the year that they become both measurable and available (within 60 days of fiscal year-end) to pay current fiscal year liabilities. The Commonwealth accrues the following major revenue sources that are both measurable and available:

Sales and use taxes, cigarette taxes, corporation taxes, personal income taxes, liquid fuels taxes, liquor taxes, grant revenues, investment income, institutional revenues, lottery revenues and sales of goods and services.

Revenues from other sources are recognized when received. Expenditures are generally recognized in the fiscal year the goods or services are received and the related fund liability is incurred. Debt service expenditures for principal and interest on general long-term obligations are recognized when due unless resources have been provided for payment early in the subsequent fiscal year. Prepaid items and inventory purchases are reported as current fiscal year expenditures, rather than allocating cost to the fiscal year when the items are used. Expenditures for claims, judgments, compensated absences and employer pension contributions are reported as the amount accrued during the fiscal year that normally would be liquidated with expendable available financial resources. Budgetary encumbrances are not reported as expenditures.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The enterprise, internal service (Proprietary Fund Types) and pension trust funds are reported using the flow of economic resources measurement focus and the accrual basis of accounting. Under this measurement focus all assets and liabilities associated with the operations of these funds are included on the balance sheet. Fund equity (i.e., net total assets) consists of contributed capital and retained earnings. Under the accrual basis of accounting, revenues are recognized in the fiscal year earned and expenses are recognized in the fiscal year incurred. Under Governmental Accounting Standards Board's (GASB) Statement 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting," the Commonwealth has elected not to adopt the Financial Accounting Standards Board pronouncements issued after November 30, 1989.

The College and University Funds, a component unit, are reported using the "financial flow" (spending) measurement focus and the accrual basis of accounting. This treatment is in accordance with existing authoritative accounting and reporting principles applicable to colleges and universities.

Basis of Accounting (Budgetary): On the budgetary basis of accounting, certain estimated tax revenue accruals are recorded at fiscal year end for the General Fund and the Motor License Fund, a Special Revenue Fund. Accruals include sales and use taxes and personal income taxes, both applicable to the General Fund, and liquid fuels taxes applicable to the Motor License Fund, which are estimated to be owed to the Commonwealth but not collected at fiscal year end. Also, estimated encumbrances are established for all funds at fiscal year end to pay certain direct expenditures for salaries, wages, travel, and utility costs payable against current year appropriation authority but expended in the subsequent year. Over estimates of prior year encumbrances are lapsed in the subsequent year and under estimates are charged to subsequent year appropriation authority.

Budgeted revenues in the Combined Statement of Revenues, Expenditures and Changes in Unreserved/Undesignated Fund Balances—Budget and Actual (Budgetary Basis) represent official estimates while expenditures represent amounts originally adopted or legally amended. Actual amounts are presented on the budgetary basis (see Note T). Because the budgetary basis of accounting differs from GAAP, a reconciliation of the differences between budgetary basis and the GAAP basis of reporting is presented in Note M.

Budget Adoption: The Commonwealth's Constitution requires that the Governor submit a budget annually to be adopted by the General Assembly for the ensuing fiscal year. The General Assembly may add, change or delete any items in the budget proposed by the Governor, but the Governor retains veto power over the individual appropriations passed by the legislature. The Governor may also reduce individual appropriations, but may not increase them. A gubernatorial veto can be overridden only by a two-thirds majority of each House of the General Assembly.

The Commonwealth's budgets are prepared essentially on a cash basis. Total appropriations enacted by the General Assembly may not exceed the ensuing fiscal year's estimated revenues, as developed by the Governor, plus (less) the unappropriated fund balance (deficit) of the preceding fiscal year, except for constitutionally authorized debt service payments.

Budgets are legally adopted each fiscal year for the following funds:

- General Fund
- Special Revenue Funds:
  - State Lottery
  - Motor License
  - Workmen's Compensation Administration
  - Banking Department
  - Milk Marketing

Budgetary Expenditure Control: Legally adopted budgets include numerous expenditure appropriations which are the legal level of expenditure control; budgetary expenditure control is exercised at the appropriation level (legislative spending authority level). Encumbrances and expenditures cannot exceed amounts appropriated plus actual augmentations (certain revenues credited to specific appropriations). Appropriation transfers between or within departments and any supplemental

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

appropriations require both executive and legislative branch approval. Unencumbered and unexpended appropriations lapse at fiscal year end and become available for appropriation in the subsequent year.

The legally adopted budget for the General Fund includes $68.2 million in state supplemental appropriations and $434.2 in Federal supplemental appropriations approved during the fiscal year ended June 30, 2001. Not all Special Revenue Funds are controlled by legally adopted budgets. Controls over spending in such Special Revenue Funds are maintained by use of spending limits (executive authorizations) established by the Governor. The Commonwealth also makes appropriations to authorize expenditures for various capital projects. Appropriations for capital projects normally remain in effect until the completion of each project unless modified or rescinded. Note T provides more information on budgetary compliance.

Pooled Cash: In accordance with the Fiscal Code, cash balances of most Commonwealth funds are pooled by the Treasury Department. Cash balances are segregated by fund, but accounted for centrally for receipt and disbursement purposes. The law requires that collateral be pledged by banks and other financial institutions to guarantee the Commonwealth's cash on deposit.

Cash Equivalents: No investments which could be defined as cash equivalents have been treated as such on the Statement of Cash Flows; therefore, only net changes in cash are displayed.

Investment Pools: The Fiscal Code provides the Treasury Department with investment control over most Commonwealth funds. The Treasury Department uses a variety of sophisticated internal investment pools to ensure safety and maximize efficiency, liquidity and yield for Commonwealth funds. All participating funds report amounts invested in such pools as temporary and/or long-term investments; the pools themselves are not financially reported. The Treasury Department maintains an external investment pool, the INVEST Program for Local Governments, which separately issues audited financial statements, and is reported as an Investment Trust Fund. Financial statements for the INVEST Program include a statement of net assets and a statement of changes in net assets prepared using the economic resources measurement focus and the accrual basis of accounting.

Temporary Investments: The Treasury Department manages the Short Term Investment Pool (STIP); practically all individual funds which are part of primary government are participants in the STIP. The Treasury Department accounts for each participating fund's equity (considered "shares") in the STIP on a daily basis. "Share" balances of participating funds fluctuate considerably during the fiscal year, based on the timing of cash receipts and disbursements in the participating fund, and are reported as temporary investments. The STIP is considered an internal investment pool. Periodic STIP earnings are allocated to specific participating funds based on the weighted daily average of "share" balances.

Several individual funds may directly own investments in specific securities. Such investments which are expected to be realized in cash within twelve months or less are reported as temporary investments. Temporary investments are reported at fair value (typically using published market prices) except for nonparticipating interest-bearing contracts, which are reported at cost.

Long-Term Investments: Investments expected to be realized in cash after twelve months are reported as long-term investments. Long-term investments are reported at fair value, except for certain nonparticipating interest-bearing contracts, which are reported at cost. Fair values are based on published market prices, quotations from national securities exchanges and securities pricing services, or by the respective fund managers for securities which are not actively traded. Other investments are valued based on appraisals or the present value of projected future income.

Investment Income: Investment income includes interest, dividends, realized gains and losses and the change in the fair value of investments, if any, during the fiscal year.

Due From Other Governments: This receivable represents amounts due primarily from the Federal Government for various department programs.

Grants: Federal grants and assistance awards made on the basis of entitlement periods are recorded as intergovernmental revenues when entitlement occurs. Federal reimbursement-type grants are recorded as revenues when the related expenditures or expenses are incurred.

Inventories: Inventories of goods, materials and supplies are maintained by the Proprietary and College and University Funds. These inventories are valued at the lower of cost or market (first-in, first-out) for Proprietary and weighted average for College and University Funds. In the governmental fund types, inventories are accounted for on the purchases method.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fixed Assets and Depreciation: General fixed assets are reported at cost or estimated historical cost. Donated general fixed assets are reported at fair market value at the time of donation. All land is reported; for other types of general fixed assets, the following minimum dollar reporting thresholds are used:

Land improvements, buildings and building improvements................	$ 25,000
Vehicles, machinery and equipment..	$ 20,000

Commonwealth agencies maintain inventories of all their respective fixed assets, including assets which are not reported in the GPFS. Public domain general fixed assets (including highways, bridges, highway land and rights-of-way) are not capitalized. No depreciation is reported for general fixed assets.

Land and buildings used by the State System of Higher Education (SSHE), which were acquired or constructed before July 1, 1983, the inception date for the SSHE, are reported in the Commonwealth's General Fixed Assets Account Group. All general fixed assets acquired or constructed by the SSHE subsequent to June 30, 1983 without the use of university funds or incurrence of the SSHE debt are also reported in the Commonwealth's General Fixed Assets Account Group. This accounting treatment is used to conform to the enabling legislation for the SSHE, which includes the vesting of title for the SSHE property. Fixed assets reported by the SSHE are stated at cost. Depreciation of SSHE fixed assets is recognized over the estimated useful life of the assets.

Fixed assets related to Proprietary and Pension Trust Funds are reported in those funds at cost or estimated historical cost. Depreciation is reported on a straight-line basis over the fixed assets' estimated useful lives. The following lives are used:

Buildings...	10-50 years
Improvements other than buildings	5-50 years
Furniture, machinery and equipment..	3-25 years

Self-Insurance: The Commonwealth is uninsured for property losses and self-insured for annuitant medical/hospital benefits, employee disability and tort claims. Note O provides disclosures for self-insurance liabilities.

Compensated Absences: Employees earn annual leave based on 2 percent to 10 percent of regular hours paid. A maximum of 45 days may be carried forward at the end of each calendar year. Employees are paid for accumulated annual leave upon termination or retirement.

Employees earn sick leave based on 5 percent of regular hours paid. A maximum of 300 days may be carried forward at the end of each calendar year. Retiring employees that meet service, age or disability requirements are paid in accordance with the following schedule:

Days Available at Retirement	Percentage Payment	Maximum Days Paid
0-100	30%	30
101-200	40%	80
201-300	50%	150
over 300 (in last year of employment)	100% of days over 300	13

Accumulated annual and sick leave liability payable in subsequent fiscal years from Governmental Funds and Expendable Trust Funds are reported in the General Long-Term Obligations Account Group. Proprietary, Pension Trust, and College and University Funds accrue annual and sick leave in the fiscal year earned.

Pension Costs: The Commonwealth's policy is to fund pension costs incurred and to amortize prior service costs over varying periods not exceeding 20 years.

Encumbrances: Encumbrance accounting, under which purchase orders, contracts and other commitments for expenditures are recorded as a reserve of the applicable appropriation, is employed as an extension of formal budgetary integration in the Commonwealth's accounting system. Encumbrances outstanding at fiscal year end are reported as reservations of fund balance for subsequent year expenditures.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Intergovernmental Revenues: These amounts represent revenues received principally from the Federal Government.

Tax Stabilization Reserve Fund: This fund, commonly referred to as the "Rainy Day Fund," was created in July of 1985 by Act 32 to provide financial assistance to minimize future revenue shortfalls and deficits, and promote greater continuity and predictability in the funding of vital government services. The tax stabilization reserve balance is not to exceed 6 percent of the estimated revenues of the General Fund. Revenue is provided through an executive authorization appropriated by the General Assembly for transfer to this Fund. Act 74 of 2001 provides that, for the fiscal year beginning July 1, 2001 and any fiscal year thereafter during which there is a surplus of operating funds in the General Fund, as certified by the Budget Secretary, ten percent of such surplus shall be deposited into this Fund. In addition, the proceeds received from the disposition of certain assets of the Commonwealth are also to be deposited into this Fund. During the fiscal year ended June 30, 2001 there was no surplus transfer to this Fund. Whenever the Governor determines a need to transfer moneys from this Fund, a request for an appropriation is made to the General Assembly. An appropriation from the Fund requires approval by two-thirds of the members of the General Assembly. For GAAP reporting purposes, this Fund is reported as a fund balance reservation in the General Fund.

Tobacco Master Settlement Agreement: In 1997, the Pennsylvania Attorney General began litigation in Commonwealth Court against several defendant tobacco product manufacturers to recover certain amounts the Commonwealth allegedly expended to provide health care to numerous tobacco product users. In 1998, along with many other states, the Commonwealth joined in a settlement which provided, among other things, that the Commonwealth ceases its litigation against manufacturers. As part of the settlement, certain manufacturers agreed to remit periodic payments to the Commonwealth and other states (amounting to over $200 billion, according to some estimates) until 2025. Amounts remitted are calculated based on a variety of specific settlement provisions; actual tobacco product sales are one key factor used in determining periodic payment amounts. During the fiscal year ended June 30, 2001 the Commonwealth received $345 million from the settlement; this amount is reported as revenue in the General Fund. Through June 30, 2001 the Commonwealth has received $809.6 million from tobacco manufacturers. Future payments will be reported as revenue when they are received; no receivable for such payments is reported. At June 30, 2001 $851.4 million is reported as a General Fund unreserved fund balance designation; this amount includes accumulated investment income of $41.8 million. Subsequent to June 30, 2001 amounts related to the settlement agreement were transferred to the new Tobacco Settlement Fund.

Interfund Transactions: The Commonwealth has the following types of transactions among funds:

> *Statutory Transfers (Operating Transfers)*—Legally required transfers that are reported when incurred as "Operating transfers in" by the recipient fund and as "Operating transfers out" by the disbursing fund. Legally required transfers between primary government and component unit organizations are reported when incurred as "Operating transfers from component unit" by the recipient organization and "Operating transfers to primary government" or "Operating transfers to component unit" by the disbursing fund.
>
> *Transfers of Expenditures (Reimbursements)*—Reimbursement of expenditures made by one fund for another that are recorded as expenditures in the reimbursing fund and as a reduction of expenditures in the reimbursed fund.
>
> *Residual Equity Transfers*—Nonroutine or nonrecurring transfers between funds that are reported as additions to or deductions from the fund equity balance.
>
> *Interfund Payments (Quasi-external Transactions)*—Charges or collections for services rendered by one fund to another that are recorded as revenues of the recipient fund and expenditures or expenses of the disbursing fund.

The composition of the Commonwealth's interfund receivables and payables at June 30, 2001 is presented in Note H.

New Accounting Pronouncement: In June 1999 the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments." The Commonwealth must adopt the new standard effective July 1, 2001 and issue financial statements in accordance with GASB 34 for the fiscal year ending June 30, 2002. Among other things, the new standard requires issuing "entity wide" financial statements, which are prepared using the economic resources measurement focus and the accrual basis of accounting, to portray the Commonwealth "as a whole." The new requirement represents a significant change from the current financial resources

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

measurement focus and modified accrual basis of accounting for governmental fund types, which are largely being retained for reporting at the "fund perspective."

During March 2000 the Commonwealth began a number of processes as part of complying with the new standard. New financial information, including highway and bridge infrastructure (and related depreciation), is being measured and summarized along with certain tax and other receivables which will be reported within entity wide statements. Following the issuance of the June 30, 2001 Comprehensive Annual Financial Report, governmental fund information will be adjusted and converted to provide a pro forma Statement of Net Assets as of June 30, 2001. Prior to the point of conversion and, subsequently, production of entity wide statements next year, it is not practical to quantify the various financial reporting changes resulting from implementation of GASB 34.

Total - Memorandum Only: The "Total (Memorandum Only)" columns represent an aggregation of the combined financial statement amounts of the fund types and account groups and are presented only for analytical purposes. These amounts are not comparable to a consolidation and do not represent the total resources available to or used by the Commonwealth. Interfund eliminations have not been made in the aggregation of the totals.

NOTE C - FUND EQUITY

Deficits: The Workmen's Compensation Supersedeas Fund and the State Racing Fund, Special Revenue Funds, reported fund balance deficits of $10,715 and $970 (amounts in thousands), respectively, at June 30, 2001. The Disaster Relief Redemption Fund, the Local Criminal Justice Sinking Fund and the Tax Note Sinking Fund, Debt Service Funds, reported unreserved/undesignated deficits of $6, $1 and $1 thousand, respectively, at June 30, 2001. None of these funds reported fund balance designated for debt service or any other designations and they are the only debt service funds that reported deficits.

The Capital Facilities Fund, a Capital Projects Fund, reported a deficit unreserved/undesignated fund balance of $668,091 at June 30, 2001. In total, the Capital Facilities Fund reported a fund balance of $71,653 at June 30, 2001. Total Capital Projects Funds reported reservations for encumbrances of $779,927, other reservations of $2,311, designations for Capital Projects of $79,867 and a deficit unreserved/undesignated fund balance of $668,091, for a total combined fund balance of $194,014 (amounts in thousands) at June 30, 2001.

The Minority Business Development Fund, an Enterprise Fund, reported deficit retained earnings of $30,238 (amount in thousands) at June 30, 2001.

The State System of Higher Education, College and University Funds, reported a current funds unrestricted fund balance deficit of $278,346 (amount in thousands) at June 30, 2001.

Reservations and Designations: Reservations represent portions of fund balances that are legally segregated for a specific future use or are not appropriable for expenditure.

The amount reserved for advances in the General Fund, $52.8 million, is applicable to advances as follows: $38 million to the Purchasing Fund, an Internal Service Fund, $2.3 million to the State Workmen's Insurance Fund, an Enterprise Fund, $2.2 million to the Motor License Fund and $10.3 million to the Pharmaceutical Assistance Fund, both Special Revenue Funds.

The amount reserved for advances in the Hazardous Sites Cleanup Fund, a Special Revenue Fund, is applicable to a $3 million advance to the Small Business First Fund, an Enterprise Fund.

The $308,125 reported as "reserved for other" in the General Fund at June 30, 2001 pertains to the following (amounts in thousands):

Continuing programs	$ 130,303
Restricted revenue	155,070
Judicial carryover appropriations	9,249
Receivables	13,503
Total General Fund	$ 308,125

The $35,739 reported as "reserved for other" in the Special Revenue Funds at June 30, 2001 pertains to the following (amounts in thousands):

Land reclamation	$ 25,450
Pharmaceutical assistance programs	5,763
Recreation programs	1,524
Recycling programs	366
Other programs	2,636
Total Special Revenue Funds	$ 35,739

The $2.3 million reported as "reserved for other" in the Capital Facilities Fund, a Capital Projects Fund, pertains to General State Authority maintenance activities. The $2.7 million reported as "reserved for other" in the Pennsylvania Higher Educational Facilities Authority, a discretely presented governmental component unit, pertains to trust indentures. The $196.6 million reported as "reserved for other" by the State System of Higher Education, a discretely presented component unit, at June 30, 2001 pertains to approved academic projects that will begin in subsequent fiscal periods.

NOTE C - FUND EQUITY (continued)

Reserved retained earnings reported for Enterprise Funds are provided principally for capital improvements for the Rehabilitation Center Fund in the amount of $3,421 and program purposes for the Small Business First Fund and the Coal and Clay Mine Subsidence Fund in the amount of $4,063. Reserved retained earnings reported for discretely presented component unit proprietary funds are provided principally for the retirement of revenue bonds relating to the Pennsylvania Turnpike Commission in the amount of $1,205,762, student loans relating to the Pennsylvania Higher Education Assistance Agency of $109,180, and housing programs relating to the Pennsylvania Housing Finance Agency of $113,794 (amounts in thousands).

Designations of unreserved fund balances reflect managerial plans for the future use of financial resources. At June 30, 2001 the Commonwealth has included the following amounts as "Designated—Other" for the General Fund and Special Revenue Funds (amounts in thousands):

General Fund:	
Tobacco Master Settlement Agreement	$ 851,362
Group medical and life insurance	72,788
Job creation tax credits	53,503
Judicial computer system	43,705
Agency construction projects	41,261
Other	16,428
Total General Fund	$ 1,079,047
Special Revenue Fund:	
State Lottery Fund – for litigated prizes	$ 264

The Insurance Fraud Prevention Authority, a discretely presented governmental fund component unit, reported $3,843 thousand as "Designated—Other" for future program grants.

Contributed Capital: During the fiscal year ended June 30, 2001, there is a net increase in contributed capital for proprietary fund types – primary government and discretely presented component units of $76,998. The increases and decrease in contributed capital by fund type are as follows (amounts in thousands):

	Primary Government		**Discretely Presented**
	Enterprise	**Internal Service**	**Proprietary Fund Component Units**
July 1, 2000 balances	$ 288,671	$ 9,187	$ 1,808,584
Contributing sources/(uses):			
Primary government	19,000	-	41,000
Federal government	5,102	-	11,920
Other decrease	(24)	-	-
June 30, 2001 balances	$ 312,749	$ 9,187	$ 1,861,504

NOTE D - DEPOSITS AND INVESTMENTS

Authority for Deposits and Investments:

The deposit and investment policies of the Treasury Department are governed by Sections 301, 301.1 and 505 of the Pennsylvania Fiscal Code (Act of 1929, P.L. 343) and Section 321.1 of the Pennsylvania Administrative Code (Act of 1929, P.L. 177, No. 175). Treasury deposits must be held in insured depositories approved by the Board of Finance and Revenue and must be fully collateralized. The power of the Treasury Department to invest moneys is subject, however, to the exercise of that degree of judgment and care under the circumstances then prevailing which persons of prudence, discretion and intelligence who are familiar with such matters exercise in the management of their own affairs not in regard to speculation but in regard to the permanent disposition of the funds considering the probable income to be derived therefrom as well as the probable safety of their capital. The power to invest such moneys shall include the power to invest in equity securities and mutual funds.

The Treasury Department manages four distinct investment programs, the Short-Term Investment Pool (STIP), General Fund Program, Motor License Fund Program and Tax Stabilization Fund Program. As of June 30, 2001 approximately 80 percent of the temporary investments of practically all Commonwealth Funds are invested on a short term basis in the STIP. The objectives of the STIP are safety, liquidity and yield and all investments are made in accordance with the preceding statutory authority. Throughout the fiscal year, the STIP participates in reverse repurchase agreements; Treasury Department policies require that the maturity date of the reverse repurchase agreements and the maturity date of the regular repurchase agreement purchased with the proceeds occur on the same date. The General Fund Program, Motor License Program and Tax Stabilization Fund Program represent funds accumulated beyond the ordinary needs of these funds. These three Programs invest in equity and intermediate-term securities. Also, the Treasury Department manages the Tuition Assistance Program and the INVEST Program for Local Governments.

Several Commonwealth departments have statutory authority to make their own temporary and long-term investments for the following funds: State Workmen's Insurance, an Enterprise Fund, Deferred Compensation and Workmen's Compensation Security Trust, Expendable Trust Funds, and Underground Storage Tank Indemnification and Statutory Liquidator, Agency Funds.

The deposit and investment policies of certain component units are established by authority other than the Fiscal Code. Enabling statutes generally provide deposit and investment authority for component units. Further, specific bond and trust indentures, as well as formal governing board resolutions, provide deposit and investment requirements. Allowable investments of component units do not significantly differ from those investments of the Treasury Department, except that, in accordance with applicable statutory authority, the State Employees' Retirement System and the Public School Employees' Retirement System, Pension Trust Funds, utilize financial instruments with off-balance sheet risk. Specific disclosures about Pension Trust Fund investments are included in this Note.

NOTE D – DEPOSITS AND INVESTMENTS (continued)

Deposits:

The Treasury Department controls the receipt and disbursement of amounts owned by agencies included in the primary government. Certain discretely presented component units, meanwhile, control receipt and disbursement of their own funds, typically through a trustee. The following summaries present the amount of primary government and discretely presented component unit (Commonwealth) deposits which are fully insured or collateralized with securities held by the Commonwealth or its agent in the Commonwealth's name (Category 1), those deposits which are collateralized with securities held by the pledging financial institution's trust department or agent in the Commonwealth's name (Category 2) and those deposits which are not collateralized or are collateralized by the pledging financial institution or the pledging institution's trust department or agent, but not in the Commonwealth's name (Category 3) at June 30, 2001 (amounts in thousands).

Primary Government

	Category 1	Category 2	Category 3	Total Bank Balance	Carrying Amount
Cash	$ 99,972	$ -	$8,161	$ $108,133	$ 219,784
Cash with fiscal agents	2,905,062	1,946	524	2,907,532	2,905,841
Certificates of deposit and related items	231,583	272	8,095	239,950	239,950

The above-listed $239,950 in certificates of deposit and related items are reported as part of primary government temporary investments at June 30, 2001. To provide increased income while maintaining safety and liquidity, the Treasury Department routinely enters into overnight repurchase agreements using "float" on outstanding checks. At June 30, 2001 the Treasury Department used $409 million of available cash for overnight repurchase agreements. These investments are registered in the Commonwealth's name and are not reported in the financial statements.

Discretely Presented Component Units

			Total	Carrying	
	Category 1	Category 2	Category 3	Bank Balance	Amount
Cash	$ 96,084	$ -	$ 60,255	$ 156,339	$ 127,805
Cash with fiscal agents	100	-	330,431	330,531	330,496

NOTE D - DEPOSITS AND INVESTMENTS (continued)

Investments:

The Treasury Department, other agencies in the primary government and discretely presented component units (Commonwealth) categorize investments according to the level of credit risk assumed by the Commonwealth. Category 1 includes investments that are insured, registered or held by the Commonwealth or the Commonwealth's agent in the Commonwealth's name. Category 2 includes uninsured and unregistered investments held by the counterparty's trust department or agent in the Commonwealth's name. Category 3 includes uninsured and unregistered investments held by the counterparty, or by its trust department or its agent, but not in the Commonwealth's name. Certain investments have not been categorized because securities are not used as evidence of the investment. These uncategorized investments include ownership interests in mutual funds, mortgage loans, real estate and venture capital. The following summaries identify the level of credit risk assumed by the Commonwealth and the related carrying amount of Commonwealth investments at June 30, 2001 (amounts in thousands).

Primary Government

All primary government investments susceptible to credit risk are in Category 1.

Commercial paper	$ 540,097
Common and preferred stocks	8,788,970
Corporate bonds and notes	3,477,479
Certificates of deposit-negotiable	87
International fixed income	57,737
International equities	52,061
Repurchase agreements	5,933,921
State and municipal obligations	648,597
U.S. Treasury obligations	2,949,061
U.S. Government agency obligations	2,327,820
Total categorized investments	24,775,830
Add investments not susceptible to credit risk categorization:	
Investments held by Tuition Payment Fund at June 30, 2001	
Securities lending collateral	16,082
Treasury Department global pool	7,298
Investments owned by the Deferred Compensation Fund at December 31, 2000	
Mutual funds	928,296
Securities lending collateral	14,605
Investments owned by the State Employes' Retirement System (SERS) at December 31, 2000:	
Mortgage loans	80,079
Mutual funds	9,460,886
Real estate	2,627,710
Securities lending collateral	940,558
Venture capital	2,954,833
Securities lent by SERS at December 31, 2000:	
U.S. Treasury securities	475,882
Corporate bonds and notes	273,128
Common and preferred stocks	256,381
Investments owned by the Statutory Liquidator Fund at June 30, 2001:	
Treasury Department global pool	73,471
Loans	12,500
Annuities	2,190
Subsidiaries	67
Mortgage loans	238
Partnership interests	18
Investments owned by the Underground Storage Tank Indemnification Fund at June 30, 2001:	
Securities lending collateral	35,548
Treasury Department global pool	4,642
Securities lending collateral held by the State Lottery Fund at June 30, 2001	2,029
Subtotal forwarded to next page	$ 42,942,271

NOTE D – DEPOSITS AND INVESTMENTS (continued)

Subtotal forwarded from prior page	$ 42,942,271
Investments held by the Workmen's Compensation Security Trust Fund at June 30, 2001:	
Securities lending collateral	80,626
Treasury Department global pool	57,249
Private placements, fixed income and equities	6,047
Investments held by Custodial Accounts:	
Corporate Bonds and Notes	1,604
Money market funds..	3,936
Various miscellaneous	20
Securities lending collateral held by the State Workmen's Insurance Fund at December 31, 2000	355,596
Investments held by the Tax Stabilization Reserve Fund at June 30, 2001:	
Securities lending collateral	151,234
Private placements, fixed income and equities	3,635
Investments held by the General Fund at June 30, 2001:	
Securities lending collateral	130,272
Private placements, fixed income and equities	5,382
Investments held by the Motor License Fund at June 30, 2001:	
Securities lending collateral	47,779
Private placements, fixed income and equities	2,198
Total	$43,787,849
Certificates of deposit and related items	239,950
Amount financially reported by discretely presented component units in Pennsylvania Treasury short-term investment pool at June 30, 2001	(600,699)
Total primary government temporary and long-term investments	$ 43,427,100

The above-listed $239,950 in certificates of deposit and related items are financially reported as part of temporary investments at June 30, 2001, but are treated as deposits for a determination of the level of credit risk associated with them.

The State Employees' Retirement System, a Pension Trust Fund, owns approximately 79 percent of the common and preferred stocks, 85 percent of the corporate bonds and notes and 64 percent of the U.S. Treasury obligations reported in the above summary. The Treasury Short-Term Investment Pool owns 85 percent of the repurchase agreements and 62 percent of the U.S. Government agency obligations in the above summary.

Subsequent to June 30, 2001 an independent auditor issued an audit report for the Treasury Department's INVEST Program for Local Governments (INVEST) for the year ended December 31, 1999. The INVEST financial statements disclosed an auditor conclusion that state laws governing some INVEST participants did not authorize investment of those participants' funds in a certain repurchase agreement, amounting to $51.3 million at December 31, 1999. The repurchase agreement matured January 4, 2000 and both principal and interest earned were returned in the INVEST Program.

Applicable laws allow investments which are backed by the full faith and credit of the U.S. Government or investments in U.S. Government Agency securities if they are considered short term. The auditor concluded that the U.S. Government Agency securities used to collateralize the INVEST repurchase agreement were not backed by the full faith and credit of the U.S. Government and were not considered short term. Treasury Department management contends that since the repurchase agreement had a four-day maturity, the repurchase agreement was a permissible short term investment.

During the year ended December 31, 2000 INVEST owned additional similar repurchase agreements; at December 31, 2000 INVEST owned $146 million of similar repurchase agreements. The Treasury Department is seeking statutory amendments to applicable laws to clarify this matter.

NOTE D – DEPOSITS AND INVESTMENTS (continued)

Financial Instruments With Off-Balance Sheet Risk

The State Employees' Retirement System (SERS) enters into foreign exchange contracts, such as forward and spot contracts, to hedge foreign currency exposure. The SERS is not a dealer but an end-user of these instruments. The contracts are used primarily to enhance performance and reduce the volatility of the portfolio. The SERS is exposed to credit risk in the event of nonperformance by counterparties to financial instruments. The SERS generally enters into transactions with institutions regarded as meeting high standards of credit worthiness. Legal risk is mitigated though careful selection of brokers and an extensive process of review of all documentation. The SERS is exposed to market risk—the risk that future changes in market conditions may make an instrument less valuable. Exposure to market risk is managed within risk limits set by management by buying or selling instruments or entering into offsetting positions.

Foreign exchange contracts involve an agreement to exchange the currency of one country for the currency of another country at an agreed upon price and settlement date. At December 31, 2000, the SERS had contracts maturing through December 31, 2001, to purchase or sell foreign currency. The $8,140,454 of total foreign currency contracts outstanding at December 31, 2000 consist of "buy" contracts, which represent the U.S. dollar equivalents of commitments to purchase foreign currency of $4,807,617, and "sell" contracts, which represent U.S. dollar equivalents of commitments to sell foreign currency of $3,332,837 (amounts in thousands). Net unrealized losses on foreign currency contracts were approximately $33.8 million at December 31, 2000.

Discretely Presented Component Units

	Category 1	Category 2	Category 3	Total
Asset backed securities	$ -	$ 59,616	$ -	$ 59,616
Commercial paper	-	117,136	46,846	163,982
Common and preferred stocks	20,548,467	716	16	20,549,199
Corporate bonds and notes	5,390,486	88,107	92,804	5,571,397
International equities	7,131,838	-	-	7,131,838
International fixed income	927,537	-	-	927,537
Mortgage-backed securities	6,096,578	78,899	-	6,175,477
Repurchase agreements	105,903	293,341	233,590	632,834
State and municipal obligations	-	19,235	9,000	28,235
U.S. Treasury obligations	-	440,529	57,114	497,643
U.S. Government agency obligations	1,009,648	299,225	176,982	1,485,855
Various short-term investments	853,216	5,811	-	859,027
Total categorized investments	$ 42,063,673	$1,402,615	$ 616,352	$ 44,082,640

NOTE D - DEPOSITS AND INVESTMENTS (continued)

Investments not susceptible to credit risk categorization:

Investments owned by the State Public School Building Authority at June 30, 2001:	
Guaranteed investment contracts	9,500
Money market funds	21,001
Pennsylvania Treasury INVEST Program	63,768
Investments owned by the Higher Educational Facilities Authority at June 30, 2001:	
Guaranteed investment contracts	93,851
Investments owned by the Ben Franklin/IRC Partnership in Pennsylvania Treasury short-term investment pool at June 30, 2001	6,749
Investments owned by the Insurance Fraud Prevention Authority in Pennsylvania Treasury short-term investment pool at June 30, 2001	3,921
Investments owned by the Philadelphia Shipyard Development Corporation at December 31, 2000:	
Money market funds	19,044
Investments owned by the Pennsylvania Industrial Development Authority in Pennsylvania Treasury short-term investment pool at June 30, 2001	198
Investments owned by the Pennsylvania Housing Finance Agency at June 30, 2001:	
Investment agreements	8,690
Mutual funds	299,965
Investments owned by the Pennsylvania Higher Education Assistance Agency at June 30, 2001:	
Guaranteed investment contracts	15,219
Investment agreements	87,991
Money market funds	187,258
Pennsylvania short-term investment pool	232,965
Investments owned by the Pennsylvania Infrastructure Investment Authority in Pennsylvania Treasury short-term investment pool at June 30, 2001:	356,866
Investments owned by the Pennsylvania Turnpike Commission at May 31, 2001:	
Mutual funds	16,767
Guaranteed investment contracts	168,170
Investments owned by the Public School Employees' Retirement System at June 30, 2001:	
Farmland investments	60,384
Invested with Pennsylvania Treasury Department	1,020,859
Mutual funds	1,189,897
Real estate	1,585,812
Securities lending collateral	2,519,806
Securities lending investments	2,424,942
Venture capital	2,224,648
Investments owned by the Pennsylvania Life and Health Insurance Guaranty Association at December 31, 2000:	
Mutual funds	1,234
Investments owned by the State System of Higher Education at June 30, 2001:	
Mutual funds and other investments	35,755
Total temporary and long-term investments	$56,737,900

The total amount reported by discretely presented component units in the Pennsylvania Treasury short-term investment pool (STIP) is $600,699 (in thousands) at June 30, 2001; STIP disclosures are included as part of Primary Government investment disclosures.

NOTE D - DEPOSITS AND INVESTMENTS (continued)

The Public School Employees' Retirement System (PSERS), a Pension Trust Fund, owns approximately 100 percent of the common and preferred stocks, 97 percent of the corporate bonds and notes, 100 percent of the international equities, 100 percent of the international fixed income, 99 percent of the mortgage-backed securities, and 65 percent of the U.S. government agency obligations reported in the above summary. There were no violations of statutory authority or contractual provisions for investments during the fiscal year ended June 30, 2001.

Financial Instruments with Off-Balance Sheet Risk

The Public School Employees' Retirement System (PSERS) enters into a variety of financial contracts, which include options and futures. The PSERS also enters into foreign exchange positions, such as forward and spot contracts to hedge foreign currency exposure; collateralized mortgage obligations (CMOs); other forward contracts; and U.S. Treasury STRIPS. The PSERS is not a dealer but an end-user of these instruments. The contracts are used primarily to enhance performance and reduce the volatility of the portfolio. Short-term investments and cash equal to or greater than performance obligations under these contracts are maintained at all times. The PSERS is exposed to credit risk in the event of nonperformance by counterparties to financial instruments. As the PSERS generally enters into transactions only with high-quality institutions, no losses associated with counterparty nonperformance on derivative financial instruments have been incurred. Legal risk is mitigated through careful selection of executing brokers and review of all documentation. The PSERS is exposed to market risk, the risk that future changes in market conditions may make an instrument less valuable. Exposure to market risk is managed in accordance with risk limits set by senior management, by buying or selling instruments or entering into offsetting positions.

The contract or notional amounts of derivatives indicate the extent of the PSERS's involvement in the various types and uses of derivative financial instruments and do not measure the PSERS's exposure to credit or market risks and do not necessarily represent amounts exchanged by the parties. The amounts exchanged are determined by reference to the notional amounts and the other terms of the derivatives.

The following table summarizes the aggregate notional or contractual amounts for the PSERS's derivative financial instruments at June 30, 2001 (amounts in thousands):

Futures contracts long and short	$ 10,725,171
Foreign exchange forward and spot contracts, gross	3,444,850
Options—calls purchased	55,528
Options—calls sold	10,483
Options—puts sold	9,840

Futures contracts are contracts in which the buyer agrees to purchase and the seller agrees to make delivery of a specific financial instrument at a predetermined date and price. Gains and losses on futures contracts are settled daily based on a notional (underlying) principal value and do not involve an actual transfer of the specific instrument. Futures contracts are standardized and are traded on exchanges. The exchange assumes the risk that a counterparty will not pay and generally requires margin payments to minimize such risk. Initial margin requirements on futures contracts are provided by investment securities pledged as collateral or by cash held in segregated accounts by the PSERS custodial bank. Although the PSERS has the right to access individual pledged securities, it must maintain the amount pledged by substituting other securities for those accessed. The value of securities pledged at June 30, 2001 and the amount of cash held in broker margin accounts represent a restriction on the amount of assets available as of year end to use for other purposes.

Option contracts provide the option purchaser with the right, but not the obligation, to buy or sell the underlying security at a set price during a period or at a specified date. The option writer is obligated to buy or sell the underlying security if the option purchaser chooses to exercise. The PSERS generally uses exchange listed index, currency, stock and futures options. The PSERS has authorized an investment manager to write covered call stock index option spreads up to a notional amount of $500 million.

Foreign exchange contracts involve an agreement to exchange the currency of one country for the currency of another country at an agreed-upon price and settlement date. The contracts reported above primarily include forwards. The $3,444.9 million of foreign currency contracts outstanding at June 30, 2001 consist of "buy" contracts of $2,008.3 million, which represent the U.S. dollar equivalent of commitments to purchase foreign currency, and "sell" contracts of $1,436.6 million, which represent U.S. dollar equivalents of commitments to sell foreign currencies.

NOTE D - DEPOSITS AND INVESTMENTS (continued)

The PSERS also invests in mortgage-backed securities (MBS) such as CMOs and MBS forwards to maximize yields. These securities are sensitive to prepayments by mortgagees, which may result from a drop in interest rates. The MBS forwards are subject to credit risk in the event of nonperformance by counterparties. The fair value of CMOs at June 30, 2001 is $1,903.1 million.

Securities Lending Program

The Treasury Department provides a securities lending program authorized by the Fiscal Code, which provides the Treasury Department with numerous custodial responsibilities; the securities program is an integral part of the custodial function. A contract between the Treasury Department and its custodian, acting as lending agent, provides that the custodian lends securities owned by the participants to independent brokers, dealers and banks, acting as borrowers.

Lending agreements between the custodian and the borrowers require that the custodian receive collateral from the borrowers in exchange for the securities lent. For securities lent which are not denominated in United States dollars or whose primary trading market is located outside the United States, the fair value of the collateral received must be a least 105 percent of the fair value of the securities lent. For all other securities lent, the fair value of the collateral received must be at least 102 percent. Securities lent consist of both domestic and foreign equity securities and United States Treasury and foreign debt obligations. Almost all collateral received consists of cash; a very small portion of collateral received consists of letters of credit, United States Treasury, corporate and/or foreign debt obligations. Collateral is marked to market daily. Additional collateral from borrowers is required if the fair value of the collateral received declines below lending agreement requirements. The lending agent cannot pledge or sell collateral securities received unless the borrower defaults. Accordingly, neither collateral securities received from borrowers nor the related obligations to borrowers are reported.

To the extent collateral received consists of cash, the lending agent may use or invest the cash in accordance with reinvestment guidelines approved by the Treasury Department. Either the participant or the borrower may terminate lending agreements on demand. Lending agreements are typically of very short duration - usually overnight. Therefore, the duration of lending agreements does not generally match the maturities of the investments made with cash collateral. The resulting rate risk is mitigated by the lending agent's ability to reallocate lending agreements among program participants.

The program requires that the lending agent indemnify the Treasury Department for all claims, liabilities and costs resulting from the lending agent's negligence or intentional misconduct. During the fiscal year ended June 30, 2001 (December 31, 2000 for the SWIF, the SERS and the Deferred Compensation Fund), there were no failures by any borrower to return securities lent or pay distributions thereon. Also, there were no losses resulting from a lending agent or borrower default and there were no Treasury Department restrictions on the amount of the loans that could be made.

At June 30, 2001 (December 31, 2000 for the SWIF, the SERS and the Deferred Compensation Fund), there was no Treasury Department or participant credit risk to the borrowers because the fair value of collateral received was greater than the fair value of the securities lent, consistent with the lending agreements outstanding. The carrying amount and fair value of the securities lent are (amounts in thousands):

General Fund..	$ 310,362
State Lottery Fund..	3,248
Motor License Fund...	56,010
State Workmen's Insurance Fund	400,377
Tuition Payment Fund..	16,805
Workmen's Compensation Security Trust Fund..	85,361
Deferred Compensation Fund	38,592
State Employees' Retirement System	1,002,056
Public School Employees' Retirement System….	2,553,391
Underground Storage Tank Indemnification Fund	41,378

NOTE E – FIXED ASSETS

A summary of fixed assets by category at June 30, 2001 is as follows (amounts in thousands):

	Primary Government			Discretely Presented Component Units		
	Enterprise Funds	Internal Service Funds	General Fixed Assets Account Group	Proprietary Funds	Fiduciary Funds	College and University Funds
Land	$ 323	$ 6	$ 264,568	$ 122,126	$ -	$ 13,687
Buildings	4,572	3,942	3,541,868	531,245	-	593,841
Improvements other than buildings	15,975	3,126	360,425	84,782	-	85,119
Machinery and equipment	78,018	88,213	581,071	227,069	11,556	404,773
Turnpike infrastructure	-	-	-	2,976,811	-	-
Construction in progress	-	-	651,362	869,432	-	79,848
Total	$ 98,888	$ 95,287	$ 5,399,294	$ 4,811,465	$ 11,556	$1,177,268

Changes in general fixed assets for the fiscal year ended June 30, 2001 are as follows (amounts in thousands):

	Balance June 30, 2000	Additions	Retirements	Balance June 30, 2001
Land	$ 259,680	$ 4,888	$ -	$ 264,568
Buildings	3,105,933	435,965	30	3,541,868
Improvements other than buildings	295,708	65,206	489	360,425
Machinery and equipment	601,381	63,372	83,682	581,071
	4,262,702	569,431	84,201	4,747,932
Construction in progress	836,805	313,766	499,209	651,362
Total general fixed assets	$ 5,099,507	$ 883,197	$ 583,410	$ 5,399,294

Interest costs of $32.4 million were capitalized for the Pennsylvania Turnpike Commission, a discretely presented component unit Proprietary Fund, for their fiscal year ended May 31, 2001.

The Commonwealth's initial valuation of general fixed assets was made as of June 30, 1986 including appraisal and historical cost reconstruction techniques. Subsequent to June 30, 1986 general fixed asset acquisitions are reported at cost or, for donations or confiscations, at fair market value. At June 30, 2001 the amount of general fixed assets related to the initial valuation amounts to $1,840 million.

Construction in progress included in the General Fixed Assets Account Group at June 30, 2001 includes project information as follows (amounts in thousands):

		Expended Through June 30, 2001		
	Project Authorization	Amounts Previously Capitalized	Amounts Not Capitalized To Date	Authorization Available
Department of Corrections Institutions	$ 822,851	$ 174,181	$ 339,074	$ 309,596
Capital Complex	563,101	192,700	194,582	175,819
Colleges and Universities	106,531	-	36,039	70,492
Veterans Homes and Military Armories	60,657	-	48,268	12,389
Department of Public Welfare Institutions	17,772	-	11,398	6,374
Other	88,083	-	22,001	66,082
Total	$1,658,995	$ 366,881	$ 651,362	$ 640,752

NOTE F - INSURANCE LOSS LIABILITY AND TUITION BENEFITS PAYABLE

Insurance Loss Liability

The reported insurance loss liability of the State Workmen's Insurance Fund (SWIF), an Enterprise Fund, is primarily based on historical claims experience. One of the assumptions used to determine the reported liability amount includes a 5.5 percent and a 4.5 percent discount rate at December 31, 1999 and 2000, respectively. There is uncertainty as to whether the reported liability will be supported by future claim experience, including payments; this uncertainty must be considered when evaluating the reported insurance loss liability.

For the calendar years ended December 31, 2000 and 1999, the following summary provides information on prior year reported insurance loss liability, incurred claims and payments, and current year reported insurance loss liability (amounts in thousands):

Year Ended	Prior Year	Incurred Claims		Payments		Current Year
December 31	Liability	Current	Prior	Current	Prior	Liability
2000	$1,137,459	$ 103,184	$ (31,831)	$ 11,505	$ 143,055	$1,054,252
1999	$1,291,212	$ 91,270	$ (69,232)	$ 11,434	$ 164,357	$1,137,459

Tuition Benefits Payable

The reported liability for tuition benefits payable of $221 million of the Tuition Payment Fund, an Enterprise Fund, at June 30, 2001, is based on several actuarial assumptions, including those related to future sales of tuition credits, tuition cost increases, investment experience and program expenses. As of June 30, 2001 the assumptions related to program expenses were changed to distinguish between fixed and variable expenses, to recognize the growing number of tuition credit contracts and to change the allocation of specific overhead expenses from the Tuition Program to the new Investment Program. The effect of these changes in assumptions related to program expenses reduced the liability for tuition benefits payable by $6.3 million at June 30, 2001.

NOTE G - TAXES, LOANS AND LEASE RENTAL RECEIVABLES

Taxes Receivable: Taxes receivable at June 30, 2001 consisted of the following (amounts in thousands):

	General Fund	Special Revenue Funds	Trust and Agency Funds	Total
Sales and use	$ 644,088	$ 24,953	$ -	$ 669,041
Unemployment compensation	-	-	279,672	279,672
Personal income	291,739	-	-	291,739
Corporation	74,232	-	-	74,232
Liquid fuels	-	61,806	-	61,806
Other	14,491	82,148	13,396	110,035
	$ 1,024,550	$ 168,907	$ 293,068	$ 1,486,525

Notes and Loans Receivable: Loans receivable at June 30, 2001 consisted of the following (amounts in thousands):

	Primary Government		Discretely Presented Component Units	
	Special Revenue Funds	Enterprise Funds	Proprietary Funds	College and University Funds
Mortgage loans	$ -	$ -	$ 2,937,297	$ -
Student loans	-	-	2,677,448	40,075
Economic development loans	48,437	144,042	603,096	-
Water and sewer system loans	13,917	-	1,192,520	-
Volunteer fire company loans	-	103,361	-	-
Other notes and loans	13,331	12,648	-	-
	75,685	260,051	7,410,361	40,075
Less: allowance for uncollectible accounts	19,421	27,791	195,656	5,417
Notes and loans receivable, net	$ 56,264	$ 232,260	$ 7,214,705	$ 34,658

The General Fund and Trust and Agency Funds reported $13,503 and $6,728 thousand of loans, respectively, for program objectives and to replace underground storage tanks at June 30, 2001.

Discretely presented component unit governmental funds reported $2,612 thousand of loans to school districts at June 30, 2001.

Lease Rentals Receivable: The Capital Facilities Fund, a Capital Projects Fund, reports amounts related to construction projects for educational institutions funded through the issuance of General Obligation Bonds, the principal and interest of which are paid through the collection of lease rental payments and deposited in the related Capital Debt Fund, a Debt Service Fund. At the conclusion of the lease terms, the project facilities are conveyed to the educational institutions. Accordingly, these lease arrangements are classified as direct financing leases. Lease rental receivables and associated deferred revenue equal to the principal lease payments to be received are recorded in the Capital Debt Fund. At June 30, 2001 the total minimum lease payments to be received were $1.7 million and the present value of the lease payments was $1.6 million, the difference representing interest of $.1 million. The Pennsylvania Higher Educational Facilities Authority and the State Public School Building Authority, discretely presented governmental fund component units, finance construction projects for educational institutions through the issuance of bonds and other obligations, the principal and interest of which are paid through the collection of lease rental payments related to the project. At the conclusion of the lease terms, the project facilities are conveyed to the educational institutions. Accordingly, these lease arrangements are classified as direct financing leases. For discretely presented governmental fund component units, total minimum lease payments were $6.6 billion, the present value was $4.1 billion and interest was $2.5 billion at June 30, 2001. The Pennsylvania Industrial Development Authority, a discretely presented proprietary fund component unit, reported a lease rental receivable with total minimum payments of $29 million, present value of $17 million and interest of $12 million at June 30, 2001. Minimum lease payments for the five fiscal years succeeding June 30, 2001 are as follows (amounts in thousands):

NOTE G - TAXES, LOANS AND LEASE RENTAL RECEIVABLES (continued)

Fiscal Year Ending June 30	Primary Government	Discretely Presented Governmental Fund Component Units	Discretely Presented Proprietary Fund Component Units
2002	$ 193	$ 309,826	$ 634
2003	193	301,012	634
2004	193	300,317	634
2005	194	295,349	634
2006	194	298,785	2,606

NOTE H - INTERFUND ACCOUNTS/OPERATING TRANSFERS/RESIDUAL EQUITY TRANSFERS

The composition of interfund balances reported at June 30, 2001 is as follows (amounts in thousands):

FUND TYPE/FUND PRIMARY GOVERNMENT	DUE FROM		DUE TO	
	OTHER FUNDS	COMPONENT UNITS	OTHER FUNDS	COMPONENT UNITS
General	$ 40,123	$ 5,460	$ 114,611	$ 51
Special Revenue:				
State Lottery Fund	1,500	-	81	-
State Racing Fund	-	-	8,704	-
Hazardous Sites Clean-up Fund	16,220	-	19	-
Motor License Fund	3,820	70	24,956	8,660
Vocational Rehabilitation Fund	112	-	1,396	-
Pharmaceutical Assistance Fund	5,364	-	-	-
Agricultural Conservation Easement Fund	10,145	-	-	-
Public Transportation Assistance Fund	3,277	-	380	-
Other Funds	2,205	53	4,143	-
	42,643	123	39,679	8,660
Debt Service:				
Pennsylvania Infrastructure Investment Authority Redemption Fund	-	23,835	-	-
Other Funds	28	-	-	-
	28	23,835	-	-
Capital Projects:				
Capital Facilities Fund	12,073	-	-	-
Keystone Recreation, Park and Conservation Fund	4,340	-	131	-
	16,413	-	131	-
Enterprise:				
State Stores Fund	353	-	19,772	-
State Workmen's Insurance Fund	224	-	1,506	-
Rehabilitation Center Fund	1,304	-	61	-
Other Funds	32	-	8	-
	1,913	-	21,347	-
Internal Service:				
Purchasing Fund	38,639	501	156	-
Manufacturing Fund	6,390	16	202	-
	45,029	517	358	-
Expendable Trust:				
Unemployment Compensation Fund	2,228	290	-	-
Workmen's Compensation Security Trust Fund	18,541	-	26	-
Deferred Compensation Fund	-	-	106	-
Catastrophic Loss Benefits Continuation Fund	-	-	18,551	-
	20,769	290	18,683	-
Pension Trust:				
State Employees' Retirement System	14,417	2,622	-	-
Agency:				
Local Sales and Use Tax Fund	1,247	-	-	-
Allegheny Regional Asset District Sales and Use Tax Fund	1,407	-	167	-
Liquid Fuels Tax Fund	2,391	-	179	-
Other Funds	320	-	454	-
	5,365	-	800	-
TOTAL PRIMARY GOVERNMENT	$ 186,700	$ 32,847	$ 195,609	$ 8,711

NOTE H - INTERFUND ACCOUNTS/OPERATING TRANSFERS/RESIDUAL EQUITY TRANSFERS (continued)

DISCRETELY PRESENTED COMPONENT UNITS	DUE FROM			DUE TO		
	Other Funds	Component Units	Primary Government	Other Funds	Component Units	Primary Government
Governmental	$ 706	$ -	$ -	$ 706	$ -	$ -
Proprietary:						
Pennsylvania Infrastructure Investment Authority	-	128	-	-	17	25,358
Pennsylvania Turnpike Commission	-	-	6,461	-	-	3,979
Other Funds	-	17	-	-	128	98
	-	145	6,461	-	145	29,435
Fiduciary:						
Public School Employees' Retirement System	-	-	319	-	-	2,166
College and University	234,901	-	-	234,901	-	1,145
TOTAL DISCRETELY PRESENTED COMPONENT UNITS	$ 235,607	$ 145	$ 6,780	$ 235,607	$ 145	$ 32,746

The amount of total interfund receivables of $462,079 thousand does not agree with total interfund payables of $472,818 thousand at June 30, 2001 due to different fiscal year ends for certain funds included in the combined balance sheet at June 30, 2001. The amount reported for the Pennsylvania Turnpike Commission, a discretely presented proprietary fund component unit, is as of its fiscal year end of May 31, 2001. The amounts reported as interfund accounts for the State Employees' Retirement System, a Pension Trust Fund, the INVEST Program for Local Governments, an Investment Trust Fund, the State Workmen's Insurance Fund, an Enterprise Fund, and the Deferred Compensation Fund, an Expendable Trust Fund, are as of their fiscal years ended December 31, 2000. The following presents a reconciliation of interfund accounts reported at June 30, 2001 and those amounts which would have been reported if all funds used the same fiscal year end (amounts in thousands):

Due from other funds - Combined Balance Sheet at June 30, 2001	$ 422,307
Due from primary government - Combined Balance Sheet at June 30, 2001	6,780
Due from component units - Combined Balance Sheet at June 30, 2001	32,992
Interfund receivables — Combined Balance Sheet	462,079
Pennsylvania Turnpike Commission increase in receivables from June 1, 2000 to June 30, 2001	2,199
State Workmen's Insurance Fund decrease in receivables from January 1, 2000 through June 30, 2001	(181)
State Employees' Retirement System increase in receivables from January 1, 2000 through June 30, 2001	7,909
TOTAL INTERFUND RECEIVABLES	$ 472,006
Due to other funds - Combined Balance Sheet at June 30, 2001	$ 431,216
Due to primary government - Combined Balance Sheet at June 30, 2001	32,746
Due to component units - Combined Balance Sheet at June 30, 2001	8,856
Interfund payables — Combined Balance Sheet	472,818
State Employees' Retirement System increase in payables from January 1, 2000 through June 30, 2001	469
State Workmen's Insurance Fund decrease in payables from January 1, 2000 through June 30, 2001	(1,286)
Deferred Compensation Fund increase in payables from January 1, 2000 through June 30, 2001	5
TOTAL INTERFUND PAYABLES	$ 472,006

NOTE H - INTERFUND ACCOUNTS/OPERATING TRANSFERS/RESIDUAL EQUITY TRANSFERS (continued)

At June 30, 2001 the General Fund has reported Advances to Other Funds of $52,808. Specifically, this amount has been advanced as follows: $2,300 to the State Workmen's Insurance Fund, an Enterprise Fund, $2,175 to the Motor License Fund, $10,333 to the Pharmaceutical Assistance Fund, both Special Revenue Funds, and $38,000 to the Purchasing Fund, an Internal Service Fund. These amounts have been reported by the respective owing Funds as Advances from Other Funds, except for the State Workmen's Insurance Fund, which has reported an advance of $1,987 at its fiscal year ended December 31, 2000 (amounts in thousands).

At June 30, 2001 the Hazardous Sites Cleanup Fund, a Special Revenue Fund, has reported an Advance to Other Funds of $3,000. This amount was advanced to the Small Business First Fund, an Enterprise Fund, which has reported an Advance from Other Funds of $3,000 (amounts in thousands).

At June 30, 2001 the Tuition Payment Fund, an Enterprise Fund, has reported an Advance from Other Funds of $150 thousand.

A summary of operating transfers reported for the fiscal year ended June 30, 2001 is as follows (amounts in thousands):

	OPERATING TRANSFERS			
PRIMARY GOVERNMENT	**In**	**From Component Units**	**Out**	**To Component Units**
General	$ 75,491	$ -	$ 582,822	$ 877,609
Special Revenue:				
State Lottery Fund	-	-	290,000	-
State Racing Fund	-	-	8,696	-
Hazardous Sites Clean-up Fund	-	-	5,000	-
Motor License Fund	-	-	110,089	-
Vocational Rehabilitation Fund	36,198	-	-	-
Pharmaceutical Assistance Fund	313,744	-	-	-
Water Facilities Loan Fund	-	-	2,308	-
Environmental Stewardship Fund	130,000	-	19,828	
Other Funds	52,109	-	37,789	-
	532,051	-	473,710	-
Debt Service:				
Land and Water Development Sinking Fund	13,316	-	-	-
Water Facilities Loan Redemption Fund	12,629	-	-	-
Capital Debt Fund	391,284	-	-	-
Pennsylvania Infrastructure Investment Authority Redemption Fund	24,590	-	-	-
Local Criminal Justice Sinking Fund	15,966	-	-	-
Agricultural Conservation Easement Sinking Fund	8,137	-	-	-
Keystone Recreation, Park and Conservation Fund	4,360	-	-	-
Disaster Relief Redemption Fund	9,498	-	-	-
Pennsylvania Economic Revitalization Sinking Fund	6,314	-	-	-
Volunteer Company Loan Sinking Fund	2,988	-	-	-
Other Funds	1,074	-	1	-
	490,156	-	1	-
Enterprise:				
State Stores Fund	-	-	51,758	-
Small Business First Fund	-	-	407	-
	-	-	52,165	-
TOTAL PRIMARY GOVERNMENT	$ 1,097,698	$ -	$ 1,108,698	$ 877,609

Transfers out exceed transfers in by $11,000 because of a transfer from the General Fund to the State Employees' Retirement System after December 31, 2000.

DISCRETELY PRESENTED COMPONENT UNITS	**In**	**From Primary Government**	**Out**	**To Primary Government**
Governmental Funds	$ 491,994	$ 39,100	$ 491,994	$ -
Proprietary:				
Pennsylvania Higher Education Assistance Agency	-	366,688	-	-
College and University Funds	-	471,821	-	-
TOTAL DISCRETELY PRESENTED COMPONENT UNITS	$ 491,994	$ 877,609	$ 491,994	$ -

NOTE H - INTERFUND ACCOUNTS/OPERATING TRANSFERS/RESIDUAL EQUITY TRANSFERS (continued)

The following summary reconciles total governmental residual equity transfers out of $175,442 to the reported net increase in proprietary fund contributed capital as follows (in thousands):

Net residual equity transfers	$ 175,442
less: program grant receipts of the Pennsylvania Infrastructure Investment Authority	(115,442)
add: Federal funds received by the Pennsylvania Turnpike Commission	11,920
add: Federal funds received by the Pennsylvania Infrastructure Bank Fund	5,102
less: other decrease to the Rehabilitation Center Fund	(24)
Net increase in contributed capital for proprietary fund types—primary government and discretely presented component units	$ 76,998

Increases and decreases in contributed capital for proprietary fund types—primary government and discretely presented component units—during the fiscal year ended June 30, 2001 are summarized as follows (amounts in thousands):

Cash flows from capital and noncapital financing activities:	
Increases in contributed capital—primary government	$ 24,102
Decreases in contributed capital—primary government	(24)
Increases in contributed capital—discretely presented component units	52,920
Net increase in contributed capital for proprietary fund types—primary government and discretely presented component units	$ 76,998

Assigned Investment Income: Certain funds, as follows, receive but do not financially report investment income which is assigned to (and reported by) another fund for legal or contractual reasons. Investment income and related interfund transfers are reported by those funds which assign/receive investment income for other than legal or contractual reasons (amounts in thousands).

Assigning Fund	Receiving Fund	Reason	Amount
Liquor License	General	Legal/contractual	$ 127
Liquid Fuels Tax	Motor License	Legal/contractual	635
Land and Water Development	Land and Water Development Sinking	Legal/contractual	106
Remining Financial Assurance	Land and Water Development Sinking	Other than legal/contractual	154
PA Economic Revitalization	PA Economic Revitalization Sinking	Other than legal/contractual	80
Fire Insurance Tax	State Insurance	Legal/contractual	1,441
Fire Insurance Tax	Municipal Pension Aid	Legal/contractual	278

NOTE I - RETIREMENT AND OTHER POSTEMPLOYMENT BENEFITS

PENSION SYSTEMS

Commonwealth laws established contributory defined benefit pension plans covering substantially all Commonwealth and public school employees. Commonwealth employees are members of the State Employees' Retirement System (SERS), a blended component unit. The SERS is the only blended component unit in the financial reporting entity and it is the only pension trust fund included in the primary government. Public school employees are members of the Public School Employees' Retirement System (PSERS), a discretely presented component unit. The PSERS is the only Fiduciary Fund reported as a discretely presented component unit. Both the SERS and the PSERS issue stand-alone financial statements which are available to the public. Written requests for financial statements should be directed to the following addresses:

State Employees' Retirement System
Executive Office
P.O. Box 1147
Harrisburg, PA 17108

Public School Employees' Retirement System
Bureau of Communications
P.O. Box 125
Harrisburg, PA 17108

STATE EMPLOYEES' RETIREMENT SYSTEM

Plan Description: The SERS is the administrator of a cost-sharing multiple-employer defined benefit retirement system established to provide pension benefits for employees of state government and certain other organizations. At December 31, 2000 there were 106 employer state agencies and other organizations participating in the SERS. The SERS provides retirement, death, and disability benefits. Retirement benefits vest after 10 years of credited service. Employees who retire at age 60 with three years of service, or with 35 years of service if under age 60, are entitled to a normal (unreduced) annual retirement benefit. Members of the General Assembly and certain employees classified in hazardous duty positions can retire with full benefits at age 50 with at least three years of service.

The general annual benefit for full retirement is 2 percent of the member's highest three-year average salary multiplied by years of service. State police troopers are entitled to an annual benefit equal to a percentage of their highest annual salary (excluding their year of retirement). The annual benefit is 75 percent of salary for 25 or more years of service and 50 percent of salary for 20-24 years of service. Judges are entitled to a benefit of 4 percent of final average salary for each of the first 10 years of service and 3 percent for subsequent years. District Justices are entitled to a benefit of 3 percent of final average salary for each year of service. The Commonwealth has the authority to establish or amend benefit provisions. Act 41, signed into law on April 2, 1998, permitted certain participants with at least 30 years of credited service to retire without a reduction in benefits from July 1, 1998 to June 30, 1999. This early retirement "window" did not require a minimum age in conjunction with length of service for a member to be eligible for full benefits. Act 9, signed into law on May 17, 2001 is to, generally, increase annual full retirement benefits for electing active members by 25 percent and, for certain members of the General Assembly, by 50 percent effective July 1, 2001.

Funding Policy: The SERS Board has the authority to establish or amend periodic employer contributions at actuarially determined rates, expressed as a percentage of annual covered payroll. All member contribution rates are determined by Commonwealth law. The active plan member contribution rate is 5 percent of covered payroll for most employees; higher contributions are required for certain members of the General Assembly and judges and district justices who elect higher contribution rates. During each of the three years ended December 31, the annual required employer contributions (amounts in thousands) and the related percentage of that amount actually contributed are as follows:

Year ended December 31	Annual Required Contribution	Percentage Contributed
1999	$ 269,869	100
1998	$ 310,501	100
1997	$ 324,093	100

During the year ended December 31, 2000 employer contributions amounted to $168,002 thousand; the SERS did not report an annual required contribution for the year ended December 31, 2000. At December 31, 2000, the SERS disclosed no long-term contracts for contributions to the plan.

NOTE I - RETIREMENT AND OTHER POSTEMPLOYMENT BENEFITS (continued)

Summary of Significant Accounting Policies: The SERS financial statements are prepared on the accrual basis of accounting, whereby expenses are recorded when the liability is incurred, revenues are recorded in the accounting period in which they are earned and become measurable, and investment purchases and sales are recorded as of the related trade date. Member and employer contributions are recognized in the period in which employee salaries are reported. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Investment Valuation: Investments are reported at fair value. United States government obligations, corporate and foreign bonds and notes, and common and preferred stocks, including collective trust fund, are generally valued based on published market prices and quotations from national security exchange and securities pricing services. Securities that are not traded on a national security exchange are valued by the asset manager or third parties based on similar sales. Mortgage loans are valued by the asset manager using the present value of future cash flows. Real estate is primarily valued based on appraisals performed by independent appraisers or, for properties not appraised, at the present value of the projected future net income stream. Venture capital and alternative investments are valued based on amounts established by valuation committees. Foreign exchange contracts, which are not reported in the statement of plan net assets, are marked-to-market daily with changes in fair value recognized as part of investment income. The investment in the Commonwealth Treasury short-term investment pool is reported at cost plus allocated interest, which approximates fair value. Collateral received under the Commonwealth Treasury securities lending program is reported at cost plus accrued interest. Since December 31, 2000, due to a decline in the overall fair value of equity securities, there was a decline in the total fair value of SERS assets.

Investment Concentration: At December 31, 2000, approximately $491 million, or 18.7 percent, of the total real estate portfolio was located in the Commonwealth of Pennsylvania.

PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

Plan Description: The PSERS is a cost-sharing multiple-employer defined benefit retirement system established to provide pension and other benefits for public school employees. At June 30, 2001 there were 694 participating employers, generally school districts. The PSERS provides retirement, death, disability and health care benefits. Retirement benefits vest after 10 years of credited service. Members are eligible for full monthly retirement benefits upon reaching (a) age 62 with at least one year of service, (b) age 60 with 30 or more years of service, or (c) 35 or more years of service regardless of age.

Benefits for full retirement are generally equal to 2 percent of the member's final average salary multiplied by years of credited service. The Commonwealth has the authority to establish or amend benefit provisions.

Funding Policy: The Public School Employees' Retirement Code provides that the PSERS Board has the authority to establish or amend periodic employer contributions at actuarially determined rates, expressed as a percentage of annual covered payroll. The active plan member contribution rate for employees hired before July 22, 1983 is 5.25 percent of covered payroll; for employees hired after July 21, 1983, the rate is 6.25 percent. Member contribution rates are determined by Commonwealth law.

Effective July 1, 1995, employers defined as school entities (school districts, area vocational-technical schools, and intermediate units) are required to pay the entire employer contribution. The Commonwealth partially reimburses school entities in accordance with Act 29 of 1994. The amount of reimbursement is at least one half of the total employer contribution. For employers which are not school entities, the employer contribution is paid equally by the employer and the Commonwealth to the PSERS; no Commonwealth reimbursement occurs.

During each of the three fiscal years ended June 30, the annual required employer contributions (in thousands) and the related percentage of that amount actually contributed are as follows:

Fiscal year Ended June 30	Annual Required Contribution	Percentage Contributed
2001	$158,193	100
2000	$390,504	100
1999	$513,940	100

At June 30, 2001, the PSERS disclosed no long-term contracts for contributions to the plan.

NOTE I - RETIREMENT AND OTHER POSTEMPLOYMENT BENEFITS (continued)

Summary of Significant Accounting Policies: The PSERS financial statements are prepared on the accrual basis of accounting, whereby expenses are recorded when the liability is incurred, revenues are recorded in the accounting period in which they are earned and become measurable, and investment purchases and sales are recorded as of the related trade date. Member and employer contributions are recognized in the period in which employee salaries are reported. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Investment Valuation: Investments are reported at fair value, which is the amount that the PSERS can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller, that is, other than in a forced or liquidation sale. Short-term securities are reported at cost, which approximates fair value, unless they have a published market price or quotation from national security exchanges and securities pricing services, in which case they are reported at the published market price. Fixed income securities and common and preferred stocks are generally reported based on published market prices and quotations from national security exchanges and securities pricing services. Securities which are not traded on a national security exchange are valued by the respective fund manager or other third parties based on similar sales. Real estate and farmland are primarily valued based on appraisals performed by independent appraisers or, for properties not appraised, at the present value of projected future net income. Private equity/venture capital, equity real estate and private placements are reported based on amounts established by independent advisors. Futures contracts, foreign exchange contracts, and options are marked-to-market daily; changes in market value are recognized as part of net appreciation (depreciation) in fair value of investments. Initial margin requirements for such financial instruments are provided by investment securities pledged as collateral or by cash held in a broker margin account.

Investment Concentration: At June 30, 2001, there were no investments in any one organization that represented 5 percent or more of plan net assets.

OTHER POSTEMPLOYMENT BENEFITS

The Commonwealth funds certain health care benefits for retired primary government and certain component unit employees (that meet specified length-of-service and age requirements) and their eligible dependents. These benefits are provided as a result of negotiated union contracts and through administrative policy. The Commonwealth recognizes the cost of providing these benefits as paid, which totaled $253 million for the fiscal year ended June 30, 2001. Approximately 84,000 individuals were covered by these benefits during the fiscal year.

The Commonwealth provides several other postemployment benefits, including disability life insurance and certain benefits to beneficiaries of state police officers killed in the line of duty. The amount expended for these benefits was not material during the fiscal year ended June 30, 2001.

NOTE J - NOTES AND DEMAND REVENUE BONDS PAYABLE

Primary Government

During the fiscal year ended June 30, 1997, the Commonwealth issued General Obligation Bond Anticipation Notes, Series 1997 A (notes), pursuant to a resolution adopted on February 18, 1997, in anticipation of the issuance of general obligation bonds of the Commonwealth. No general obligation bonds to retire the notes were issued during the 1996-97 or the 1997-98 fiscal years. During the fiscal years ended June 30, 1999 and June 30, 2000, general obligation bonds were issued to retire a portion of the notes. Also during these fiscals years, additional notes were issued under the original resolution. During the fiscal year ended June 30, 2001 the term of the original resolution came to a close and all outstanding notes were retired using the proceeds of general obligation bonds.

Discretely Presented Component Units

The Pennsylvania Higher Education Assistance Agency (PHEAA), a proprietary fund component unit, has reported $1,711.0 million of demand revenue bonds outstanding and $857.3 million of notes payable consisting of student loan financing of $735.8 million, other lines of credit of $20.0 million and other notes and bonds payable of $101.5 million at June 30, 2001 as follows (amounts in thousands):

Demand student loan revenue bonds payable, due 2018-2040, at weighted average interest rates of 3.23 and 5.10 percent at June 30, 2001 and 2000, respectively	$ 1,711,000
Student loan financing notes payable, due in 2001-2007, at weighted average interest rates of 5.25 and 6.44 percent at June 30, 2001 and 2000, respectively	735,785
Other lines of credit, due on demand, at weighted average interest rates of 6.50 and 6.49 percent at June 30, 2001 and 2000, respectively	20,000
Other notes and bonds payable, due 2001-2031, at weighted average interest rates of 6.06 and 6.11 percent at June 30, 2001 and 2000, respectively	101,507
Total	$ 2,568,292

The note and bond indentures among other things require PHEAA to comply with various covenants including minimum parity levels as defined, student loan and investment yields, and program expenses. The demand bonds payable are subject to purchase, at par plus accrued interest, by PHEAA on demand of the bondholders upon seven days prior irrevocable written notice. Under the irrevocable letters of credit issued by the Student Loan Marketing Association, the trustee is entitled to draw an amount sufficient to pay the purchase price of the bonds delivered to it. The letters of credit are valid from 2001 through 2030. The PHEAA is required to pay annual commitment fees ranging from 12 to 45 basis points on the stated amount of the letter of credit coverage. At June 30, 2001 total letter of credit coverage was $2.3 billion.

All student loan financing notes payable, demand student loan revenue bonds payable and student loan revenue bonds payable are collateralized by student loans and investments. At June 30, 2001, $2.985 billion of debt is collateralized by $2.7 billion of student loan principal and related interest receivable, and $466.2 million of investments. The other notes and bonds payable are collateralized with operational assets. Amounts due under the lines of credit are collateralized with accounts receivable and student loans. As of June 30, 2001 the PHEAA has $119.2 million of available credit under student loan financing arrangements and $26 million available under other lines of credit.

NOTE J - NOTES AND DEMAND REVENUE BONDS PAYABLE (continued)

Stated maturities of notes and bonds payable for each of the five years subsequent to June 30, 2001 and through maturity are as follows (amounts in thousands):

Year of Maturity	Demand Student Loan Revenue Bonds Payable	Student Loan Financing Notes Payable	Other Notes and Bonds Payable
2002	$ -	$ 121,275	$ 7,145
2003	-	31,600	7,211
2004	-	-	7,820
2005	-	547,910	7,907
2006	-	-	4,069
2007-40	1,711,000	35,000	67,355
Total	$ 1,711,000	$ 735,785	$ 101,507

Notes and bonds payable, as well as all other debt, are limited obligations of the PHEAA. The PHEAA has no taxing power and the Commonwealth is not obligated to pay principal, redemption price, if any, or interest on any of the PHEAA's debt.

The Pennsylvania Housing Finance Agency (PHFA), a proprietary fund component unit, maintains a $50 million note for the funding of the Hafer Homebuyer Program, bearing interest from the date of issuance at a rate equal to the daily short-term investment pool rate, which was 4.25 percent at June 30, 2001. At June 30, 2001 $37.5 million is owed against this note. The PHFA also maintains a Regional Housing Development Corporation Bridge Loan Note bearing interest at a fixed rate of 3 percent. At June 30, 2001 $3.6 million is owed against this note. Total reported notes payable at June 30, 2001 for the PHFA is $41.1 million.

NOTE K – LONG TERM OBLIGATIONS

Long-term obligations of the Commonwealth's primary government at June 30, 2001 and changes for the fiscal year ended June 30, 2001 are as follows (amounts in thousands):

GENERAL LONG-TERM OBLIGATIONS ACCOUNT GROUP	Issue Dates	Interest Rates	Maturity Dates Through	Bonds Authorized But Unissued	Balance July 1, 2000	Additions	Reductions	Balance June 30, 2001
General Obligation Bonds Payable From Tax Revenues:								
Capital Facilities	1972-01	4.47-6.60%	2021	$ 32,036,905	$ 3,327,740	$ 641,000	$ 280,855	$ 3,687,885
Disaster Relief	1973-01	4.60- 5.56%	2021	105,908	41,865	3,000	7,315	37,550
Land and Water Development	1972-94	4.89- 6.44%	2014	300	31,805	-	12,145	19,660
Nursing Home Loan Development	1983	8.26%	2002	31,000	1,600	-	525	1,075
Volunteer Companies Loan	1982-98	4.84-10.75%	2018	-	22,525	-	1,850	20,675
Vietnam Conflict Veterans Compensation	1974	5.36%	2003	3,000	1,770	-	405	1,365
Water Facilities Loan	1983-97	4.89- 8.26%	2017	11,500	105,875	-	6,995	98,880
Pennsylvania Economic Revitalization	1991-95	5.04- 6.44%	2015	14,000	28,235	-	4,770	23,465
Pennsylvania Infrastructure Investment Authority	1991-01	4.62- 6.44%	2021	267,000	239,110	6,000	14,175	230,935
Agricultural Conservation Easement Purchase	1991-98	4.47- 6.60%	2018	-	70,515	-	4,445	66,070
Local Criminal Justice	1992-01	4.47- 6.60%	2021	9,000	152,125	2,000	7,525	146,600
Keystone Recreation, Park and Conservation	1994-98	4.84- 6.60%	2018	-	43,640	-	2,000	41,640
Refunding Bonds	1992-97	5.12- 5.73%	2011	-	1,299,816	3,460	133,995	1,169,281
				32,478,613	5,366,621	655,460	477,000	5,545,081
Other General Long-Term Obligations Payable From Tax Revenues:								
Installment Purchase Obligations	-	-	-	-	38,054	4,481	16,370	26,165
Capital Lease Obligations	-	-	-	-	52,498	3,122	3,321	52,299
Obligations Under Master Lease Agreement—Equipment	-	-	-	-	680	-	680	-
Obligations Under Master Lease—Prison Facilities	-	-	-	-	624,635	-	30,115	594,520
Self-Insurance—Note O	-	-	-	-	587,054	146,694	100,302	633,446
Compensated Absences	-	-	-	-	667,921	344,652	313,395	699,178
Catastrophic Motor Vehicle Losses	-	-	-	-	162,205	-	35,837	126,368
Other	-	-	-	-	291,524	148,690	111,002	329,212
				-	2,424,571	647,639	611,022	2,461,188
TOTAL GENERAL LONG-TERM OBLIGATIONS ACCOUNT GROUP				$ 32,478,613	$ 7,791,192	$ 1,303,099	$ 1,088,022	$ 8,006,269

Long-term obligations of the discretely presented component unit organizations at June 30, 2001 (May 31, 2001 for the Pennsylvania Turnpike Commission) and changes for the fiscal year then ended are as follows (amounts in thousands):

	Issue Dates	Interest Rates	Maturity Dates Through	Balance July 1, 2000	Additions	Reductions	Balance June 30, 2001
GOVERNMENTAL FUNDS							
Bonds Payable from Lease Rentals:							
Pennsylvania Higher Educational Facilities Authority	1969-01	2.70-9.63%	2039	$ 3,532,914	$ 474,039	$ 246,903	$ 3,760,050
State Public School Building Authority	1986-01	2.60-7.88%	2031	433,753	70,129	65,530	438,352
TOTAL GOVERNMENTAL FUNDS				3,966,667	544,168	312,433	4,198,402
PROPRIETARY FUNDS							
Revenue Bonds Payable from User Charges:							
Pennsylvania Higher Education Assistance Agency	1986-92	6.48-6.71%	2026	834,405	-	296,480	537,925
Pennsylvania Housing Finance Agency	1982-01	2.88-10.875%	2031	2,904,898	97,185	117,314	2,884,769
Pennsylvania Industrial Development Authority	1994-96	4.50-7.00%	2014	351,225	-	23,005	328,220
Pennsylvania Turnpike Commission	1991-01	2.50-6.60%	2030	1,544,535	430,950	39,120	1,936,365
Pennsylvania Infrastructure Investment Authority	1990-98	4.00-6.45%	2013	174,765	-	13,365	161,400
				5,809,828	528,135	489,284	5,848,679
Less: Bond discounts	-	-	-	50,945	4,770	13,633	42,082
Deferred costs of refunding	-	-	-	12,266	-	701	11,565
TOTAL PROPRIETARY FUNDS				5,746,617	523,365	474,950	5,795,032
TOTAL COMPONENT UNIT LONG-TERM OBLIGATIONS				$ 9,713,284	$ 1,067,533	$ 787,383	$ 9,993,434

NOTE K – LONG TERM OBLIGATIONS (continued)
Primary Government

The Commonwealth has pledged its full faith and credit for the payment of principal and interest on general obligation bonds accounted for in the General Long-Term Obligations Account Group.

The total "Additions" of $655,460 for General Obligations Bonds Payable from Tax Revenues at June 30, 2001, as reported in Note K, differs from total bond proceeds of $663,919 for Governmental Fund Types, as reported in the Combined Statement of Revenues, Expenditures and Changes in Fund Balances, by $8,459. This difference includes premium on bonds issued of $17,919, less bond proceeds for non-governmental funds of $6,000 and less principal accretion for capital appreciation bonds of $3,460 (amounts in thousands).

The Commonwealth uses fiscal agents to process payments for the servicing of certain bond issues. Additional cash with fiscal agents is held by the Federal government for unemployment compensation claims.

The balance outstanding at June 30, 2001 in the General Long-Term Obligations Account Group for Refunding Bonds includes $23.0 million of accreted value for capital appreciation bonds. No principal or interest is payable on the capital appreciation bonds until maturity.

Included in "Other" for Other General Long-Term Obligations payable from tax revenues are the following (amounts in thousands):

Workmen's Compensation Security Trust Claims	$ 192,798
Public Utility Realty Tax Act (PURTA)	25,538
Litigation—Note P	108,516
Arbitrage Rebate Tax	2,360
	$ 329,212

The Workmen's Compensation Security Trust Fund provides for payment of valid claims under the Workmen's Compensation Law to individuals whose employers are insured by insolvent insurance carriers. The PURTA provides for a tax on utility realty property whereby amounts received during the fiscal year are used as a General Fund revenue source. The Act also provides for payment of a majority of the PURTA revenues as a distribution to local taxing authorities during the following fiscal year (normally in October). Such payments are appropriated for expenditure in the following fiscal year and are, therefore, not expendable during the fiscal year the related revenue is received. The other amounts included in the General Long-Term Obligations Account Group at June 30, 2001 relating to Workmen's Compensation Claims, Litigation and Arbitrage Rebate Tax are not payable with currently expendable available financial resources.

In 1991, the Commonwealth entered into lease arrangements with five local government authorities for the rental of five new prisons. Each authority issued bonds to finance the construction of the prisons. Each lease provided for the Commonwealth to pay periodic rentals equal to debt service payments on each authority's debt obligation. On July 1, 1993 a finance corporation issued certificates of participation to refund the authority debt obligations, to consolidate the financing of the prisons and to provide additional construction funding. As a result of the consolidated financing, the Commonwealth makes lease payments equal to the finance corporation's debt service payments. Both the original and the new leases provide that the Commonwealth's obligation to make lease payments is subject to Commonwealth appropriations made to provide for these obligations. In the fiscal year ended June 30, 1994 the Commonwealth began using the new prison facilities. The finance corporation holds nominal title to the facilities as security for the Commonwealth lease payments. When the certificates are fully redeemed, at which time the lease agreement expires, legal title vests with the Commonwealth. At June 30, 2001 the Commonwealth has reported $594.5 million as a liability under prison master lease arrangements and has reported general fixed assets for the related prison facilities.

The Commonwealth's constitutional debt limit, which allows for the incurrence of debt to be used for capital projects without electorate approval as specifically itemized in a capital budget, was $40.3 billion as of August 31, 2001, with net debt outstanding of $4.6 billion.

Discretely Presented Component Units

The Pennsylvania Housing Finance Agency (PHFA), the Pennsylvania Higher Education Assistance Agency (PHEAA), the Pennsylvania Industrial Development Authority, the Pennsylvania Turnpike Commission (PTC) and the Pennsylvania Infrastructure Investment Authority, discretely presented proprietary fund component units, have pledged substantially all of their revenues for the redemption of revenue bonds outstanding. Revenue bonds outstanding as reported in this note disclosure for the fiscal year ended June 30, 2001 (May 31, 2001 for the PTC) include bond discounts and deferred costs of refunding of $42.1 million and $11.6 million, respectively.

NOTE K – LONG-TERM OBLIGATIONS (continued)

The Pennsylvania Higher Educational Facilities Authority and the State Public School Building Authority (SPSBA), discretely presented governmental fund component units, have bonds outstanding as of June 30, 2001 which are payable from the lease rentals of the projects financed. The lease rentals are pledged as collateral for the bonds outstanding.

At June 30, 2001 the SPSBA reported $250 thousand in other general long-term obligations which represents a liability for compensated absences.

The following table presents annual principal and interest payments for long-term debt outstanding for the primary government and discretely presented component units at June 30, 2001 (May 31, 2001 for the Pennsylvania Turnpike Commission) (amounts in thousands):

PRIMARY GOVERNMENT

	2002	2003	2004	2005	2006	2007 Through Maturity	Total
GENERAL OBLIGATION BONDS:							
Capital Facilities	$ 469,724	$ 405,096	$ 379,663	$ 362,710	$ 355,788	$ 3,384,606	$ 5,357,587
Disaster Relief	9,761	9,717	2,735	2,656	2,577	23,264	50,710
Land and Water Development	7,926	4,554	1,153	1,146	1,142	8,156	24,077
Nursing Home Loan Development	549	550	-	-	-	-	1,099
Volunteer Companies Loan	2,907	2,520	2,061	2,040	2,022	17,364	28,914
Vietnam Conflict Veterans Compensation	482	487	490	-	-	-	1,459
Water Facilities Loan	12,200	11,407	10,871	10,722	10,662	81,543	137,405
Pennsylvania Economic Revitalization	5,393	2,394	2,385	2,375	2,370	16,961	31,878
Pennsylvania Infrastructure Investment Authority	26,758	25,511	25,230	24,993	24,761	197,039	324,292
Agricultural Conservation Easement Purchase	7,776	7,308	7,221	7,124	7,036	56,292	92,757
Local Criminal Justice	16,129	16,110	16,095	16,065	16,038	130,035	210,472
Keystone Recreation, Park and Conservation	4,322	4,289	4,244	4,210	4,171	40,314	61,550
Refunding Bonds	199,881	218,002	208,626	173,061	151,725	500,973	1,452,268
Total Principal and Interest	763,808	707,945	660,774	607,102	578,292	4,456,547	7,774,468
Less: Interest Payments	284,413	260,549	237,185	220,645	200,509	1,026,086	2,229,387
	479,395	447,396	423,589	386,457	377,783	3,430,461	5,545,081
Other General Long-Term Obligations	161,550	133,951	134,760	135,040	135,621	1,760,266	2,461,188
TOTAL GENERAL LONG-TERM OBLIGATIONS ACCOUNT GROUP	$ 640,945	$ 581,347	$ 558,349	$ 521,497	$ 513,404	$ 5,190,727	$ 8,006,269

DISCRETELY PRESENTED COMPONENT UNITS

	2002	2003	2004	2005	2006	2007 Through Maturity	Total
GOVERNMENTAL FUNDS:							
Other Bonds:							
Pennsylvania Higher Educational Facilities Authority	$ 266,872	$ 258,369	$ 258,523	$ 255,058	$ 258,813	$ 4,783,035	$ 6,080,670
State Public School Building Authority	46,890	46,455	45,608	44,051	43,786	408,134	634,924
Total Principal and Interest	313,762	304,824	304,131	299,109	302,599	5,191,169	6,715,594
Less: Interest Payments	169,912	171,735	166,737	161,165	155,361	1,692,282	2,517,192
TOTAL GOVERNMENTAL FUNDS	$ 143,850	$ 133,089	$ 137,394	$ 137,944	$ 147,238	$ 3,498,887	$ 4,198,402
PROPRIETARY FUNDS:							
Revenue Bonds:							
Pennsylvania Higher Education Assistance Agency	$ 39,993	$ 40,008	$ 40,013	$ 40,014	$ 34,738	$ 982,255	$ 1,177,021
Pennsylvania Housing Finance Agency	242,158	245,708	230,412	231,341	229,313	4,359,997	5,538,929
Pennsylvania Industrial Development Authority	42,525	42,399	42,243	41,623	40,322	245,907	455,019
Pennsylvania Turnpike Commission	361,817	142,125	141,205	141,398	140,707	2,092,026	3,019,278
Pennsylvania Infrastructure Investment Authority	22,226	22,075	21,768	21,388	20,493	100,602	208,552
Total Principal and Interest	708,719	492,315	475,641	475,764	465,573	7,780,787	10,398,799
Less: Interest Payments	326,315	323,073	313,511	304,080	293,393	2,989,748	4,550,120
TOTAL PROPRIETARY FUNDS	382,404	169,242	162,130	171,684	172,180	4,791,039	5,848,679
TOTAL COMPONENT UNITS	$ 526,254	$ 302,331	$ 299,524	$ 309,628	$ 319,418	$ 8,289,926	$10,047,081

NOTE K – LONG-TERM OBLIGATIONS (continued)

The Commonwealth has entered into certain agreements to lease various facilities and equipment. Such agreements are in-substance purchases (capital leases) and are reported as Capital Lease Obligations. In addition, the Commonwealth also makes purchases using installment purchase arrangements. The following is a schedule by fiscal year of future minimum payments under capital leases and installment purchase obligations, together with the present value of the net minimum lease payments as of June 30, 2001 (amounts in thousands):

	Primary Government			Discretely Presented Component Units	
	General Long-Term Obligations	Master Lease Obligations	Installment Purchase Obligations	Pennsylvania Higher Education Assistance Agency	College and University Funds
Fiscal year ending June 30					
2002	$ 8,046	$ 61,387	$ 9,906	$ 6,498	$ 37,621
2003	7,355	61,337	8,584	52,730	36,334
2004	6,794	61,287	4,824	-	36,040
2005	6,328	61,224	1,784	-	35,518
2006	6,224	61,197	708	-	35,045
Later years	62,307	520,955	4,255	-	482,192
Total minimum lease payments	97,054	827,387	30,061	59,228	662,750
Less: amount representing estimated executory cost included in minimum lease payments	12,152	-	-	-	-
Net minimum lease payments and Installment purchases	84,902	827,387	30,061	59,228	662,750
Less: amount representing interest	32,603	232,867	3,896	8,398	261,260
TOTAL CAPITAL LEASE AND INSTALLMENT PURCHASE OBLIGATIONS	$ 52,299	$ 594,520	$ 26,165	$ 50,830	$ 401,490

At June 30, 2001 general fixed assets included $95.8 million of buildings and $4.9 million of equipment being procured by capital leases. A total of $51.7 million in general fixed assets is being procured by vendor-financed installment purchase arrangements.

Capital lease obligations outstanding as of June 30, 2001 for the College and University Funds relate to various capital projects currently under construction for which a related public financing authority is the lessor. Revenue bonds were issued by the public financing authority to provide funding for these capital projects. College and University Funds fixed assets include $79.8 million of construction in progress related to capital leases at June 30, 2001.

In prior fiscal years, the Commonwealth entered into three lease arrangements with a trustee for the refinancing of previously existing leases and installment purchase arrangements and for the leasing of new equipment. These arrangements provided that the trustee issue certificates of participation, the proceeds of which allowed for immediate payment to Commonwealth equipment vendors. These arrangements were not a general or moral obligation of the Commonwealth; under the arrangements, Commonwealth agencies were responsible for securing appropriations to make lease payments to the trustee, over a specified term, sufficient to fund periodic principal and interest payments to the certificate holders. While Commonwealth agencies maintained custody and use of the leased equipment, the trustee held legal title to the equipment as security for the agency payments. During the fiscal year ended June 30, 2001 the certificates were fully funded and legal title to the equipment now vests with the Commonwealth agencies.

Conduit Debt

The Pennsylvania Economic Development Financing Authority (PEDFA) finances projects on behalf of local industrial and commercial development authorities to promote economic growth within the Commonwealth. Revenue bonds issued by the PEDFA represent limited obligations payable solely from Authority financed project revenues. At June 30, 2001 the PEDFA has $1,240 million of debt outstanding. Neither PEDFA nor the Commonwealth has any obligation for this debt. Therefore, neither the financed assets nor the bonds are included in the accompanying financial statements.

The Pennsylvania Energy Development Authority (PEDA) finances projects related to energy conservation and research. Fees are assessed to recover related processing and application costs incurred. The bonds issued by the Authority represent limited obligations payable solely from payments made by the borrowing entities. The majority of the bonds are secured by the property financed. Upon repayment of a bond, ownership of acquired property transfers from the trustees to the entity served by the bond issuance. The PEDA has $99.7 million in revenue bonds outstanding at June 30, 2001. The Commonwealth has no obligation for this debt. Accordingly, neither the financed assets nor the bonds are included in the accompanying financial statements.

NOTE L - REFUNDED DEBT

Primary Government

In prior years, the Commonwealth defeased certain general obligation bonds by placing the proceeds of refunding bonds in irrevocable trusts to provide for all future debt service payments on the refunded bonds. At June 30, 2001, $336.1 million of general obligation bonds outstanding that were previously accounted for in the General Long-Term Obligations Account Group have been defeased through advance refundings.

Discretely Presented Component Units

During the fiscal year ended June 30, 2001 the State Public School Building Authority (SPSBA) and the Pennsylvania Higher Educational Facilities Authority (PHEFA), governmental fund component units, issued revenue bonds to advance and current refund $20.5 million and $42.5 million, respectively, of previously issued revenue bonds as follows (amounts in thousands):

Category	School Revenue Bonds North Star School District Series of 2001	College Revenue Bonds Butler County Community College Series A of 2001	University of the Arts Revenue Bonds Series of 2000
Issuing Authority	SPSBA	SPSBA	PHEFA
Bond Type	Revenue	Revenue	Revenue
Date Issued	6/01/01	4/26/01	12/20/00
Refunding Bonds Principal	$8,330	$13,925	$27,150/$2,250
Interest Rate (Refunding)	4.35%	5.13%	5.84%
Refunded Series	School Revenue Bonds North Star School District Series H of 1991*	College Revenue Bonds Butler County Community College Series D of 2000 Series G of 2000	University of the Arts Revenue Bonds Series of 1999 Series of 2000
Refunded Bonds Principal	$8,060	$11,135/$1,280	$23,300/$2,000
Interest Rate (Refunded)	6.56%	5.97%/5.88%	5.40%/Variable
Payment to Escrow Agent	$8,262	$13,253	$22,331
Payment to Paying Agent.	-	-	$2,159
Debt Service Savings (Loss)	$436	$211	**
Economic Gain (Loss)	$418	$302	**

Category	St. Joseph's University College Revenue Bonds Series A of 2001	Fortier Development Corp. St. Joseph's University Revenue Bonds Series H	King's College Assn. Of Independent Colleges & U. of PA Finance Program Revenue Bonds Series H6 and H7 of 2001
Issuing Authority	PHEFA	PHEFA	PHEFA
Bond Type	Revenue	Revenue	Revenue
Date Issued	3/01/01	6/12/01	6/12/01
Refunding Bonds Principal	$10,000	$5,600	$3,200
Interest Rate (Refunding)	Variable	Variable	Variable
Refunded Series	St. Joseph's University Revenue Bonds Series C-4 of 1998	Fortier Development Corp. St. Joseph's University Revenue Bonds Series G2 of 2000	King's College Revenue Bonds Series B4 of 1997
Refunded Bonds Principal	$8,600	$5,500	$3,100
Interest Rate (Refunded)	Variable	Variable	Variable
Payment to Escrow Agent	$8,712	-	$3,125
Payment to Paying Agent.	-	$5,527	-
Debt Service Savings (Loss)	***	****	$5
Economic Gain	***	****	($81)

* Current refunding.

** University of the Arts advance refunded the 1999 issue due to zoning litigation on the proposed construction of a new student dormitory. The 2000 bonds will result in the purchase of two existing buildings for that purpose. The 2000 notes were refunded to convert a short-term note to long-term bonds.

*** Tax exempt bonds were refunded by taxable bonds due to litigation over a proposed conversion of an apartment building to student housing.

**** Refunded short-term financing with a long-term bond issue.

NOTE L – REFUNDED DEBT (continued)

The net refunding bond proceeds, after payment of underwriting fees, insurance, and other issuance costs, were used to purchase U.S. Government securities which were deposited in irrevocable trusts to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from the General Long-Term Obligations Account Group.

The SPSBA and the PHEFA reported advance and current refundings in their component unit financial statements for the Hazleton Area School District, the Danville Area School District, the Southern Lehigh School District, the Allegheny County Hospital, the Cumberland County Municipal Authority, and the Allegheny County Higher Education Building Authority, which are not reported in the preceding table. The liability for the refunded debt was removed from their General Long-Term Obligations Account Group; however, since the SPSBA and the PHEFA did not issue any new debt, these were not advance or current refunding transactions of the SPSBA or the PHEFA. Furthermore, there were no debt service savings nor any economic gain or loss to the SPSBA or the PHEFA.

At June 30, 2001, $490.8 million of bonds outstanding that were previously accounted for in their General Long-Term Obligations Account Group have been defeased through advance or current refundings for the PHEFA and the SPSBA. Included are $426.7 million for the PHEFA and $64.1 million for the SPSBA.

During the fiscal year ended June 30, 2001, the Pennsylvania Housing Finance Agency (PHFA), a proprietary fund component unit, redeemed prior to maturity $53.8 million of Single Family Mortgage Revenue Bonds, Series Z, 1990-29, 1991-30, 1991-31, 1992-33, 1994-38, 1994-41, 1994-42, 1995-44, 1995-45, 1995-46, 1996-47, 1996-48, 1996-50, 1996-51, 1996-52, 1996-53, 1997-54, 1997-56, 1997-57, 1997-58, 1997-59, 1997-60, 1997-61 1997-62, 1998-64, 1999-65, 1999-66, 1999-67 and 1999-68 using mortgage prepayments. Extraordinary losses of $548 thousand resulted from the redemptions as unamortized bond discount and related costs of issuance for the bonds redeemed were expensed. During the year ended June 30, 2001 the PHFA did not redeem any Single Family Mortgage Revenue Bonds prior to maturity, using bond proceeds.

At June 30, 2001, $7.1 million of bonds outstanding that were previously accounted for in the financial statements of the PHFA have been defeased through refundings.

During the fiscal year ended May 31, 2001 the Pennsylvania Turnpike Commission (PTC), a proprietary fund component unit, issued $244.9 million in Series S Revenue Refunding Bonds at 3.4 to 5.6 percent to advance refund the PTC's Series L Revenue Bonds which occurred on June 1, 2001.

At May 31, 2001, $724 million of bonds outstanding that were previously accounted for in the financial statements of the PTC have been defeased through refundings.

At June 30, 2001, $24.3 million of bonds outstanding that were previously accounted for in the financial statements of the Pennsylvania Infrastructure Investment Authority, a proprietary fund component unit, have been defeased through refundings.

At June 30, 2001, $89.4 million of bonds outstanding that were previously accounted for in the financial statements of the Pennsylvania Industrial Development Authority, a proprietary fund component unit, have been defeased through refundings.

At June 30, 2001, $65.0 million of bonds outstanding that were previously accounted for in the financial statements of the State System of Higher Education, a college and university fund component unit, have been defeased through refundings.

NOTE M - RECONCILIATION OF BUDGETARY TO GAAP BASIS AMOUNTS

The Commonwealth adopts formal annual budgets for the General and five Special Revenue Funds (Motor License, State Lottery, Workmen's Compensation Administration, Banking Department, and Milk Marketing). The Combined Statement of Revenues, Expenditures, and Changes in Unreserved/Undesignated Fund Balances—Budget and Actual (Budgetary Basis)—presents comparisons of the legally adopted budget, as amended, with actual data on a budgetary basis, which differs from GAAP primarily by the omission of certain revenue and expenditure accruals.

The following presents a reconciliation of the budgetary basis to the GAAP basis of reporting (amounts in thousands):

	General Fund	Special Revenue Funds
BUDGETARY BASIS:		
Budgetary basis — revenues and other sources under expenditures	$ (275,069)	$ (49,685)
Adjustments:		
To adjust revenues, other financing sources and related receivables and deferred revenue	917,513	1,831,759
To adjust expenditures, other financing uses and related accounts payable and accrued liabilities	(305,402)	(1,722,658)
Net adjustments	612,111	109,101
NONBUDGETED FUNDS:		
GAAP basis — revenues and other sources over expenditures and other uses	-	12,891
TOTAL ALL FUNDS:		
GAAP basis — revenues and other sources over expenditures and other uses	$ 337,042	$ 72,307

The above revenue adjustments include net revenue accruals, amounts to recognize certain pass-through grants and amounts to recognize certain intergovernmental revenues that are not reported for budgetary reporting purposes. Likewise, the above expenditure adjustments include net expenditure accruals, amounts to recognize certain pass-through grants and amounts to recognize certain expenditures related to Federal and other grants that are not reported for budgetary reporting purposes.

NOTE N – SEGMENT INFORMATION

The Commonwealth's Primary Government includes seven major Enterprise Funds that provide for a variety of loan programs to business and government organizations, workmen's compensation insurance services, liquor sales and capital development loans. The following is a summary of selected financial information related to these Enterprise Funds (amounts in thousands):

	Tuition Payment	Small Business First	State Workmen's Insurance (Dec. 31, 2000)	State Stores (Jun. 26, 2001)	Volunteer Company Loan	Minority Business Development	Machinery and Equipment Loan	Other Enterprise Funds	Total Enterprise Funds
Operating revenues	$ 51,315	$ 6,515	$ 200,245	$ 922,805	$ 2,780	$ 365	$ 3,056	$ 25,410	$ 1,212,491
Depreciation	-	-	299	2,959	-	-	-	2,053	5,311
Operating income (loss)	(11,130)	3,851	78,443	81,270	2,754	(51)	1,664	4,347	161,148
Operating transfers out	-	407	-	51,758	-	-	-	-	52,165
Net income (loss)	(11,130)	3,444	78,443	36,011	2,754	(51)	1,664	5,470	116,605
Increase in contributed capital	-	13,000	-	-	-	-	6,000	5,078	24,078
Acquisition and construction of capital assets	-	-	185	6,999	-	-	-	506	7,690
Net increase (decrease) in cash	(45)	85	886	842	33	15	102	(1)	1,917
Total assets	251,548	124,014	1,714,136	282,583	113,766	5,435	63,329	81,926	2,636,737
Bonds and other long-term liabilities payable from operating revenues	-	-	1,054,252	-	-	-	-	-	1,054,252
Total fund equity	14,034	120,895	271,411	145,480	113,694	5,422	63,309	76,543	810,788
Net working capital	83,139	52,742	56,799	124,842	10,498	3,644	19,771	57,159	408,594

NOTE O - SELF-INSURANCE

The Commonwealth is self-insured for statutory workers' compensation, which includes indemnity and medical benefits (employee disability), for its employees injured on the job. The Commonwealth is also self-insured for annuitant medical/hospital claims and for tort liability claims. Major tort risks include automobile, employee and general torts. For property losses, the Commonwealth has $1 million retention with excess commercial insurance coverage up to $134 million per occurrence. The Commonwealth is also self-insured for claims against the Department of Transportation (transportation claims). The Commonwealth has established various administrative policies that are intended to avoid or limit the aforementioned risks.

There were no reductions in commercial insurance coverage during the fiscal year ended June 30, 2001. No settlements exceeded commercial insurance coverage during each of the past three fiscal years.

The accrued liabilities for employee disability and annuitant medical/hospital claims are determined by an actuary in accordance with accepted actuarial principles. The accrued liability for employee disability was calculated including the effects of changes in statutory benefits from Act 44 of 1993 and Act 57 of 1997. Accrued liabilities for tort and transportation claims are established based on reserves computed from the Commonwealth's claim experience; such claims are not discounted. These liabilities include liabilities for allocated claim adjustment expenditures/expenses and include salvage and subrogation. Salvage and subrogation were not material for the fiscal year ended June 30, 2001. No accrued liability has been reported for property losses.

At June 30, 2001, the accrued liabilities which will be paid with current expendable available financial resources are reported in the General Fund and the Motor License Fund, a Special Revenue fund. Those liabilities which will not be paid with current expendable available financial resources at June 30, 2001 are reported in the General Long-Term Obligations Account Group (GLTOAG). All accrued self-insurance liabilities at June 30, 2001 are summarized as follows (amounts in thousands):

	General Fund	Motor License Fund	GLTOAG	Total
Employee disability	$ 71,272	$ -	$ 307,662	$ 378,934
Annuitant medical/hospital	36,181	-	-	36,181
Automobile tort	2,771	-	15,015	17,786
Employee tort	2,450	-	23,636	26,086
General tort	1,625	-	31,104	32,729
Transportation	-	16,786	256,029	272,815
Totals	$ 114,299	$ 16,786	$ 633,446	$ 764,531

The following summary provides aggregated information on June 30, 2000 reported self-insurance liabilities; incurred claims and payments during the fiscal year ended June 30, 2001 and reported self-insurance liabilities at June 30, 2001 (amounts in thousands):

	June 30, 2000	Incurred Claims		Payments		June 30, 2001
	Liability	Current	Prior	Current	Prior	Liability
Employee disability	$ 351,801	$ 42,509	$ 51,240	$ 6,770	$ 59,846	$ 378,934
Annuitant medical/hospital	32,205	289,386	-	253,205	32,205	36,181
Automobile tort	17,827	6,079	(3,596)	917	1,607	17,786
Employee tort	29,242	1,754	(2,664)	4	2,242	26,086
General tort	36,407	6,751	(8,138)	32	2,259	32,729
Transportation	254,131	56,858	(26,811)	440	10,923	272,815
Totals	$ 721,613	$ 403,337	$ 10,031	$ 261,368	$109,082	$ 764,531

NOTE O - SELF-INSURANCE (continued)

The following summary provides aggregated information on June 30, 1999 self-insurance liabilities; incurred claims and payments during the fiscal year ended June 30, 2000 and reported self-insurance liabilities at June 30, 2000 (amounts in thousands):

	June 30, 1999 Liability	Incurred Claims Current	Incurred Claims Prior	Payments Current	Payments Prior	June 30, 2000 Liability
Employee disability	$ 366,785	$ 33,726	$ 16,869	$ 5,630	$ 59,949	$ 351,801
Annuitant medical/hospital	32,630	254,455	-	222,250	32,630	32,205
Automobile tort	16,740	1,600	2,785	784	2,514	17,827
Employee tort	27,931	232	4,290	-	3,211	29,242
General tort	35,931	870	918	17	1,295	36,407
Transportation	245,952	4,448	20,188	495	15,962	254,131
Totals	$ 725,969	$ 295,331	$ 45,050	$ 229,176	$115,561	$ 721,613

NOTE P – COMMITMENTS AND CONTINGENCIES

Construction and Other Commitments: At June 30, 2001, the Department of Transportation and at May 31, 2001, the Pennsylvania Turnpike Commission, a discretely presented component unit, have contractual commitments of approximately $2,291.4 million and $499 million, respectively, for various highway construction and mass transit projects. Financing for these future expenditures will be primarily from approved federal grants and general obligation bond proceeds. In addition, the Commonwealth has a variety of contractual and other commitments for future subsidies and purchases of goods and services for approximately $5.3 billion at June 30, 2001. Actual expenditures are contingent upon approved spending authority and/or availability of financial resources.

Loan Commitments: At June 30, 2001, the following discretely presented component units had approved loans that had not been disbursed (amounts in millions):

Pennsylvania Housing Finance Agency	$ 208
Pennsylvania Industrial Development Authority	173
Pennsylvania Infrastructure Investment Authority	362

Operating Lease Commitments: The Commonwealth and its discretely presented component units have commitments to lease certain buildings and equipment. Future minimum rental commitments for noncancelable operating leases as of June 30, 2001 were as follows (amounts in thousands):

Fiscal year ending June 30:

	Primary Government	Discretely Presented Component Units
2001	$ 183,296	$10,685
2002	130,591	9,515
2003	93,417	4,843
2004	71,194	987
2005	54,044	194
Later years	164,626	219
Total Minimum Lease Payments	$ 697,168	$26,443

Rental expenditures/expenses for all operating leases for the fiscal year ended June 30, 2001 amounted to $329.9 million ($323.9 million for primary government, $6 million for discretely presented component units).

NOTE P – COMMITMENTS AND CONTINGENCIES (continued)

Litigation: The Commonwealth is a defendant in numerous legal proceedings pertaining to matters normally incidental to routine operations. Such litigation includes, but is not limited to, claims asserted against the Commonwealth arising from alleged torts, alleged breaches of contracts, condemnation proceedings and other alleged violations of Commonwealth and Federal laws. The Commonwealth has recorded accrued liabilities at June 30, 2001 with respect to torts as described in Note O, and other General Long-Term Obligations with respect to other matters of litigation in the amount of $108,516 thousand for which the likelihood of an unfavorable outcome is probable.

Additionally, the Commonwealth is currently involved in certain legal proceedings relative to a case concerning the distribution of certain state funding for public education in an approximate amount ranging from $200 million to $1 billion. Other cases that the Commonwealth is vigorously contesting could range from approximately $173 million to $825 million, zero to $223 million, zero to $15 million, zero to $3 million, zero to $1 million, and zero to $27 million of additional liabilities for the General Fund, Special Revenue Funds, Capital Projects Funds, Enterprise Funds, Expendable Trust Funds and the Pension Trust Fund, respectively. Based on the current status of all these legal proceedings, for which accruals have not been made, it is the opinion of the Commonwealth's management and counsel that they will not have a material effect on the Commonwealth's financial position.

Federal Grants: The Commonwealth receives significant financial assistance from the Federal government in the form of grants and entitlements, including several non-cash programs (which are not included in the general purpose financial statements). Receipt of grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable Federal regulations, including the expenditure of resources for eligible purposes. Substantially all grants are subject to either the Federal Single Audit Act or to financial and compliance audits by the grantor agencies of the Federal government or their designees. Disallowances and sanctions as a result of these audits may become liabilities of the Commonwealth. The Commonwealth is currently involved in administrative and legal proceedings, with certain Federal agencies, contesting various disallowances and sanctions related to Federal Assistance Programs ranging from $120 to $496 million at June 30, 2001. The Commonwealth's management believes ultimate disallowances and sanctions, if any, will not have a material effect on the general purpose financial statements.

Student Loan Guarantees: The Pennsylvania Higher Education Assistance Agency (PHEAA), a discretely presented proprietary component unit, guarantees loans made by private lenders to certain resident students. Total original principal of outstanding guarantees issued by PHEAA approximated $17 billion at June 30, 2001. Under the Higher Education Act of 1965, as amended, the PHEAA has entered into an agreement with the U.S. Department of Education for reinsurance of death, disability, bankruptcy, default, school closure and borrower ineligibility claims paid to lenders. Pursuant to this agreement, PHEAA receives reimbursement of claims paid to lenders, provided that PHEAA is in compliance with various federal requirements. Reinsurance rates vary from 75 percent to 100 percent depending upon default rates in the portfolio guaranteed by PHEAA. During the year ended June 30, 2000, PHEAA's default rate was in a range that permitted the maximum reinsurance reimbursement from the U.S. Department of Education.

Lottery Prizes: The State Lottery Fund, a Special Revenue Fund, awards a variety of prizes, including immediate, lump-sum cash prizes and certain large prizes which provide for periodic payments to winners for specific periods of time (in some cases throughout the winners' lifetimes, and to designated beneficiaries). At June 30, 2001, the amount of future payments owed to prizewinners is $1.6 billion. To satisfy its financial obligation to these prizewinners, the Fund purchases annuity contracts from insurance companies whereby the insurance companies make periodic payments to prizewinners. Generally, in the event of insurance company default, the Fund is liable for the related annuity payments. However, certain prizewinners voluntarily assign their annuity rights to other parties and receive lump-sum payments in return. In the event of insurance company default where annuity rights have been voluntarily assigned by prizewinners, the Fund is not liable for the related annuity payments. At June 30, 2001, the future payments of $365 million have been voluntarily assigned by prizewinners.

Child Support Payments: At June 30, 2001, the Commonwealth is contingently liable for approximately $48 million in payments received by a contractor to be used for child support payments.

NOTE Q - CERTAIN AGENCY FUND CLAIMS LIABILITIES

The Medical Professional Liability Catastrophe Loss Fund, an Agency Fund, acts as a service agent to facilitate the payment of medical malpractice claims exceeding basic liability coverage carried by healthcare providers practicing in the Commonwealth. The Fund levies healthcare provider surcharges, as a percentage of insurance premiums for basic coverage, to pay claims and administrative expenses paid on behalf of healthcare providers during the prior year. The actuarially computed liability to the healthcare providers for claims outstanding at June 30, 2001 totals $2,283.3 million ($1,771.8 million at present value based on the expected payment pattern and an assumed long-term interest rate of 6 percent). The amount of expendable financial resources available to pay claims at June 30, 2001 is $136.7 million. This is reported as a fund liability. The remaining claims will be funded exclusively through surcharge assessments in future years as claims are settled and paid; as a result, a financial liability for remaining claims is not reported.

The Underground Storage Tank Indemnification Fund (the Fund), an Agency Fund, is used to collect fees from underground storage tank owners and operators sufficient to pay owners and operators for costs associated with corrective actions or for bodily injury or property damage caused by tank leaks and other releases. Owners and operators are assessed actuarially determined amounts to accumulate sufficient assets to pay claims. The Fund actuary has estimated potential claims of $380.5 million at December 31, 2000; on a pro-rata basis, $346.7 million at June 30, 2001. There are statutory limits on the extent of the Fund's liability to participating owners and operators; the Fund is not obligated beyond assets held at June 30, 2001. Owners and operators will be assessed for any claims exceeding Fund assets and no financial liability is reported for those claims.

NOTE R - DEFERRED COMPENSATION

The Commonwealth sponsors a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, which is administered by the State Employees' Retirement System, permits participants to defer a portion of their salary until future years. Amounts deferred under the plan are not available to employees until termination, retirement, death or unforeseeable emergency.

Of the $974 million in assets reported in the Deferred Compensation Fund, an Expendable Trust Fund, at December 31, 2000, $943 million relates to primary government employees and $27 million relates to employees of discretely presented component units. The remaining balance of $4 million relates to organizations not included in the Commonwealth's financial reporting entity.

NOTE S - JOINT VENTURE

The Commonwealth and various labor unions representing Commonwealth employees participate in a joint venture, the Pennsylvania Employees Benefit Trust Fund (PEBTF). The PEBTF establishes and provides health and welfare benefits for active Commonwealth employees and is a third party administrator for Commonwealth annuitant medical/hospital benefits. The Commonwealth is required to fund all necessary contributions to pay for the cost of providing benefits; the unions are not required to make contributions. Collective bargaining agreements and administrative policies establish contribution rates and/or amounts. During the fiscal year ended June 30, 2001, the Commonwealth contributed almost $715 million to fund benefits. Neither the Commonwealth nor the unions have an equity interest in the PEBTF. At June 30, 2001, the PEBTF reported total assets of $362 million, total liabilities and benefit obligations of $103 million, and net assets available for benefits of $259 million. During the fiscal year, net assets available for benefits decreased by $27 million. The financial status of the PEBTF is monitored on an ongoing basis; financial stress is not evident.

Audited financial statements for the PEBTF are available, by request, from:

William K. Schantzenbach
Chief Financial Officer
Pennsylvania Employees Benefit Trust Fund
150 South 43rd Street
Harrisburg, Pennsylvania 17111-5700

NOTE T – BUDGETARY COMPLIANCE

The General Assembly passes, and the Governor approves (or reduces or vetoes), individual appropriations as part of the annual budget adoption process. Budgetary expenditure control occurs at the appropriation level; this is the lowest level of legislative spending control. Encumbrances and expenditures within individual appropriations may not exceed total amounts appropriated plus actual augmentations (certain revenues credited to specific appropriations). Also, appropriation transfers between or within departments and any supplemental appropriations require both legislative and gubernatorial approval. The legislatively adopted budget for the General Fund includes $502 million in supplemental appropriations approved during the fiscal year ended June 30, 2001.

A separately available report, the "*Status of Appropriations*," demonstrates budgetary expenditure compliance for the General Fund for the fiscal year ended June 30, 2001. This report includes a variety of detail information and summaries related to individual appropriations. A second "*Status of Appropriations*" report (for Special Funds) demonstrates compliance for the five budgeted Special Revenue funds: Motor License, State Lottery, Workmen's Compensation Administration, Banking Department and Milk Marketing. Both "*Status*" reports are available from the Office of the Budget. The Governor controls spending by using executive authorizations for Special Revenue funds not controlled by legislatively adopted budgets.

The General Appropriation Act of 2000, for the fiscal year ended June 30, 2001, provided for one-time property tax rebates to qualifying Pennsylvania homeowners. The amounts paid to individual homeowners were based on amounts homeowners paid to school districts during the 1999-2000 fiscal year; the maximum payment per homeowner was one hundred dollars. Total disbursements of $249 million are reported as a tax revenue reduction for budgetary reporting purposes.

Total reported expenditures for "Total State Programs" included in the Combined Statement of Revenues, Expenditures and Changes in Unreserved/Undesignated Fund Balances – Budget and Actual (Budgetary Basis) are based on appropriation, augmentation and lapse amounts reported in the respective "*Status of Appropriations*" (Total All Current State Ledgers) as follows (in thousands):

	"*Status*" Page Reference	Total Approved Appropriations	+	Total Actual Augmentations	-	Total Actual Lapses	=	Reported Expenditure Amounts
General Fund amounts	7[1]	$ 21,180,672		$ 1,962,909		$199,976		$22,943,605
less: tax refunds	7[1]	(870,000)		-		-		(870,000)
less: property tax rebates	49	(330,000)		-		(81,000)		(249,000)
Amount reported		$ 19,980,672		$ 1,962,909		$118,976		$21,824,605
Special Revenue Funds:								
Motor License	50	$ 2,756,540		$ 1,167,613		$ 77,099		$ 3,847,054
less: reductions[2]		(758,324)		(1,122,481)		(52,319)		(1,828,486)
Amount reported		1,998,216		45,132		24,780		2,018,568
State Lottery	3	994,180		7,518		55,312		946,386
Workmen's Compensation Administration	252	46,388		178		308		46,258
Banking Department	89	10,538		-		649		9,889
Milk Marketing	95	2,432		-		39		2,393
Total Special Revenue Funds		$ 3,051,754		$ 52,828		$ 81,088		$ 3,023,494

Total actual expenditures for "Federal Programs" for the General Fund are derived from the General Fund "*Status,*" pkt page 239, page no. 239 "Summary of All Current Federal Ledgers by Character of Expenditure" as follows (in thousands): Commitments of $1,182,478 and Expenditures of $9,297,268, for a total of $10,479,746.

NOTE T – BUDGETARY COMPLIANCE (continued)

Total actual expenditures for "Federal Programs," Special Revenue funds, are derived from the Special Funds "*Status*" as follows (in thousands): Motor License - $954,542 (calculated in footnote 3 below) and State Lottery - $72,641 (sum of Commitments of $7,565 and Expenditures of $65,076, shown on page no.13), for a total of $1,027,183.

[1] Pkt page 7, page no. 7, "Summary of All Current State Ledgers by Character of Expenditure," General Fund "*Status of Appropriations*."

[2] Excludes the following appropriation symbols, beginning on page 51, Special Funds "*Status of Appropriations***:**" 010-003-102-00-1; 010-008-051-00-1; 010-008-053-00-1; 010-008-181-00-1; 010-003-198-00-2; 010-038-230-00-2; 010-008-212-00-2; 010-008-214-00-2; 010-008-217-00-2; 010-008-218-00-2; and 010-008-230-00-2 through 010-008-289-00-2.

[3] Consists of $1,120,054 in Year-to-Date "Total Federal Funds" on page 115 of "*Report of Revenues and Receipts*" less $165,512 in Year-to-Date Federal Funds amounts for the following revenue codes (also on page 115 of the "*Report*"): 010811-008051-101; 010811-008181-101; 010811-008181-108; 010811-008232-101; 010811-008284-101; 010811-008289-101; and 010811-008289-102.

NOTE U – SUBSEQUENT EVENTS

Primary Government

On September 15, 2001, the Commonwealth issued $301 million of General Obligation Bonds, Second Series of 2001 with an interest rate of 4.364 percent. Bond proceeds will be used for the construction and major rehabilitation of public buildings, to fund redevelopment assistance and transportation assistance projects, and for the expansion and construction of county and multi-county regional prison facility projects.

On October 30, 2001, the General Assembly passed and the Governor signed Senate Bill 640 that permitted the Commonwealth to take control of the financially and academically distressed Philadelphia City School District. The Mayor of Philadelphia and the Governor continue to pursue agreement on a plan addressing the School District's financial and academic problems.

Discretely Presented Component Units

On September 26, 2001, the Pennsylvania Housing Finance Agency (PHFA) a proprietary fund component unit, issued $225 million of Series 2001-72 Single Family Mortgage Revenue Bonds. The proceeds of the bonds will be used to refund certain of the PHFA's outstanding Single Family Mortgage Revenue Bonds, and to fund the purchase of new single family mortgage loans.

In April 2001, the Pennsylvania Turnpike Commission (PTC), a proprietary fund component unit, approved the issuance of Series T and Series U Revenue Refunding Bonds for the purpose of advance refunding Series M and Series N Revenue Bonds. The PTC also approved the issuance of Series V and Series W Revenue Refunding Bonds for the purpose of advance refunding Series O and Series P Revenue Bonds. Series T, Series U, Series V, and Series W Revenue Refunding Bonds will be issued in fiscal year 2002.

In July 2001, the PTC issued $476.1 million in Registration Fee Bonds. The bonds, which are used to finance a portion of the costs related to the Mon/Fayette Extension and other construction related projects will be paid back from the PTC's grants from the Commonwealth of Pennsylvania's Motor License Fund.

In July 2001, the State System of Higher Education (SSHE), a college and university fund component unit, entered into a loan agreement with the Pennsylvania Higher Educational Facilities Authority (PHEFA) in connection with the issuance by the PHEFA of $69.6 million of Series T tax-exempt bonds. Under the agreement, the SSHE pledged its full faith and credit for the repayment of the bonds. The bonds were issued to provide funds to undertake various capital projects at the universities within the SSHE.

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Schedule of Expenditures of Federal Awards - June 30, 2001

CFDA #	CFDA Name		Federal Expenditures (000's)
10.551	FOOD STAMPS	$639,755	
10.561	ST. ADMIN. MATCH. GRANTS FOR FOOD STAMP PROG.	113,402	
	TOTAL FOOD STAMP CLUSTER		753,157
10.553	SCHOOL BREAKFAST PROGRAM	35,266	
10.555	NATIONAL SCHOOL LUNCH PROGRAM	163,554	
10.556	SPECIAL MILK PROGRAM FOR CHILDREN	747	
10.559	SUMMER FOOD SERVICE PROG. FOR CHILDREN	14,886	
	TOTAL CHILD NUTRITION CLUSTER		214,453
10.568	EMERGENCY FOOD ASSISTANCE PROGRAM (ADMIN.)	1,952	
10.569	EMERGENCY FOOD ASSISTANCE PROGRAM (COMM.)	12,262	
	TOTAL EMERGENCY FOOD ASSISTANCE CLUSTER		14,214
10.025	PLANT & ANIMAL DISEASE & PEST CONTROL		353
10.156	FEDERAL – STATE MARKETING IMPROV. PROGRAM		39
10.162	INSPECTION GRADING & STANDARDIZATION		93
10.250	AGRICULTURAL & RURAL ECONOMIC RESEARCH		116
10.550	FOOD DONATION		28,489
10.557	SPECIAL SUPP. NUTRITION PROGRAM FOR WIC		123,829
10.558	CHILD AND ADULT CARE FOOD PROGRAM		37,579
10.560	STATE ADMIN. EXP. FOR CHILD NUTRITION		2,826
10.564	NUTRITION EDUCATION & TRAINING PROGRAM		-8
10.570	NUTRITION PROGRAM FOR THE ELDERLY		6,377
10.572	WIC FARMERS' MARKET NUTRITION PROGRAM		1,927
10.574	TEAM NUTRITION GRANTS		260
10.652	FORESTRY RESEARCH		67
10.664	COOPERATIVE FORESTRY ASSISTANCE		2,001
10.665	SCHOOLS AND ROADS – GRANTS TO STATES		2,982
10.769	RURAL BUSINESS ENTERPRISE GRANTS		12
10.902	SOIL AND WATER CONSERVATION		964
10.904	WATERSHED PROTECTION & FLOOD PREVENTION		13
	TOTAL DEPARTMENT OF AGRICULTURE		**$1,189,743**
11.307	ECONOMIC ADJUSTMENT ASSISTANCE		200
11.419	COASTAL ZONE MGMT. ADMIN. AWARDS		1,119
11.450	INTEGRATED FLOOD OBSERVING & WARNING SYSTEM		89
11.457	CHESAPEAKE BAY STUDIES		262
	TOTAL DEPARTMENT OF COMMERCE		**$1,670**
12.112	PAYMENTS TO STATES IN LIEU OF REAL ESTATE TAXES		175
12.400	MILITARY CONSTRUCTION – NATIONAL GUARD		9
12.401	NATL. GUARD MILITARY OPERATIONS & MAIN. PROJECTS		16,880
	TOTAL DEPARTMENT OF DEFENSE		**$17,064**

- See Notes to Schedule of Expenditures of Federal Awards -

Schedule of Expenditures of Federal Awards - June 30, 2001

CFDA #	CFDA Name		Federal Expenditures (000's)
14.228	COMMUNITY DEV. BLOCK GRANTS – STATE'S PROGRAM		53,686
14.231	EMERGENCY SHELTER GRANTS PROGRAM		2,767
14.239	HOME INVESTMENT PARTNERSHIPS PROGRAM		17,585
14.241	HOUSING OPPORTUNITIES FOR PERSONS WITH AIDS		1,176
14.401	FAIR HOUSING ASSISTANCE PROGRAM		676
	TOTAL DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT		**$75,890**
15.605	SPORT FISH RESTORATION	6,174	
15.611	WILDLIFE RESTORATION	8,045	
	TOTAL FISH AND WILDLIFE CLUSTER		14,219
15.250	REGULATION OF SURFACE COAL MINING		11,389
15.252	ABANDONED MINE LAND RECLAMATION PROGRAM		17,693
15.612	ENDANGERED SPECIES CONSERVATION		53
15.616	CLEAN VESSEL ACT		38
15.808	U.S. GEOLOGICAL SURVEY – RESEARCH AND DATA ACQ.		24
15.810	NATL. COOP. GEOLOGIC MAPPING PROGRAM		86
15.904	HISTORIC PRESERVATION FUND GRANTS		905
15.916	OUTDOOR RECREATION – ACQ. DEV. & PLAN.		275
	TOTAL DEPARTMENT OF THE INTERIOR		**$44,682**
16.004	LAW ENFORCEMENT ASSIST. – NARC. & DANGEROUS DRUGS		244
16.007	STATE DOMESTIC PREPAREDNESS EQUIP. SUPPORT		71
16.523	JUVENILE ACCOUNT. INCENTIVE BLOCK GRANTS		7,772
16.540	JUVENILE JUSTICE & DELINQUENCY PREVENTION		3,119
16.548	TITLE V – DELINQUENCY PREVENTION PROGRAM		1,564
16.549	PART E – STATE CHALLENGE ACTIVITIES		522
16.550	STATE JUSTICE STATISTICS PROGRAM		16
16.554	NATIONAL CRIMINAL HISTORY IMPROVEMENT PROGRAM		4,167
16.560	JUSTICE RESEARCH EVAL. & DEV. PROJECT GRANTS		127
16.572	STATE CRIMINAL ALIEN ASSISTANCE		4,544
16.574	BYRNE EVALUATION PARTNERSHIP PROGRAM		6,123
16.575	CRIME VICTIM ASSISTANCE		14,289
16.576	CRIME VICTIM COMPENSATION		1,315
16.579	BYRNE FORMULA GRANT PROGRAM		19,978
16.582	CRIME VICTIM ASSISTANCE – DISCRETIONARY GRANTS		115
16.588	VIOLENCE AGAINST WOMEN FORMULA GRANTS		5,110
16.589	RURAL DOMESTIC VIOLENCE & CHILD VIC. PROGRAM		110
16.592	LOCAL LAW ENFORCEMENT BLOCK GRANTS PROGRAM		2,354
16.607	BULLETPROOF VEST PARTNERSHIP PROGRAM		571
16.727	ENFORCING UNDERAGE DRINKING LAWS PROGRAM		378
	TOTAL DEPARTMENT OF JUSTICE		**$72,489**

- See Notes to Schedule of Expenditures of Federal Awards -

Schedule of Expenditures of Federal Awards - June 30, 2001

CFDA #	CFDA Name		Federal Expenditures (000's)
17.207	EMPLOYMENT SERVICE	39,698	
17.801	DISABLED VETERANS OUTREACH PROGRAM	3,253	
17.804	LOCAL VETERANS' EMPLOYMENT REP. PROGRAM	3,941	
	TOTAL EMPLOYMENT SERVICES CLUSTER		46,892
17.246	EMP. & TRNG. ASSISTANCE – DISLOCATED WORKERS	9,267	
17.250	JOB TRAINING PARTNERSHIP ACT	-77	
	TOTAL JTPA CLUSTER		9,190
17.002	LABOR FORCE STATISTICS		2,325
17.005	COMPENSATION AND WORKING CONDITIONS		36
17.203	LABOR CERTIFICATION FOR ALIEN WORKERS		614
17.225	UNEMPLOYMENT INSURANCE		1,920,983
17.235	SENIOR COMMUNITY SERVICE EMPLOY. PROG.		4,682
17.245	TRADE ADJUSTMENT ASSISTANCE – WORKERS		36,588
17.249	EMP. SVCS. & JOB TRNG. – PILOT & DEMO. PROG.		2,452
17.253	WELFARE-TO-WORK GRANTS TO STATES		25,537
17.255	WORKFORCE INVESTMENT ACT		89,091
17.600	MINE HEALTH AND SAFETY GRANTS		604
17.802	VETERANS EMPLOYMENT PROGRAM		16
	TOTAL DEPARTMENT OF LABOR		**$2,139,010**
20.205	HIGHWAY PLANNING AND CONSTRUCTION	1,153,416	
23.003	APPALACHIAN DEV. HIGHWAY SYSTEM	-4,816	
	TOTAL HIGHWAY PLANNING AND CONSTRUCTION CLUSTER		1,148,600
20.600	STATE & COMMUNITY HIGHWAY SAFETY	8,052	
20.601	ALCOHOL TRAFFIC SAFETY & DRUNK DRIVING PREV. GRANTS	662	
	TOTAL HIGHWAY SAFETY CLUSTER		8,714
20.005	BOATING SAFETY FINANCIAL ASSISTANCE		1,427
20.106	AIRPORT IMPROVEMENT PROGRAM		7,699
20.218	NATIONAL MOTOR CARRIER SAFETY		5,174
20.219	RECREATIONAL TRAILS PROGRAM		359
20.308	LOCAL RAIL FREIGHT ASSISTANCE		9
20.500	FEDERAL TRANSIT – CAPITAL INVESTMENT GRANTS		88
20.505	FEDERAL TRANSIT – METROPOLITAN PLANNING GRANTS		2,449
20.509	FORMULA GRANTS FOR OTHER THAN URBANIZED AREAS		7,492
20.513	CAP. ASSIST. PROGRAM – ELDERLY & PERSONS WITH DISAB.		3,402
20.514	TRANSIT PLANNING AND RESEARCH		552
20.700	PIPELINE SAFETY		293
20.703	INTER. HAZARDOUS MATL. PUBLIC TRNG. GRANTS		296
	TOTAL DEPARTMENT OF TRANSPORTATION		**$1,186,554**

Schedule of Expenditures of Federal Awards - June 30, 2001

CFDA #	CFDA Name	Federal Expenditures (000's)
23.008	APPALACHIAN LOCAL ACCESS ROADS	-21
23.011	APPALACHIAN STATE RESEARCH & TECH. ASSIST.	697
	TOTAL APPALACHIAN REGIONAL COMMISSION	**$676**
30.002	EMPLOYMENT DISCRIMINATION	1,431
	TOTAL EQUAL EMPLOYMENT OPPORTUNITY COMMISSION	**$1,431**
39.003	DONATION OF FED. SURPLUS PERSONAL PROPERTY	5,704
	TOTAL GENERAL SERVICES ADMINISTRATION	**$5,704**
45.025	PROMOTION OF THE ARTS – PARTNERSHIP AGREEMENTS	612
45.310	STATE LIBRARY PROGRAM	6,122
	TOTAL NATIONAL FOUNDATION ON THE ARTS AND HUMANITIES	**$6,734**
64.010	VETERANS NURSING HOME CARE	729
64.014	VETERANS STATE DOMICILIARY CARE	3,462
64.015	VETERANS STATE NURSING HOME CARE	18,777
64.111	VETERANS EDUCATION ASSISTANCE	801
	TOTAL DEPARTMENT OF VETERANS AFFAIRS	**$23,769**
66.001	AIR POLLUTION CONTROL PROGRAM SUPPORT	3,960
66.032	STATE INDOOR RADON GRANTS	408
66.419	WATER POLLUTION CONTROL – STATE & INTERSTATE	3,084
66.432	STATE PUBLIC WATER SYSTEM SUPERVISION	3,428
66.438	CONSTRUCTION MANAGEMENT ASSISTANCE	432
66.454	WATER QUALITY MANAGEMENT PLANNING	396
66.458	CAPITALIZATION GRANTS FOR STATE REVOLVING FUNDS	52,596
66.460	NONPOINT SOURCE IMPLEMENTATION GRANTS	4,560
66.461	WETLANDS GRANTS	129
66.463	WATER QUALITY COOPERATIVE AGREEMENTS	451
66.466	CHESAPEAKE BAY PROGRAM	3,756
66.467	WASTEWATER OPERATOR TRNG. PROGRAM	3
66.468	CAPITALIZATION GRANTS FOR DRINKING WATER	30,143
66.470	HARDSHIP GRANTS PROGRAM FOR RURAL COMM.	553
66.606	SURVEYS STUDIES INVEST. & SPEC. PURPOSE GRANTS	1,088
66.608	ONE STOP REPORTING	247
66.700	CONSOLIDATED PESTICIDE ENFORCEMENT COOP. AGREE.	862
66.701	TOXIC SUBSTANCES COMPLIANCE MON. COOP. AGREE.	104
66.707	TSCA TITLE IV STATE LEAD GRANTS	858

- See Notes to Schedule of Expenditures of Federal Awards -

Schedule of Expenditures of Federal Awards - June 30, 2001

CFDA #	CFDA Name		Federal Expenditures (000's)
66.708	POLLUTION PREVENTION GRANTS PROGRAM		54
66.801	HAZARDOUS WASTE MGMT. STATE PROG. SUPP.		4,328
66.802	SUPERFUND STATE SITE – SPECIFIC COOP. AGREEMENTS		37
66.804	STATE UNDERGROUND STORAGE TANKS PROGRAM		187
66.805	LEAKING UNDERGROUND STORAGE TANK PROGRAM		1,578
	TOTAL ENVIRONMENTAL PROTECTION AGENCY		**$113,242**
81.041	STATE ENERGY PROGRAM		1,690
81.042	WEATHERIZATION ASSIST. FOR LOW-INCOME PERSONS		8,568
81.105	NATIONAL INDUST. COMP. – ENERGY ENV. & ECON.		13
81.111	ALTERNATIVE FUEL TRANS. PROGRAM		5
	TOTAL DEPARTMENT OF ENERGY		**$10,276**
83.010	NATIONAL FIRE ACADEMY EDUCATIONAL PROGRAM		14
83.105	COMMUNITY ASSIST. PROGRAM – STATE SUPPORT		148
83.536	FLOOD MITIGATION ASSISTANCE		654
83.543	INDIVIDUAL AND FAMILY GRANTS		133
83.544	PUBLIC ASSISTANCE GRANTS		2,588
83.547	FIRST RESPONDER COUNTER-TERRORISM TRNG.		68
83.548	HAZARD MITIGATION GRANT		6,275
83.550	NATIONAL DAM SAFETY PROGRAM		77
83.552	EMERGENCY MANAGEMENT PERFORMANCE GRANTS		4,728
	TOTAL FEDERAL EMERGENCY MANAGEMENT AGENCY		**$14,685**
84.027	SPECIAL EDUCATION – GRANTS TO STATES	168,406	
84.173	SPECIAL EDUCATION – PRESCHOOL GRANTS	13,731	
	TOTAL SPECIAL EDUCATION CLUSTER		182,137
84.002	ADULT EDUCATION – STATE GRANT PROGRAM		19,250
84.010	TITLE I GRANTS TO LOCAL EDUC. AGENCIES		356,421
84.011	MIGRANT EDUCATION – BASIC STATE GRANT PROG.		7,204
84.013	TITLE I PROGRAM FOR NEGLECTED & DEL. CHILDREN		458
84.034	PUBLIC LIBRARY SERVICES		74
84.048	VOCATIONAL EDUC. – BASIC GRANTS TO STATES		40,701
84.063	FEDERAL PELL GRANT PROGRAM		347
84.086	SPECIAL EDUCATION – SEVERELY DISAB. PROGRAM		75
84.126	REHAB. SERVICES – VOC. REHAB. GRANTS TO STATES		103,748
84.162	IMMIGRANT EDUCATION		646
84.169	INDEPENDENT LIVING – STATE GRANTS		470
84.177	REHAB. SERVICES – INDEPENDENT LIVING SERVICES		763
84.181	SPEC. EDUC. – GRANTS FOR INFANTS AND FAM. WITH DISAB.		13,237
84.184	SAFE AND DRUG-FREE SCHOOLS & COMM. – NATL. PROG.		80

- See Notes to Schedule of Expenditures of Federal Awards -

Schedule of Expenditures of Federal Awards - June 30, 2001

CFDA #	CFDA Name		Federal Expenditures (000's)
84.186	SAFE AND DRUG-FREE SCHOOLS & COMM. – STATE GRANTS		18,952
84.187	SUPPORTED EMPLOYMENT SERV. FOR INDIV. WITH DISAB.		1,540
84.194	BILINGUAL EDUCATION SUPPORT SERVICES		85
84.196	EDUCATION FOR HOMELESS CHILDREN & YOUTH		1,830
84.213	EVEN START – STATE EDUC. AGENCIES		6,110
84.215	FUND FOR THE IMPROVEMENT OF EDUCATION		178
84.216	CAPITAL EXPENSES		1,589
84.243	TECH-PREP EDUCATION		4,018
84.265	REHAB. TRNG. – ST. VOC. REHAB. UNIT IN-SERVICE TRNG.		223
84.276	GOALS 2000 – SATE AND LOCAL EDUC. GRANTS		14,147
84.281	EISENHOWER PROF. DEV. STATE GRANTS		13,017
84.282	CHARTER SCHOOLS		3,705
84.298	INNOVATIVE EDUCATION PROGRAM STRATEGIES		15,899
84.314	EVEN START – STATEWIDE FAMILY LITERACY		240
84.318	TECHNOLOGY LITERACY CHALLENGE FUND GRANTS		14,270
84.323	SPECIAL EDUC. – ST. PROG. FOR CHILDREN WITH DISAB.		1,383
84.324	SPECIAL EDUC. – RESEARCH FOR CHILDREN WITH DISAB.		84
84.330	ADVANCED PLACEMENT INCENTIVE PROGRAM		90
84.331	GRANTS TO STATES FOR INCARCERATED YOUTH		280
84.332	COMPREHENSIVE SCHOOL REFORM DEMO.		6,774
84.338	READING EXCELLENCE		9,308
84.340	CLASS SIZE REDUCTION		52,090
84.346	OCCUPATIONAL & EMPLOYMENT INFO. STATE GRANTS		148
84.348	TITLE I ACCOUNTABILITY GRANTS		3,284
	TOTAL DEPARTMENT OF EDUCATION		**$894,855**
93.044	SPECIAL PROGRAMS FOR AGING – TITLE III PART B	25,554	
93.045	SPECIAL PROGRAMS FOR AGING – TITLE III PART C	22,540	
	TOTAL AGING CLUSTER		48,094
93.575	CHILD CARE AND DEVELOPMENT BLOCK GRANT	41,113	
93.596	CHILD CARE MANDATORY & MATCHING FUNDS	146,605	
	TOTAL CHILD CARE CLUSTER		187,718
93.775	STATE MEDICAID FRAUD CONTROL UNITS	3,102	
93.777	ST. SURVEY & CERT. OF HEALTH CARE PROVIDERS	7,894	
93.778	MEDICAL ASSISTANCE PROGRAM	6,082,566	
	TOTAL MEDICAID CLUSTER		6,093,562
93.041	SPEC. PROG. FOR AGING – TITLE VII CH. 3		231
93.042	SPEC. PROG. FOR AGING – TITLE VII CH. 2		423
93.043	SPEC. PROG. FOR AGING – TITLE III PART F		799
93.048	SPEC. PROG. FOR AGING – TITLE IV TRNG.		573
93.052	SPEC. PROG. FOR AGING – TITLE IIIE NFCSP		1,500
93.103	FOOD & DRUG ADMINISTRATION – RESEARCH		20
93.110	MAT. & CHILD HEALTH FED. CONSOL. PROGRAM		99

- See Notes to Schedule of Expenditures of Federal Awards -

CFDA #	CFDA Name	Federal Expenditures (000's)
93.116	PROJ. GRANTS & COOP. AGREE. FOR TUBER. CONTROL	665
93.127	EMERGENCY MEDICAL SERVICES FOR CHILDREN	154
93.130	PRIMARY CARE SERVICES – RESOURCE COORD. & DEV.	177
93.136	INJURY PREVENTION AND CONTROL RESEARCH	168
93.150	PROJ. FOR ASSISTANCE IN TRANS. FROM HOMELESS	1,098
93.161	HEALTH PROG. FOR TOXIC SUB. & DISEASE REG.	286
93.165	GRANTS FOR STATE LOAN REPAYMENT	201
93.197	CHILDHOOD LEAD POISONING PREVENTION	1,749
93.235	ABSTINENCE EDUCATION	1,769
93.268	IMMUNIZATION GRANTS	5,886
93.283	CENTERS FOR DISEASE CONTROL & PREV. TECH. ASST.	2,507
93.556	PROMOTING SAFE AND STABLE FAMILIES	11,090
93.558	TEMPORARY ASSISTANCE FOR NEEDY FAMILIES	635,626
93.560	FAMILY SUPP. PAY. TO STATES – ASSIST. PAYMENTS	-182,688
93.561	JOB OPPORT. & BASIC SKILLS TRAINING	-28
93.563	CHILD SUPPORT ENFORCEMENT	95,528
93.566	REFUGEE & ENTRANT ASSISTANCE – ST. ADMIN. PROG.	7,610
93.568	LOW-INCOME HOME ENERGY ASSISTANCE	159,119
93.569	COMMUNITY SERVICES BLOCK GRANT	22,485
93.571	COMMUNITY SERVICES BLOCK GRANT – FOOD & NUTR.	142
93.576	REFUGEE & ENTRANT ASSISTANCE – DISC. GRANTS	658
93.584	REFUGEE & ENTRANT ASSISTANCE – TARGETED ASST.	895
93.585	EMPOWERMENT ZONES PROGRAM	5,679
93.597	GRANTS TO STATES FOR ACCESS AND VISIT. PROG.	275
93.600	HEAD START	220
93.602	NEW ASSETS FOR INDEP. DEMO. PROGRAM	602
93.603	ADOPTION INCENTIVE PAYMENTS	601
93.630	DEVEL. DISAB. BASIC SUPP. & ADV. GRANTS	2,952
93.645	CHILD WELFARE SERVICES – STATE GRANTS	10,579
93.658	FOSTER CARE – TITLE IV-E	331,062
93.659	ADOPTION ASSISTANCE	48,333
93.667	SOCIAL SERVICES BLOCK GRANT	101,886
93.669	CHILD ABUSE AND NEGLECT STATE GRANTS	697
93.671	FAMILY VIOLENCE PREV. & SERVICES	3,400
93.674	INDEPENDENT LIVING	2,631
93.767	STATE CHILDREN'S INSURANCE PROGRAM	87,271
93.779	HEALTH CARE FINAN. RESEARCH DEMO. AND EVAL.	843
93.917	HIV CARE FORMULA GRANTS	16,656
93.919	COOP. AGREE. FOR STATE CANCER PROGRAM	2,217
93.940	HIV PREVENTION ACTIVITIES – HEALTH DEPT. BASED	4,408
93.944	HIV/AIDS SURVEILLANCE	451
93.945	ASST. PROG. FOR CHRONIC DISEASE PREV. & CONTROL	49
93.958	BLOCK GRANTS FOR COMM. MENTAL HEALTH SERV.	13,215
93.959	BLOCK GRANTS FOR PREV. & TREAT. OF SUBS. ABUSE	59,465

- See Notes to Schedule of Expenditures of Federal Awards -

Schedule of Expenditures of Federal Awards - June 30, 2001

CFDA #	CFDA Name	Federal Expenditures (000's)
93.965	COAL MINERS RESP. IMPAIRMENT TREATMENT	218
93.977	PREV. HEALTH SERVICES – SEXUALLY TRANS. DIS. CONTROL	2,456
93.988	COOP. AGREE. FOR STATE-BASED DIABETES PROG.	355
93.991	PREV. HEALTH & HEALTH SVCS. BLOCK GRANT	9,227
93.994	MATERNAL & CHILD HEALTH SVCS. BLOCK GRANT	22,128
	TOTAL DEPARTMENT OF HEALTH AND HUMAN SERVICES	**$7,825,992**
94.001	COMMISSION ON NATL. AND COMM. SERVICES	6
94.003	STATE COMMISSIONS	126
94.004	LEARN AND SERVE AMERICA – SCHOOL & COMM. PROG.	1,126
94.006	AMERICORPS	5,843
94.007	PLANNING AND PROGRAM DEVELOPMENT GRANTS	21
94.009	TRAINING & TECHNICAL ASSISTANCE	171
	TOTAL CORPORATION FOR NATIONAL AND COMMUNITY SERVICE	**$7,293**
96.001	SOCIAL SECURITY – DISABILTY INSURANCE	60,962
	TOTAL SOCIAL SECURITY ADMINISTRATION	**$60,962**
99.999	MISCELLANEOUS	10,507
	TOTAL MISCELLANEOUS	**$10,507**
	GRAND TOTAL	**$13,703,228**

- See Notes to Schedule of Expenditures of Federal Awards -

INDEX TO NOTES

Notes to the Schedule of Expenditures of Federal Awards - June 30, 2001

Note A: Single Audit Reporting Entity

The Commonwealth of Pennsylvania (the Commonwealth) includes expenditures in its schedule of expenditures of federal awards for all federal programs administered by the same funds, agencies, boards, commissions, and component units included in the Commonwealth's financial reporting entity used for its general purpose financial statements. However, the State System of Higher Education (SSHE), the Pennsylvania Higher Education Assistance Agency (PHEAA), and the Pennsylvania Housing Finance Agency (PHFA) submit their own single audit report to their federal granting agencies and are therefore excluded from the Commonwealth's schedule of expenditures of federal awards.

Note B: Basis of Accounting

All expenditures for each program included in the schedule of expenditures of federal awards are net of applicable program income and refunds.

Expenditures for the following programs are presented on the accrual basis for payroll expenditures and the cash plus vouchers payable basis for all non-payroll expenditures.

CFDA#	PROGRAM
10.561	State Administrative Matching Grants for Food Stamp Program (L&I only)
17.002	Labor Force Statistics
17.203	Labor Certification for Alien Workers
17.207	Employment Service
17.225	Unemployment Insurance
17.245	Trade Adjustment Assistance – Workers
17.255	Workforce Investment Act (L&I Only)
17.801	Disabled Veterans Outreach Program
17.804	Local Veterans Employment Representative Program
84.346	Occupational and Employment Information State Grants (L&I Only)
93.558	Temporary Assistance For Needy Families (L&I Only)

Expenditures for CFDA #20.205, Highway Planning and Construction Program, are presented on the basis that expenditures are reported to the U.S. Department of Transportation. Accordingly, certain expenditures are recorded when paid and certain other expenditures are recorded when the federal obligation is determined.

Expenditures reported under CFDA #10.550, Food Distribution, and CFDA #10.569, Emergency Food Assistance Program, represent the value of food commodity distributions calculated using the U.S. Department of Agriculture, Food and Nutrition Service commodity price list in effect as of January 2000.

Expenditures reported under CFDA #10.551, Food Stamps, represent amounts the Electronic Benefits Transfer (EBT) contractor paid to retail outlets for participants' food stamp purchases during the fiscal year ended June 30, 2001.

Subrecipient expenditures reported under CFDA #14.228, Community Development Block Grants, and CFDA #14.239, Home Investment Partnerships Program, represent funds drawn directly from the Housing and Urban Development (HUD) Integrated Disbursement and Information System (IDIS) by subrecipients of the Commonwealth.

Amounts reported as expenditures for CFDA #39.003, Donation of Federal Surplus Personal Property, represent the General Services Administration's average fair market value percentage of 23.3 percent of the federal government's original acquisition cost (OAC) of the federal property transferred to recipients by the Commonwealth.

Amounts reported under CFDA 93.560, Family Support Payments to States – Assistance Payments, represent disallowances by the federal government for prior year expenditures in the amount of $182.7 million. The Commonwealth is currently appealing these disallowances.

Notes to the Schedule of Expenditures of Federal Awards - June 30, 2001

Note B: Basis of Accounting (Continued)

The remaining expenditures included in the schedule of expenditures of federal awards are presented on the cash plus vouchers payable basis. Vouchers payable represent Commonwealth expenditures recorded on the general ledger for which the Commonwealth Treasury Department has not made a cash disbursement.

Note C: Categorization of Expenditures

The schedule of expenditures of federal awards reflects federal expenditures for all individual grants which were active during the fiscal year ended June 30, 2001. The categorization of expenditures by program included in the schedule of expenditures of federal awards is based on the Catalog of Federal Domestic Assistance (CFDA). Changes in the categorization of expenditures occur based on revisions to the CFDA which are issued in June and December of each year. In accordance with the Commonwealth's policy, the schedule of expenditures of federal awards for the year ended June 30, 2001 reflects CFDA changes issued through December 2000.

Note D: Nonmonetary Federal Financial Assistance

The Commonwealth distributes federal surplus food to institutions (schools, hospitals, and prisons) and to the needy. The total inventory balance of federal surplus food on hand as of June 30, 2001, was $3.4 million for CFDA #10.550, Food Distribution Program, and $1.2 million for CFDA #10.569, Emergency Food Assistance Program. The surplus food was valued using the U.S. Department of Agriculture, Food and Nutrition Service, commodity price list in effect as of January 2000.

The value of donated federal surplus property on hand at June 30, 2001 was $12.4 million, which represents the federal government's OAC of the property. When the related surplus property is transferred to recipients, it is valued at 23.3 percent of its OAC, which represents an estimated fair market value of the property transferred. The estimated fair market value is reported as an expenditure in the schedule of expenditures of federal awards under CFDA #39.003, Donation of Federal Surplus Personal Property.

Note E: Oil Overcharge Funds

The Commonwealth has received restitutionary funds from certain oil companies, either directly or through the federal government, as a result of settlement agreements for overcharging customers. All oil overcharge funds expended by the Commonwealth have been included within the scope of its single audit in accordance with the settlement agreements and federal guidance.

Expenditures of such funds reflected in the schedule of expenditures of federal awards include: $.2 million under CFDA #81.041, State Energy Conservation; $.8 million under CFDA #93.568, Low-Income Home Energy Assistance; and $.1 million under CFDA #99.999, Miscellaneous.

Oil overcharge funds received by the Commonwealth that remain unexpended earn interest which is credited on a monthly basis to the oil overcharge fund for future expenditure as approved in the Commonwealth's energy plan. At June 30, 2001, the Commonwealth had unexpended oil overcharge funds including interest of approximately $4.1 million.

Note F: Pennsylvania Infrastructure Investment Authority

The Pennsylvania Infrastructure Investment Authority (the Authority) is an instrumentality of the Commonwealth created by Act 16 of the General Assembly in March 1988 (the PENNVEST Act). The purpose of the Authority is to finance long-term, low-interest loans for corporations, partnerships, sole proprietorships, nonprofit organizations, authorities, and municipalities for repair, construction, reconstruction, rehabilitation, extension, and improvement of drinking water (CFDA #66.468) and wastewater (CFDA #66.458) systems. The Authority is funded through revenue bonds, federal grants, Commonwealth general fund appropriations, and Commonwealth general obligation bonds. The Authority is a component unit of the Commonwealth.

Note F: Pennsylvania Infrastructure Investment Authority (Continued)

The Authority accounts for the drinking water and wastewater programs in separate funds.

At June 30, 2001, the Authority had gross outstanding federal loans of $379.4 million for CFDA #66.458 and $63.4 million for CFDA #66.468. No losses were incurred by the Authority on these loans during the fiscal year ended June 30, 2001.

Note G: Unemployment Insurance

In accordance with Department of Labor, Office of Inspector General instructions, the Commonwealth recorded State Regular Unemployment Compensation (UC) benefits under CFDA #17.225 on the schedule of expenditures of federal awards. The individual state and federal portions are as follows (amounts in thousands):

State Regular UC Benefits	$1,755,647
Federal UC Benefits	39,445
Federal Admin.	125,891
Total Benefits	$1,920,983

Note H: Workforce Investment Act

In accordance with the Department of Labor regulations, unexpended funds made available under the Job Training Partnership Act (JTPA) Title II and Title III programs were used for transition to and implementation of the Workforce Investment Act (WIA). Expenditures of such funds include $23.2 million of JTPA Title II funds and $9.1 million of JTPA Title III funds. These expenditures are reflected in the schedule of expenditures of federal awards under CFDA 17.255, Workforce Investment Act.

Department of the Auditor General
Commonwealth of Pennsylvania
Harrisburg, Pennsylvania 17120-0018

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Commerce Court, Suite 200
2601 Market Place
Harrisburg, PA 17110-9359

Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

The Honorable Mark S. Schweiker, Governor
Commonwealth of Pennsylvania
Harrisburg, Pennsylvania

We have jointly audited the general purpose financial statements of the Commonwealth of Pennsylvania as of and for the year ended June 30, 2001, and have issued our report thereon dated November 16, 2001. We did not jointly audit the financial statements of certain component units, which represent 80 percent of total assets of the Trust and Agency Funds, 100 percent of the revenues of the Pension Trust Fund, and 100 percent of the discretely presented component units. We also did not jointly audit the financial statements of one enterprise fund which represents 2 percent of total assets of the enterprise funds. The financial statements of these component units and enterprise fund were audited by other auditors, including Ernst & Young LLP acting separately, whose reports thereon have been furnished to us and our opinion expressed herein, insofar as it relates to the amounts included for those component units, is based solely on the reports of the other auditors. Ernst & Young LLP has audited separately 5 percent of total assets and 11 percent of operating revenues of the discretely presented component units. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Commonwealth of Pennsylvania's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as Comment Number 01-3.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Commonwealth of Pennsylvania's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Commonwealth of Pennsylvania's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as Comments 01-1 through 01-5.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider Comments 01-1, 01-2, 01-3, and 01-5 to be material weaknesses.

We also noted other matters involving the internal control over financial reporting which we have reported to the management of the Commonwealth of Pennsylvania in a separate letter dated November 16, 2001.

This report is intended solely for the information and use of management, the Office of Inspector General - U.S. Department of Health and Human Services, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

Robert P. Casey, Jr. Ernst + Young LLP

November 16, 2001

Department of the Auditor General
Commonwealth of Pennsylvania
Harrisburg, Pennsylvania 17120-0018

ERNST & YOUNG LLP

■ Central Pennsylvania Practice
Commerce Court, Suite 200
2601 Market Place
Harrisburg, PA 17110-9359

Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133

The Honorable Mark S. Schweiker, Governor
Commonwealth of Pennsylvania
Harrisburg, Pennsylvania

Compliance

We have jointly audited the compliance of the Commonwealth of Pennsylvania with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2001. The Commonwealth's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Commonwealth's management. Our responsibility is to express an opinion on the Commonwealth's compliance based on our audit.

The Commonwealth's general purpose financial statements included the operations of the State System of Higher Education, the Pennsylvania Higher Education Assistance Agency, and the Pennsylvania Housing Finance Agency, component units which received federal awards, and which are not included in the schedule of expenditures of federal awards for the year ended June 30, 2001. Our audit, described below, did not include the operations of these three component units because the Commonwealth engaged other auditors to perform an audit in accordance with OMB Circular A-133.

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

As explained in Comment 01-5 in the accompanying schedule of findings and questioned costs, we were unable to obtain sufficient audit evidence supporting compliance of the Commonwealth with requirements governing the procurement of goods and services for competitively-bid Commonwealth contracts. This is as a result of the Commonwealth's overall policy to not release certain procurement documentation that management considers to be proprietary and confidential, and which management will not allow us to review as part of our audit. As explained in Comment 01-5 in the accompanying schedule of findings and questioned costs, we do not agree with the Commonwealth's policy in this regard. As a result of this overall Commonwealth policy, we are prevented from reviewing documentation that would enable us to determine whether procurements in the Medicaid Cluster (CFDA #93.778), the Temporary Assistance for Needy Families Program (CFDA #93.558), the Child Support Enforcement Program (CFDA #93.563), the State Administrative Matching Grants for the Food Stamps Program (CFDA #10.561), and the Child Care Cluster (CFDAs #93.575 and #93.596) were made in compliance with the Commonwealth's requirements governing the procurement of goods and services, nor are we able to satisfy ourselves as to the Commonwealth's compliance with those requirements by other auditing procedures.

As described in the accompanying schedule of findings and questioned costs, the Commonwealth did not comply with requirements as noted below that are applicable to its major programs as follows:

- The Community Development Block Grant (CFDA #14.228), as reported in Finding 01-2, did not comply with federal reporting requirements.
- The Temporary Assistance for Needy Families Program (CFDA #93.558), as reported in Finding 01-14, did not comply with federal reporting requirements and, as reported in Finding 01-13, did not comply with a special test and provision related to individual assessment requirements.
- The Child Support Enforcement Program (CFDA #93.563), as reported in Finding 01-15, did not comply with a special test and provision related to the timeliness of processing responses to inquiries on interstate registry cases.
- The Child Care Cluster (CFDA #93.575 and 93.596) and Social Services Block Grant (CFDA #93.667), as reported in Finding 01-16, did not comply with subrecipient cash management requirements.
- For all major federal programs covered by CMIA, as reported in Finding 01-20, the Commonwealth did not comply with CMIA-90 cash management regulations.

Compliance with such requirements is necessary, in our opinion, for the Commonwealth to comply with the requirements applicable to those programs.

In our opinion, except for the effects of such noncompliance, if any, as might have been determined had we been able to examine sufficient evidence regarding the Commonwealth's compliance with procurement requirements in the federal programs identified above, and except for the noncompliance described in the preceding paragraph, the Commonwealth complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2001. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as finding numbers 01-5, 01-6, 01-11, and 01-17.

Internal Control Over Compliance

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

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Commonwealth's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as Findings 01-1 through 01-21.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider finding numbers 01-1, 01-2, 01-3, 01-8, 01-9, 01-13 through 01-16, 01-19, and 01-20, as identified in the accompanying schedule of findings and questioned costs, to be material weaknesses.

This report is intended solely for the information and use of management, the Office of Inspector General—U.S. Department of Health and Human Services, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

Robert P. Casey, Jr.   Ernst + Young LLP

January 25, 2002

Summary of Auditors' Results - June 30, 2001

Financial Statements

Type of auditors' report issued: Unqualified

Internal control over financial reporting:

Material weakness(es) identified? _X_ yes ____no

Reportable condition(s) identified not considered to be material weaknesses? _X_ yes ___no

Noncompliance material to financial statements noted? _X_ yes ___no

Federal Awards

Internal control over major programs:

Material weakness(es) identified? _X_ yes ____no

Reportable condition(s) identified not considered to be material weaknesses? _X_ yes ____no

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

Qualified for noncompliance in the following major programs:

Community Development Block Grant (CFDA #14.228)
Temporary Assistance for Needy Families (CFDA #93.558)
Child Support Enforcement Program (CFDA #93.563)
Child Care Cluster (CFDA #93.575 and #93.596)
Social Services Block Grant (CFDA #93.667)
All Major Federal Programs Covered by CMIA

Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)? _X_ yes ____no

Identification of Major Programs:

CFDA Number(s)	Name of Federal Program or Cluster	Federal Expenditures (000s)
10.551 and 10.561	Food Stamp Cluster	$ 753,157
10.558	Child and Adult Care Food Program	37,579
14.228	Community Development Block Grants/State's Program	53,686
14.239	HOME Investment Partnerships Program	17,585
15.250	Regulation of Surface Coal Mining	11,389
15.252	Abandoned Mine Land Reclamation Program	17,693
17.225	Unemployment Insurance	1,920,983
17.245	Trade Adjustment Assistance – Workers	36,588
17.253	Welfare-To-Work Grants to States	25,537
17.255	Workforce Investment Act	89,091
20.205 and 23.003	Highway Planning and Construction Cluster	1,148,600
66.458	Capitalization Grants for State Revolving Funds	52,596
66.468	Capitalization Grants for Drinking Water	30,143
83.548	Hazard Mitigation Grant	6,275
84.010	Title I Grants to Local Educational Agencies	356,421
84.048	Vocational Education – Basic Grants to States	40,701
84.126	Rehabilitation Services – Vocational Rehabilitation Grants to States	103,748
84.340	Class Size Reduction	52,090
93.558	Temporary Assistance for Needy Families	635,626
93.563	Child Support Enforcement	95,528
93.568	Low-Income Home Energy Assistance	159,119
93.575 and 93.596	Child Care Cluster	187,718
93.658	Foster Care Title IV-E	331,062
93.659	Adoption Assistance	48,333
93.667	Social Services Block Grant	101,886
93.767	State Children's Insurance Program	87,271
93.775, 93.777 and 93.778	Medicaid Cluster	6,093,562
93.959	Block Grants for Prevention and Treatment of Substance Abuse	59,465
96.001	Social Security – Disability Insurance	60,962
	Total Federal Expenditures – Major Programs	$ 12,614,394

Dollar threshold used to distinguish between Type A and Type B programs: $30,000,000

Auditee qualified as low-risk auditee? ____yes __X__no

Index to General Purpose Financial Statement Comments - June 30, 2001

* - Reportable Condition
** - Material Weakness
CAP - Corrective Action Plan

Comment 01 – 1:

Executive Offices
Office of the Budget – Central Services Comptroller Office
Public Protection and Recreation Comptroller Office

Improving Financial Reporting – Capital Projects Funds Liabilities (A Similar Condition Was Noted in Prior Year Comment #1)

Condition: The Capital Projects Funds' GAAP packages contained misstatements that required an adjusting entry by the auditors. The misstatement understated liabilities by $37 million.

Criteria: Strong internal controls ensure that accounting transactions are reported accurately in the financial statements, and are appropriately reviewed and approved by management to detect errors in reporting.

Cause: The misstatement was caused by errors in the Central Services Comptroller Office (CS) and the Public Protection and Recreation Comptroller Office (PPR) methodologies for accruing liabilities related to expenditure transactions after year-end. The CS and PPR internal review procedures were not detailed enough to detect and correct the errors.

Effect: The misstatement would have understated the Capital Facilities Fund's liabilities on the financial statements by $29.3 million and the Keystone Recreation Park and Conservation Fund by $7.7 million. In addition, the noted errors in methodology and weaknesses in internal review procedures could cause additional misstatements in the future.

Recommendation: CS and PPR should evaluate their methodologies and review procedures for accruing and reporting financial activity to ensure that correct amounts are reported in the financial statements.

Agency Response: We concur with the finding. Central Services will initiate an evaluation of its methodologies and review procedures for accruing and reporting financial activity in the Capital Projects Funds' GAAP packages to ensure that the correct amounts are received and reported.

Auditors' Conclusion: Based on the agency response, the finding and recommendation remain as stated above.

The corrective action plan for this comment, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Comment 01 – 2:

Executive Offices
Office of the Budget – Central Services Comptroller Office

Improving Financial Reporting – Lottery Fund (A Similar Condition Was Noted in Prior Year Comment #2)

Condition: The Lottery Fund GAAP package contained misstatements that required adjusting entries by the auditors. The misstatements understated liabilities by $4.5 million.

Criteria: Strong internal controls ensure that accounting transactions are reported accurately and are appropriately reviewed and approved by management.

Cause: The misstatements were caused by an error in the Central Services Comptroller Office's (CS) methodology for accruing and reporting Lottery game sales and related activities. The CS internal review procedures were not detailed enough to detect and correct these errors.

Effect: The misstatements would have overstated the Lottery Fund's fund equity on the financial statements. In addition, the noted errors in methodology and weakness in internal review procedures could cause additional misstatements in the future.

Recommendation: CS should evaluate its methodology and review procedures for accruing and reporting game activity to ensure that correct amounts are reported.

Agency Response: We concur with the finding. We will strengthen our review procedures to ensure that the correct amounts for game activity are accrued and reported.

Auditors' Conclusion: Based on the agency response, the finding and recommendation remain as stated above.

The corrective action plan for this comment, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Comment 01 – 3:

Department of Treasury

Noncompliance With Pennsylvania Laws Governing Authorized Investments for Participants in the INVEST Program

Condition: As part of our current audit of the INVEST Program, an Investment Trust Fund, we reviewed Treasury's investment portfolios to ensure that they included only those investments which are authorized under Pennsylvania law for Treasury and for the individual investing entities. We determined in the course of our audit that, for the local government/nonprofit participants in INVEST, Treasury is authorized to invest funds only in those financial instruments that the local entities are authorized to invest in themselves directly. Therefore, our testwork included verifying whether the investments selected by Treasury were authorized by the various state statutes governing the different types of INVEST participants.

These laws generally allow investments in the same types of instruments, including obligations of agencies of the United States Government. However, they consistently limit authorized investments to either short-term obligations of the United States or its agencies or instrumentalities, or long-term obligations of the United States or its agencies or instrumentalities which are *backed by the full faith and credit* of the United States of America.

Treasury's INVEST portfolios included a significant amount of funds invested in repurchase agreements during our audit period. The repurchase agreements in the INVEST program are solely of the "buy/sell" type rather than the "loan" type, which means that the INVEST participants actually "buy" and assume ownership of the underlying collateral for the time period covered by the agreement. It has been the position of the Department of the Auditor General that, in the absence of specific statutory language expressly authorizing investments in repurchase agreements, a local entity may only invest in repurchase agreements where it assumes ownership of underlying collateral which it would be authorized to invest in *directly*. In other words, if the entity cannot invest in the underlying securities outside of the repurchase agreement context, it cannot make such an investment through a repurchase agreement.

Our position follows from the fact that there is no express statutory authorization for most local entities to invest directly in repurchase agreements. Accordingly, the authority of those entities to invest in repurchase agreements must derive entirely from their authority to hold the types of securities being bought and sold in the repurchase transaction and their actual ownership of those securities during the repurchase period.

Our review of INVEST portfolios as of the December 31, 2000 balance sheet date disclosed $145.5 million in investments which do not appear to have been authorized by Pennsylvania laws governing the investments of the INVEST participants. The $145.5 million in unauthorized investments consisted of four types of U.S. Government agency obligations which were included in the underlying collateral pool for repurchase agreements totaling $393.8 million at year-end. These obligations were not short-term, yet none of these obligations were backed by the full faith and credit of the United States, as required by law for instruments which are not short-term. Because the collateral was neither short-term nor backed by full faith and credit, the collateral and the repurchase agreement itself were unauthorized investments for participants in the INVEST program.

The four unauthorized U.S. Government agency obligations and related balances in the collateral pool were as follows:

Federal Home Loan Bank (FHLB)	$101.3 million
Federal Farm Credit Bank Funding Corp. (FCSB)	42.1 million
Financing Corporation (FICO)	1.9 million
Resolution Funding Corporation (REFC)	.2 million
Total	$145.5 million

Comment 01 – 3: (continued)

As explained above, because these obligations were neither short-term nor backed by full faith and credit, they were not authorized investments for certain INVEST participants, including counties, cities, boroughs, townships, municipal authorities, school districts, intermediate units, and area vocational-technical schools. We also noted that, in addition to the $145.5 million at year-end, Treasury was investing in similar unauthorized repurchase agreements throughout the year under audit.

Criteria: Pennsylvania statutes authorizing investments contain the same or similar provisions for the various local entities participating in the INVEST program. For example, 24 P.S. § 4-440.1, which governs the investments of school districts, intermediate units, and area vocational-technical schools, states in relevant part:

(c) Authorized types of investments for school district funds shall be:

(ii) Short-term obligations of the United States Government or its agencies or instrumentalities.

(iv) Obligations of the United States of America or any of its agencies or instrumentalities backed by the full faith and credit of the United States of America, . . .

Similar investment provisions apply to the following local government participants in INVEST:

2nd Class Counties	*16 P.S. § 4964(c)*
3rd through 8th Class Counties	*16 P.S. § 1706(c)*
3rd Class Cities	*53 P.S. § 36804.1(d)*
Boroughs	*53 P.S. § 46316(c)*
1st Class Townships	*53 P.S. § 56705.1(d)*
2nd Class Townships	*53 P.S. § 68204(d)*
Municipal Authorities	*53 P.S. § 309.1(D)*

Cause: In response to our inquiries about the $145.5 million identified above, Treasury officials stated that the U.S. Government agency obligations in the collateral pool were authorized investments for INVEST participants. They maintained that the maturity date of the repurchase agreements, rather than that of the underlying collateral, is the determining factor in classifying the obligations as short- versus long-term. According to Treasury, because the repurchase agreement in question matured on January 2, 2001, the entire investment, including the underlying collateral, should be considered short-term, regardless of the actual maturity date of each U.S. Government agency obligation.

Treasury officials stated that their interpretation is supported by the securities market and the rules and regulations of the United States Securities and Exchange Commission (SEC). However, they did not provide any reasonable evidence to support that assertion. Moreover, the SEC rules cited do not appear to expressly apply to the investments at issue.

During our audit, we noted that Treasury's internal controls over monitoring the legality of investments in the INVEST program were not sufficient. Treasury officials provided contradictory and inconsistent answers to our questions and reversed their positions several times during the course of our audit. It appears that Treasury had not completely researched the legality of the investments at issue prior to our audit. Therefore, the internal controls needed to ensure the legality of investments made on behalf of the INVEST participants were deficient and need to be strengthened.

Treasury officials indicated that they are seeking statutory amendments to applicable laws to clarify this matter.

Effect: Local entities participating in Treasury's INVEST program owned investments in which they are not authorized by Pennsylvania law to invest; Treasury has failed to demonstrate otherwise. Further, the Commonwealth is in material non-compliance with Pennsylvania laws governing authorized investments for participants in the INVEST program.

Comment 01 – 3: (continued)

Recommendation: We recommend that Treasury only invest INVEST program funds in those investments authorized by Pennsylvania law for each type of participant. Similarly, the collateral underlying repurchase agreements should consist only of the types of investments that all participants are authorized to invest in themselves directly. Furthermore, Treasury should strengthen its existing internal controls and implement more thorough monitoring of investments in the INVEST program in order to ensure that all investments made are authorized for all participants in accordance with applicable laws.

Agency Response: We disagree with this comment.

Maturity of Securities

We believe our position on securities maturity is supported by the U.S. Securities and Exchange Commission (SEC) rules and the positions of both Standard & Poor's and Fitch IBCA ratings agencies.

The essential question is whether, in a repurchase agreement involving U.S. Government agency securities, the maturity of the investment shall be deemed to be the time until repurchase is to occur or the time until the underlying security will mature. The SEC (as detailed below) agrees it is the former. The Auditor General asserts it is the latter. SEC rules establish an investment as "short-term" if it matures in less than 397 days.

The practice of investing through the contractual agreement known as a repurchase agreement is both widespread and well regulated. A repurchase agreement is a contract to purchase securities, known as the collateral, and then sell those securities on a date certain. In the instances the finding cites, the term of the repurchase agreement never exceeded four days. The collateral purchased by the Treasury Department is always an obligation of the United States Government or its agencies or instrumentalities. The SEC, an agency of the federal government, regulates the market for repurchase agreements. In evaluating the maturity of a repurchase agreement for the purpose of determining whether or not that investment is a long-term or short-term obligation, the SEC has issued the following rule which appears at 17 CFR 270.2a-7 and which states in pertinent part as follows:

> (6) Repurchase Agreements. ***A repurchase agreement shall be deemed to have a maturity equal to the period remaining until the date on which the repurchase of the underlying securities is scheduled to occur***, or, where the agreement is subject to demand, the notice period applicable to a demand for the repurchase of the securities (emphasis added).

The portfolio securities in this case are the U.S. Government agency securities that are the collateral for the repurchase agreements. By operation of this regulation, the maturity of these portfolio securities, as they are part of a repurchase agreement, is deemed to be the maturity of the repurchase agreement. This is the federal rule governing these transactions.

The language cited above was provided to the Auditor General's staff, in writing. However, the Auditor General fails to so much as acknowledge – let alone address – the SEC regulation and, having chosen to ignore our supporting documentation, claims that we failed to provide any.

There is no reading of this SEC rule that lends itself to the Auditor General's conclusion. Generally applicable federal rules do apply to both the Treasury Department and the participants in the INVEST program – and to the Auditor General, for that matter. There is no legal prohibition against any participating entity in INVEST entering into a contract to buy and sell a security (they all have the statutory power to contract), and no such prohibitions have been cited in the Auditor General's finding. There is express statutory authority for the purchase of obligations of the government of the United States and its agencies and instrumentalities. There is no disputing that the securities cited, FHLB, FICO, REFC, and FCSB, are obligations of U.S. Government Agencies. (The finding does not cite any contrary legal authority for this

Comment 01 – 3: (continued)

proposition). As stated above, the maturity of the investment in these securities is determined by operation of federal rule as the term of the repurchase agreement itself. As these contracts were never longer than four days, these investments were short-term. The audit finding is completely dependent on ignoring existing federal rule, state law, and generally accepted market practices. The Auditor General does not cite any legal authority for his conclusions.

In a report on the results of a survey of Pennsylvania school districts, the Auditor General expressed much less conviction on the definition of "short-term obligations" under the School Code by stating as follows:

> "Section 440.1 of the Pennsylvania Public School Code: *Investment of school district funds*, is ambiguous in its statutory language and is unclear to persons who have not had training in the field of investment finances. The section contains phrases such as 'invest school district funds consistent with sound business practice' and 'short-term obligations' which are terms that do not have a consistent definition and their specific meaning is debatable even among professional accountants and investors.
>
> "Part (c) of Section 440.1, allows school districts to invest in short-term obligations of the United States Government or its agencies or instrumentalities. 'Short-term obligations' have been defined by school district personnel as being anywhere in length from one year to five years and professional investors define short-term obligations as twelve months, less than twelve months, or thirteen months.
>
> The Auditor General went on to state: "This lack of specificity in definition is troublesome in light of the fact that the Pennsylvania Public School Code permits **short-term** investments in United States Government agency investment offerings that are **not** backed by the full faith and credit of the United States of America. Since the Pennsylvania Public School Code does not define short-term, and the term does not have a specific definition that is universally accepted, school districts could invest, over an extended period of time, in United States Government Agency obligations that are not backed by the full faith and credit guarantee. These investments carry a greater risk of loss than those that have the guarantee, and the longer the investment time period, the greater the risk." (Emphasis added.)

The only change occurring since the Auditor General issued these remarks in 1999 has been to the Auditor General's opinion. The Treasury Department has uniformly applied the SEC's definition since the inception of the INVEST program in 1993. It is worthwhile noting that the "investment time period" of the instruments at issue was four days.

Controls

The Treasury Department reviews every INVEST application to determine the statutory investment authority of the applicant. The Auditor General's statements on controls are completely inaccurate. The Treasury Department's Investment Policy and Procedures has been provided to the Auditor General and all remarks have been uniform with these policies and procedures.

Treasury Department's Conclusion

Notwithstanding the Treasury Department's firm foundation for its position, the Treasurer has decided that, pending a resolution of this dispute and for any concern the pool's participants have concerning this dispute, it would be prudent to take a more conservative approach of limiting the underlying securities for such repurchase agreements to short-term U.S. or U.S. Agency securities unless they are backed by the full faith and credit of the U.S.

Auditors' Conclusion: Treasury's response presents a number of separate points in an attempt to justify its position that the securities in question are authorized. Overall, however, Treasury's response has a fundamental flaw: **None of the arguments or evidence presented by Treasury actually address the state laws cited in our finding.** Therefore, Treasury's response does not mitigate the finding.

Comment 01 – 3: (continued)

Treasury states that the "essential question is whether, in a repurchase agreement involving U.S. Government agency securities, the maturity of the investment shall be deemed to be the time until repurchase is to occur or the time until the underlying security will mature." Treasury quotes SEC regulation 17 CFR 270.2a-7 to support its position that the repurchase agreements in question are short-term and, therefore, allowable under state law. The SEC regulation governs repurchase agreements in the context of money market funds and is not mandatory legal authority in the present context. More importantly, Treasury implies throughout its response that we are questioning its use of repurchase agreements and how it is classifying those repurchase agreements on its financial statements, i.e., short term. This is not what we are questioning.

We believe that Treasury's description of the "essential question" does not apply to this finding and ignores the state laws cited in the "Criteria" section which are the focal point of the finding. As we explained in the finding, there is no express statutory authorization in state law which allows the INVEST program to invest its local participants' funds in repurchase agreements. Therefore, the authority for those local participants to invest in repurchase agreements must derive entirely from their authority to hold the types of securities being bought and sold in the repurchase transaction (i.e., the underlying collateral) and their actual ownership of those securities during the repurchase period. Even if the repurchase period is only four days, and the probability is low that a counterparty would default on its obligation to repurchase the underlying securities, nevertheless the local entities participating in INVEST are the owners of these pooled collateral securities for the four-day period. As the only legal support for its position, Treasury places total reliance on the above SEC regulation which simply defines the maturity of a repurchase agreement, and is not relevant since it does not address any state laws or the maturity of the underlying collateral.

Treasury also implies that we have concluded that any local entity investments in repurchase agreements are not authorized by state law, but this is not true as explained above. Treasury's statements that we failed to "acknowledge – let alone address – the SEC regulation," or that we chose "to ignore . . . supporting documentation," that we are "ignoring existing federal rule (and) state law . . . ," and we do "not cite any legal authority" for our conclusions are all baseless because, as explained above, the SEC rule has no relevance to the state laws we clearly cite in the finding to support our conclusions.

Treasury's citations from the Department of the Auditor General's 1999 survey on school district investments are not relevant to the above finding. This 1999 survey, including the citations quoted above, was intended to provide assistance to Commonwealth and local officials in improving the statutory language in the Public School Code to better delineate limitations on the length of securities not backed by the full faith and credit of the U.S. Government, which can be held by school districts. Thus, nothing in the above finding is inconsistent with the passages cited by Treasury in the 1999 survey, nor has the department's opinion changed on any of the relevant issues discussed herein. Furthermore, in this case, there is no question that the $145.5 million in non-guaranteed government securities held by INVEST were long-term by any definition and hence not permissible investments. Specifically, $145.5 million in collateral securities cited in the finding have maturities varying from well beyond 397 days up to 23 years, and for the most part are clearly long-term by any definition. Therefore, any ambiguity about the long-term maturity of these collateral securities is not an issue.

Treasury's statements about controls do not change this portion of the finding. We disagree with Treasury's characterization of our disclosures on controls as "completely inaccurate." We believe the evidence obtained in the course of our audit inquiries is reasonable and adequately supports our conclusion on controls. Treasury's response provides no information to prove otherwise.

One final point we wish to make is that the $145.5 million reported in the finding as unauthorized investments for four days only represents the amount at the balance sheet date of December 31, 2000. Due to the inappropriate investment policy and internal control weakness described above, there exists the possibility that other repurchase agreements throughout the current audit period were not authorized in accordance with the Pennsylvania Law quoted above.

Comment 01 – 3: (continued)

Further, we agree with the Treasurer's decision to limit the underlying securities for repurchase agreements to short-term U.S. or U.S. agency securities unless they are backed by the full faith and credit of the U.S. This will ensure compliance with the existing state law quoted in the finding.

Based on the discussion points above, the finding and recommendation remain as stated. Any corrective action will be reviewed as part of our subsequent audit.

The corrective action plan for this comment, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Comment 01 – 4:

Department of Corrections

Internal Control Weaknesses in the Physical Inventory at the State Correctional Institution at Graterford

Condition: As part of our audit of the Manufacturing Fund, one of the Commonwealth's Internal Service Funds, we performed an inventory observation at SCI Graterford for the year ended June 30, 2001. During our audit procedures, we noted significant problems in our test counts, cut-off testing, valuation, review of obsolete inventory, and organization of the facility.

In the area of test counts, we noted several problems when reconciling our physical inventory test counts to the final inventory listing. First, inventory counts were done using tags and we recorded our test counts by tag number. The final inventory listing, however, did not include tag numbers, so that if one product was in several locations and included on multiple tags, only the total of all tags was included on the final inventory listing. Complete documentation regarding which tag numbers made up the totals was not maintained. We noted an instance where an inventory item (20/2 Natural Yarn 100 percent) was double counted by Weave Plant personnel in both the warehouse and the plant because of this weakness. Although facility personnel indicated that this was an isolated incident, no record was made as to which tag numbers made up the total that appeared for that product on the final inventory listing. We also noted that some plants were including work-in-process in their inventory counts, while others were not. For example, the Hosiery Plant included spools on machines in their counts; however, other plants did not include such work-in-process in their counts. In addition, work-in-process for the facility was calculated by adding raw material, labor and burden, and subtracting finished goods. However, the work-in-process was not always physically counted and compared to the perpetual records. Finally, on July 9, 2001, well after the physical count had taken place and after the fiscal year, management informed us that the Shoe Plant's finished goods were being recounted because they were not satisfied with the counts. These subsequent recounts were never recorded in the June 30, 2001 GAAP package.

In the area of cut-off testing, we noted that reductions to the finished goods inventory were not posted by invoice number. Therefore, the shipping invoices we selected for testing could not be verified for proper cut off. We also noted two invoices with invoice dates of June 11, 2001 and bill of lading dates of July 10, 2001. It appears that these items were erroneously included in the June 30, 2001 inventory balance. In addition, we did not observe any segregation of inventory within the facility between items to be counted and items not to be counted.

In the area of valuation, we tested unit prices for raw material items by comparing prices from recent invoices to the unit prices per the final inventory listing. We noted an average unit variance of $3.75. We also noted one product, Polyspun Thread T-27, that was valued at three different prices in three different cost centers on the final inventory listing.

In the area of obsolete inventory, we noted that obsolete inventory was not maintained in separate areas of the warehouse or plants. Also, items included on the facility's obsolete inventory listing were recorded on the final inventory listing at full value. In addition, we noted several items on the final inventory listing that should have been included on the obsolete inventory listing based upon their last issued dates of 1996, but they were not included as obsolete.

Finally, we noted that the warehouse was not well organized in that like inventory items were not grouped together to allow for efficient and accurate counting by product.

Criteria: In order to ensure that the inventory balance for the Manufacturing Fund is properly stated in accordance with accounting principles generally accepted in the United States, strong internal controls need to be in place and properly functioning during physical inventory observations at the state correctional institutions.

Cause: Proper inventory counting procedures were not followed at SCI Graterford to ensure an accurate count. Internal controls over the inventory counting process are not adequate.

Comment 01 – 4: (continued)

Effect: The inventory balance for SCI Graterford was misstated in the Manufacturing Fund. Although audit adjustments to current-year inventory balances were not deemed necessary for this year's audit, significant misstatements could occur in future periods and not be detected and corrected by DOC management. A proper audit trail is not maintained by SCI Graterford to allow for complete testing of inventory balances. Internal controls may also be weak at other SCIs within the Commonwealth.

Recommendation: We recommend that more complete physical inventory procedures be established and followed at SCI Graterford and internal controls be strengthened. DOC should review its existing inventory procedures for all SCIs and ensure that proper internal controls are in place to ensure accurate inventory counts.

The internal controls should include, at a minimum:

- Proper segregation and write-off of obsolete inventory;
- Reconciliations of all tags issued;
- Clear audit trails showing all tags used and reconciled to the compilation listing; and
- Better supervisory review of the entire process, including spot test counts and valuation reviews.

Agency Response: We concur with the conclusion and recommendations. As a result, we plan to implement the following corrective actions in all SCI locations by May 15, 2002.

- Acquire an inventory taking software module to record the inventory by part number, inventory tag number, and value the physical inventory.
- Establish procedures for inventory taking including cut-off procedures, define raw materials, work in process and finished goods inventories.
- Implement procedures for re-counts, internal audits, and reconciliation processes.
- Tie invoices to shop order and product number on shipments. Establish shipment cut-offs and document last shipments prior to inventory.
- List, value and record obsolete inventory; re-value as appropriate.
- Improve accuracy of inventory by organization of storage and ease of identification of materials.
- Implement cycle counting.

These internal corrective actions will strengthen our inventory policies, procedures, and position. We intend for the new procedures to be in place for the end of FY 2001-2002 physical inventory.

Auditors' Conclusion: Based on the agency response, the finding and recommendation remain as stated. We will review any corrective action in our subsequent audit.

The corrective action plan for this comment, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Comment 01 – 5:

Office of Administration

Lack of Documentation and Internal Control Weaknesses Over Contracting and Procurement (A Similar Condition Was Noted in Prior Year Comment #4)

Condition: During our current audit period, the Governor's Office of Administration (OA) awarded two major contracts as part of an Enterprise Resource Planning (ERP) project to modernize and upgrade the Commonwealth's statewide information systems technology. These two contracts were for the purchase of ERP software and the procurement of services from an ERP systems integrator acting as a consultant.

According to OA officials, the Commonwealth decided not to use the standard Request for Proposal (RFP) process specifically outlined in Commonwealth procurement regulations for these contracts. Each of these procurements, however, did incorporate a competitive process as required by regulations since they included advertising and invitations to potential vendors to submit competitive proposals for review and evaluation by the Commonwealth in order to award the contracts competitively to the most qualified proposers. The ERP software procurement included an "Enterprise Software Selection Vendor Package" to select the most qualified software product first, and then negotiate costs later after a sole source vendor was decided upon. The consultant procurement included a "Call For Business Proposal" similar to an RFP process as described in Commonwealth procurement regulations.

For the $112.0 million, five-year ERP consulting contract and the $51.9 million, three-year software contract, OA refused to provide us with key procurement documentation to enable us to audit the awarding of these contracts to verify they reasonably complied with Commonwealth procurement regulations. Documentation not provided to us included:

- Listings of evaluation committee members along with their qualifications to serve on the evaluation committees;
- Copies of losing proposals submitted in response to the Commonwealth's invitations for proposals;
- Detailed scoring sheets and evaluation criteria used by evaluation committee members for each of the proposals submitted for review;
- Summary documentation to audit the overall scoring and selection process and the evaluation committees' final recommendations for each of the selected vendors; and
- Documentation required for evaluating the participation of Socially and Economically Restricted Businesses (SERB) for each of the submitted proposals.

Furthermore, based on documentation that was provided to us for these two ERP contracts, we also noted the following weaknesses in the Commonwealth's internal controls over documentation and/or contracting and procurement:

- Both vendors signed and submitted the required STD 21, Compliance Review Form, after we requested the form as part of our audit, or 4 and 14 months late, respectively. The forms, which provide key data on the contractors' Equal Employment Opportunity (EEO) and nondiscrimination plans, recent personnel transactions, and the current work force breakdown and additional hiring needs because of the new contracts awarded, were dated July and August 2001 and appear to have been completed by the contractors and submitted to OA as a result of our audit request.
- OA did not check the Commonwealth Contractor Responsibility File for 8 of 10 subcontractors on the ERP consultant contract prior to the award to ensure they were responsible and did not have a liability to the Commonwealth for delinquent taxes or other reasons.

Comment 01 – 5: (continued)

- Commonwealth management awarded both ERP contracts based on the professional recommendations of another outside consultant on contract (two contracts totaling $773,000) to assist management in designing and evaluating proposals, and choosing the most qualified vendors for the ERP project. Our audit inquiries disclosed potential conflicts of interest for this outside consultant who was a business client of both the software vendor and the consultant at the time it recommended these two vendors to the Commonwealth. Commonwealth management, before awarding the two contracts, performed no follow up on this potential conflict.

- For both the software and consulting contracts, internal approvals to proceed into negotiations with the selected vendors were not documented by management. Officials stated to us that executive approval was obtained verbally prior to moving forward with the contracts, but there is no evidence of this executive approval. The sole source justification for the software contract was prepared on June 26, 2000, which was clearly untimely since this was only three days before the effective date of the contract and included no approval signature of management. We also found evidence in the ERP software contract file demonstrating that the Central Services (CS) Comptroller Office was prevented from properly reviewing documentation supporting that the procurement was done in accordance with applicable laws and regulations prior to giving its approval of the contract.. A CS Comptroller Office file memo dated February 16, 2001, and entitled "Back-up Information To Support Selection of …Software," includes the following statement: …*We asked but were not given any of the supporting documentation during the solicitation and selection period. Top management is well aware that we do not possess this information.*

- The Commonwealth's Vendor Information Payment System (VIPS), established by management to track payments by individual Commonwealth contract, did not provide accurate payment totals for these two contracts and did not agree with vendor payment totals on the ICS accounting system. Comptroller personnel informed us that VIPS and ICS should contain the correct payment information for these vendors, but the two systems did not agree. Significant differences occurred if payments were posted to ICS but never made by Treasury, re-posted after being cancelled, and where payments were not properly charged to the vendor account on ICS, and corrections were never made to ensure the systems were accurate and in agreement. Overall, we noted the accounting for these contracts on the Commonwealth's systems was poor and totals were not reliable for management tracking.

- For the ERP software contract, $540,000 in excess funds were encumbered and committed to the project on the ICS accounting system because of clerical errors that were not detected and corrected by management either in the contract preparation, review, or approval process. Because this contract was executed before June 30, 2000, the total contract award was discounted by $1.5 million, but the individual who encumbered a portion of the funds (i.e., the maintenance fee) used the higher award amount for this project, making less funds available for other programs.

- The ERP software contract required the signing of a performance bond by the contractor since Commonwealth officials believed this to be essential to the best interests of the Commonwealth (see Chapter 37 of M215.3). However, the contractor refused to sign the requested performance bond stating this was not standard practice within the industry and that the bond would only be issued if the ERP consultant "will not, or otherwise cannot, verify that the…software will meet the functional specifications." No documentation was provided by management to support any follow up with the ERP consultant and no performance bond was signed by the contractor.

During our current audit period, we also noted internal control weaknesses over evaluating and documenting contract amendments, which significantly increased total contract costs after the awarding of the original contracts. For this testwork, we examined the two ERP contracts referred to above and two additional statewide contracts awarded in a prior year and amended in the current year: a $515.5 million data powerhouse contract and a $228 million telecommunications contract. In testing amendments to these four large contracts, we noted the following:

Two amendments were made to the $112 million five-year ERP consulting contract in the first year, one for $1.1 million in May and the other for $5.8 million in August of 2001, or $6.9 million in total. The consultant described each of these as an "Additional Services Addendum," one to provide "Sandbox and Development Implementation" and the other for "QA/Test, Training, and Production Implementation and Operational Support." However, management provided no

Comment 01 – 5: (continued)

documentation to justify increasing the $112 million consultant contract amount for these services. We noted the same services were described within the original contract, and that the statements of work attached to these contract increases appeared, like other work statements, to be submitted in accordance with the original agreed-upon terms. No documentation was provided to support why these two work statements should cause an increase in the contract award, while other statements of work submitted by the consultant did not result in any award increases. There was also no documentation to reasonably demonstrate that management adequately reviewed the justifications for these amendments or their amounts. Furthermore, for the $1.1 million amendment, the consultant indicated the services were actually related to another ERP services contract with the Commonwealth for $98,048 (FL1333820), not the $112 million contract being amended, so it appears that management may have amended the wrong contract.

Four amendments totaling $1.27 million were made to the $51.9 million ERP software contract between March and September 2001 for vendor training services. None of the supporting justifications for these amendments clearly documented the need for an increase in the original contract amount, which already included vendor training services. While the documented training services appear reasonable, management did not reasonably demonstrate that contract award increases were properly reviewed and determined to be appropriate for these services.

For the $515.5 million data powerhouse contract, we noted 62 increasing contract amendments totaling to $57.7 million and 10 decreasing contract adjustments for $11 million over the first two years of the seven-year contract, which net to about $46.7 million in net increases in awarded funds. We sampled the five largest amendments in our current year and found that management provided no reasonable support for the amount of each amendment or that a proper management review of the amount was performed. Two of these amendments were made because L&I's Bureau of Workers' Compensation and PHFA chose not to participate in the project. The original contract cost for these two entities was appropriately amended downward (by $8 million) because of this, but the vendor then increased the total contract by $2.8 million and $2.1 million, or $4.9 million in total, for these changes. Supporting documents indicated that the Commonwealth was obligated to pay the vendor this $4.9 million even though two less agencies were participating in the contract and included no support for the amendment amounts. Three other sampled amendments for $14.3 million, $6.4 million, and $3.2 million also included no support for the amounts of the award increase. For all five sampled amendments, there was no evidence to clearly demonstrate management's monitoring of the amounts for reasonableness, propriety, or necessity.

For the $228 million telecommunications contract, we followed up on significant internal control weaknesses over amending this contract reported in a prior audit finding. We found that these control weaknesses were not resolved in the current year. Over the first 1½ years of the 5-year contract, from April 2000 through September 2001, we noted that 77 amendments (referred to as "change requests" by the parties) were submitted for this contract, 52 of which were approved, seven rejected, and 18 of which were pending approval as of our review date. Because OA's Change Request Tracking System did not track the changes in contract cost associated with each amendment, management did not provide, and we were unable to determine, the total amount of these 70 approved and pending amendments. Furthermore, because we were refused access to key documentation supporting the procurement and selection process in our prior audit, we were not given the opportunity to assess the appropriateness of management's awarding this contract on a competitive basis in a prior year and approving 52 amendments to date. Out of the five approved amendments sampled as part of our audit, four changes increased the contract cost by $2.1 million in total, while one provided a savings of $33,700. As in our prior audit, none of these amendments showed evidence of CS Comptroller Office involvement in their approval, or any additional Commonwealth officials, other than the same bureau director within OA. We also noted that one of these five amendments (Change Request #22) contained significant clerical errors that did not appear to be detected by the Commonwealth in its review process. As in our prior audit, internal controls continue to appear weak over the monitoring and amendment of this statewide contract.

Criteria: The Commonwealth established procurement policy and procedures in the "Field Procurement Handbook" (M215.3). Commonwealth agencies are required to adhere to this handbook when awarding contracts. Chapter 7 of the handbook details a step-by-step process that must be followed when a contract is to be awarded via a "Request for

Comment 01 – 5: (continued)

Proposal." Good internal controls require management to maintain sufficient documentation to demonstrate that proper purchasing procedures were reasonably followed and contract awards and costs were properly accounted for. Regarding procurement duties, specific sections of Chapter 7 state:

Evaluation Committee	*21.*	*Determines that the offeror and the proposed subcontractors are responsible in accordance with Management Directive 215.9, Contractor Responsibility Program. The date of determination should be recorded for future reference.*
Evaluation Committee	*25.*	*Performs final technical and cost evaluations after discussions have been completed* (i.e. score sheets).
Agency	*43.*	*Forward Form STD-21 Compliance Review Form, to selected contractor, if the contract exceeds $50,000.*
Agency Comptroller	*38.*	*Reviews for fiscal responsibility, budgetary appropriateness and availability of funds….*

Chapter 32 of M215.3 states: *An amendment shall be issued for any change to the terms, conditions, requirements, or costs (increases/decreases) of a contract, except for change orders, advices of change, or internal service contract adjustments. Amendments shall require the signature of the contractor and the same Commonwealth officials as the original contract.*

Chapter 37 of M215.3, Performance Security, states: …*Contract performance security may be required when essential to the best interests of the Commonwealth. Determination to require a performance guarantee shall be made by the purchasing agency….*

Cause: Management maintains that the identity and qualifications of evaluation committee members, committee scoring sheets, SERB participation, and the losing proposals are considered confidential information that we are not entitled to review. For the ERP consultant contract, management did not believe it was necessary to verify subcontractor responsibility. For the other issues disclosed above, management did not provide a reason for the lack of documentation.

Effect: By refusing to provide the requested documentation, management has prevented the Auditor General from performing duties required of him by Pennsylvania's Constitution and by Pennsylvania law. The Constitution provides that "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." (Article VIII, Section 10) The Fiscal Code directs the Department of the Auditor General "to make all audits of transactions after their occurrence, which may be necessary, in connection with the administration of the financial affairs of the government of this Commonwealth,…" (72 P.S. § 402) Management has taken the unsupported—and unsupportable—position that the mere invocation of confidentiality supersedes these constitutional and statutory directives.

Management has thus thwarted the department's efforts to ensure that financial transactions have been executed in accordance with applicable law. Without the necessary documentation, we could not verify that management adhered to Commonwealth procurement standards or exercised due diligence in awarding and amending the two ERP contracts we tested. More specifically, we could not verify that management awarded contracts to the most qualified vendors or that the appropriate Commonwealth officials conducted proper fiscal reviews of amendments that substantially increased contract costs. In short, management improperly imposed limitations on our audit procedures.

We also noted significant control weaknesses with regard to documentation supporting compliance with Commonwealth procurement law and regulations, and supporting a proper accounting for contract awards and related costs. If these weaknesses are not corrected, we can have only limited assurance that the overall procurement system is functioning as intended and that services are being properly contracted out. The Commonwealth is attempting to attain significant cost

Comment 01 – 5: (continued)

savings by consolidating statewide services in both the data powerhouse and telecommunications contracts; but with weak fiscal controls over the many amendments which are increasing contract costs, these potential cost savings may not be attained as planned.

Furthermore, management's refusal to provide procurement documentation to our department is a violation of the Commonwealth Procurement Code, which states: *Retention of procurement records. All procurement records, including any written determinations issued in accordance with section 561 (relating to finality of determinations), shall be retained for a minimum of three years from the date of final payment under the contract and disposed of in accordance with records retention guidelines and schedules as provided by law. In accordance with applicable law, all retained documents shall be made available to the . . . Auditor General . . . upon request. (62 Pa.C.S.A. § 563)*

Recommendation: We recommend that management more closely monitor the above contracts to ensure Commonwealth funds are being properly committed at the most reasonable cost. Subcontractor liability and responsibility should be reviewed timely; the fiscal impact of amendments and their amounts should be better documented, and reviewed and approved by required Commonwealth officials; all required contract forms should be filed timely; contract amendment amounts should be appropriately supported; performance security should be obtained or appropriately followed up on to protect the best interests of the Commonwealth; and vendor activities should be adequately monitored and better documented in the future to ensure that services are appropriate and at the most reasonable cost. In addition, the accounting for contract encumbrances and payments should be improved to provide management with a more accurate tracking of contract costs.

We also recommend that management evaluate the disclosures above for their impact on the overall procurement and accounting functions, and take similar corrective action where considered necessary on an overall basis.

Finally, we recommend that management abandon its obstructionist practice of withholding documentation so that we can perform our constitutional and statutory duties, and can provide the public with independently verified audit information on which they can rely.

Agency Response: Regarding the procurement documentation noted in the finding that was not provided for the ERP consulting contract and the ERP software contract, the OA response is as follows:

The auditor did not request qualifications for the evaluation committee members. In addition, as stated in prior correspondence from the Office of the Budget to the Auditor General's Department, it is the position of the Commonwealth that materials concerning the evaluation, scoring, and selection are proprietary and confidential to the Commonwealth and not subject to release.

The auditor did not request copies of the losing proposals for the ERP Software or Systems Integration initiatives. However, if the OA were asked for them, it is Commonwealth's position that these are confidential and they are not subject to release.

In addition, when similar SERB information was requested last year for the telecommunications contract, DGS's Bureau of Contract Administration and Business Development would not provide any information or documentation to substantiate the SERB evaluations and scores citing confidentiality.

Regarding the internal control weaknesses noted in the finding on the awarding of the ERP consulting contract and the ERP software contract, the OA response is as follows:

The STD 21 form (Compliance Review) was completed by the ERP software vendor and the ERP consultant (or Systems Integrator); however, they were not completed in the recommended period.

Comment 01 – 5: (continued)

The auditor's statement regarding subcontractor responsibility is in reference to the Systems Integration contract. All of the appropriate and required checks on contractors and their subs were performed. The OA however did not have the "certificate of contractor responsibility" prepared and signed by the appropriate agency fiscal office.

A Systems Integration Due Diligence Committee was created and reported to the Evaluation Committee. Information noted as the "Lexus Check" was provided to the auditor in its June 28, 2001 request, Item #9. The Due Diligence Team checked the Contractor Responsibility file for all primes and subs of the primes, as well as all references. In fact, this checking was performed twice for all vendors and subcontractors who submitted a proposal. The first check was done upon receipt of the proposals to provide all vendors and their subs an advanced notice of any noncompliance issues, thus allowing them time to either come into compliance or resolve the issue that was making them appear not in compliance. This checking was performed again for the selected vendor prior to processing the resultant contract for approval.

The role of the additional outside consultant noted in the finding was to facilitate the competitive process of selecting a software product and qualified vendor to implement that product. **This contractor in no way whatsoever made any recommendations or influenced the OA to arrive at any decision during the evaluation, scoring, and selection periods.** Rather, the contractor brought a methodology and a process, based on a wide range of ERP industry standard experience as well as independently developed research data to guide the OA in these two ERP related procurements. Due to the complexities of ERP Projects, the OA contracted with the consultant to learn of the complexities and assist the OA in the procurement of ERP software and the subsequent System Integrator.

<u>As the auditor stated in its opening comments of this finding</u>, "Each of these procurements, however, did incorporate a competitive process as required by regulations since they included advertising and invitations to potential vendors to submit competitive proposals for review and evaluation by the Commonwealth in order to award the contracts competitively to the most qualified proposers."

Regarding internal approvals, in both cases cited, approvals to proceed were given in meetings where the results of the evaluation by the committee along with its recommendation were presented to appropriate senior administration decision makers. At the conclusion of each presentation and upon further discussion by the decision makers, verbal approvals were given to proceed with the recommended solution. At the time of these verbal recommendations, the OA was not obligated by any statutory, regulatory or management practice, for such approval to be in writing or memorialized in some type of documentation. In March 2001, in the Commonwealth's response to Prior Year Comment #4, the OA disclosed to the auditor the same information above with a note that it would begin this "written approval" practice in future engagements.

It is an unreasonable conclusion to state that the sole source justification was untimely simply because it was close in time to the effective date of the contract. The OA negotiated up to the eleventh hour of a deadline set by the vendor for an agreement in return for a very substantial discount ($1.5M) in the price of the software. The negotiations were successfully concluded within several days of the vendor imposed deadline, hence the need to follow Commonwealth prescribed procedures for obtaining Sole Source Approvals and other required contractual approvals culminating in a fully executed contract before the expiration of the vendor deadline. The Sole Source Request document submitted (auditor request January 4, 2002, Item #4) is irrelevant given that all necessary steps for a sole source approval had been followed and the independent Sole Source Board gave approval. While these factors caused the contract effective date to be close in time to the sole source approval, <u>it resulted in a substantial savings to the Commonwealth of Pennsylvania</u>, which would have not otherwise occurred. In short, the process and the result was an example of well-executed negotiation skills and management control over the process while at the same time following all Commonwealth procedures and receiving all required approvals.

Regarding contractor payments recorded on the accounting system, when the Comptroller cancels a payment and re-encumbers the funds back onto the document and then re-pays the vendor, the expenditures will show higher on the document history because there is no way to link the expenditure correction to the encumbered document. This is a limitation of the ICS system. However, if the auditor had delved further into the ICS system, it would be clear that the payments were applied back on the document.

Comment 01 – 5: (continued)

When the ERP software contract was encumbered, it was not fully executed; therefore, it was encumbered at the higher amount. Once it was fully executed, there should have been an adjustment made in the encumbrance; however, invoices were calculated and paid based upon the lower license fee. A memo will be sent to the Comptroller's Office to reduce the funds for fiscal year 01/02 and 02/03. The OA disagrees this error made "less funds available for other programs." Since the software contract did not include specific funding for training, OA was able to use these available funds to efficiently and effectively obtain critical initial training on the ERP software without the need to request additional funding.

The lack of a performance bond in the ERP software contract was a negotiated settlement which allowed the successful and timely execution of a contract with the vendor at a very substantial discount; while linking the ERP software contract and the performance of the software products to the implementation of those products by the System Integrator (SI) (to be selected at a later time than the software contract). Provisions in the software and the subsequent SI contracts have the performance of the software linked to the verification of that performance by the SI. If the SI could not certify such performance, then a retroactive performance bond would be triggered in the software contract. If the SI would certify the software performance, then no performance bond would be needed by the software vendor. Since the cost of such bonds are merely passed on costs to the Commonwealth, once again the negotiation tactic saved that cost to the taxpayers. This is but another example of good negotiation strategies and tactics as well as a demonstration of strong management control over the procurement process and the ultimate reduction and/or elimination of risk to the Commonwealth.

Regarding the internal control weaknesses noted in the finding over evaluating and documenting contract amendments, the OA response is as follows:

The SI (or ERP consulting) contract provided for the creation of Statements of Work (SOW) to define the services to be carried out by the SI. The SOW's, by contract definition, included only services within the scope of the contract, and again, by contract definition, could not increase the value of the contract. SOW number 1 was actually executed with the contract. SOW number 2 was completed when it was clear exactly what services would be required to complete the project, within the scope of the original contract. Amendments were required to include services that were not included within the scope of the original contract. To date, two amendments have been executed related to the SI contract. Those two amendments, which were for services not within the scope of the original contract, appropriately increased the cost of the contract.

The two amendments to the SI contract provide for additional optional services, which were originally requested as optional services in the Call For Business Proposal (CFBP). The rationale and documentation for such services was detailed in the CFBP and again in the terms of the resultant contract. The OA was simply exercising the options that it set out in the CFBP. No further need for documentation appeared to be necessary as all appropriate steps were followed in the CFBP and subsequent contract, which obviously had all required approvals. OA is not aware of any requirement for further justifying the need for services, which were first outlined according to existing procurement regulations and procedures. The OA would consider adopting this as a best practice if that would further demonstrate the due diligence of its management discretion. **The amendments referenced above were executed against the correct contract. FL # 1333820 was an ITQ and not the contract in question.**

The software contract included language, which allowed training services to be provided by the software vendor. No funds, however, were included in the actual contract for training to be performed. The OA elected to keep its training options open as much as possible by waiting to see if the incoming Systems Integrator might provide this same type of training as part of its proposal or subsequent contract. Once the scope of training was known, the OA exercised the prior approved option to procure training via the software contract.

Based on the numerous inquiries from the auditor concerning the Data PowerHouse contract and Telecommunications contract, there appears to be a fundamental issue relative to the OA's use of Change Orders in these contracts. The auditor keeps referring to such changes as contract amendments. They are not contract amendments, but change orders. The Commonwealth Procurement Code, 62 Pa.C.S.A. § 101, *et. Seq.*, clearly permits the use of Change Orders under the

Comment 01 – 5: (continued)

general terms and conditions of the contract, if authorized by the Commonwealth contract manager. There has been only one very minor contract amendment issued to-date for the Data PowerHouse project. That involved the addition of language in the contract requested by the Federal Bureau of Investigation to help safeguard criminal data they share with the Commonwealth of Pennsylvania.

Relative to the finding that documents were not forthcoming from the OA in support of the audit:

The Auditor General's office originally requested copies of all FY 00/01 Change Orders from the Comptroller's Office. In support of this, the OA provided all information to the Comptroller's Office in a timely manner (due to the volume, the extra step of burning the documents onto a CD was taken).

- Contained in these documents were all five fully executed Change Orders, and their impact on all related Contract Exhibits.
- Copies of all Change Orders involving cost changes have been presented to the Comptroller's Office and Treasury as required in the invoice process. Neither office has ever disputed or challenged the need or propriety of any Change Order.
- All five of the referenced Change Orders were approved by both the vendor's and Commonwealth's Project Manager. Under the terms of the Data PowerHouse contract and the Procurement Code, this is all the authority needed to execute such changes.
- The concept of this contract permitting the use of Change Orders to react to constant agency business changes - versus formal contact amendments - was reviewed for "Form and Legality" and approved by, the Comptroller's Office, the Office of the Attorney General, the Chief Counsel of the Office of Administration, and the Governor's Office of General Counsel.
- OA was working towards putting together the additional supporting documentation requested on February 5, 2002 at 1:30 PM by the Auditor General's Office. However, these numerous documents could NOT be researched, copied, reviewed, and forwarded to the Auditor General's Office in the 27-hour time frame requested. Shortly after that 27-hour time period lapsed, the OA was informed that a finding would be forthcoming.

Had the OA been given a reasonable length of time to respond to this latest request, it is confident it could have provided the Auditor General's Office with additional documentation that would substantiate the "reasonableness, propriety, or necessity" of these Changes Orders. Such documents and Change Order processes in place for this contract have provided the 15 agencies under the Governor's jurisdiction, the five independent boards and commissions that voted to participate in the project, the Governor's Budget Office, and five federal agencies that reviewed and approved the project and its contractual processes the comfort level the auditor seeks.

The auditor continually and deliberately misrepresents the nature of the telecommunications contract. As advised in a February 12, 2001 letter from the OA to the Auditor General's Department:

"As explained in our earlier responses this contract is a commodities contract with a guaranteed annual minimum. (See paragraph 4.5 of the contract). The full volume of use over the term cannot be predicted, either for the original services as bid or for any changes requested. Any "total cost" figures are, therefore, only estimates. The Commonwealth, under paragraph 4.5 of the contract, is obligated to the contractor for $20 million/year, not $228 million in the aggregate."

There will never be a final value for this contract, since as a commodity contract, its value is dependent upon the volumes of services the agencies decide to obtain.

The auditor falsely presents the commodities contract when expressing savings and costs as done above. The savings are provided by either more efficient pricing resulting in cost reductions or in actual lowering of a unit price, both done to meet evolving requirements. To characterize new costs as "cost increases" deliberately misrepresents them as increases to previously contracted pricing, when actually these new costs provide for enhanced or new services that are fully within the scope of the contract and RFQC and allowable under the procurement code. The majority of these costs involve

Comment 01 – 5: (continued)

heightened security measures required by escalating threats to data and network security as evidenced by the recent terrorists attacks. In fact, all new expenditures are the result of evolving requirements of the Commonwealth's agencies or technological challenges, which is the major purpose of a commodities contract.

As with BCCS, the auditor is characterizing the BCTS Change Requests (CR's) as amendments. They are not contract amendments, but change orders. The Commonwealth Procurement Code, 62 Pa.C.S.A. § 101, *et. Seq.,* clearly permits the use of change orders under the general terms and conditions of the contract, if authorized by the Commonwealth contract manager.

This same issue was also addressed in previous correspondence. A February 12, 2001 letter from the OA to the Auditor General's office stated, "The Commonwealth of Pennsylvania Field Procurement Handbook (M 215.3) does not require a contract amendment to effect all changes….

None of these CR's increased a proposed unit price element. The impact of these changes is that additional unit price items, within the scope of services requested in the Request For Qualified Contractors (RFQC), were made available to the OA."

Finally, all CR's are presented to the Comptroller's Office and now include a cost impact statement.

The OA disagrees that there are control weaknesses. The conclusions stated by the auditor stem from an incorrect premise, that the contract changes should have been contract amendments. It was previously established that the "Change Order" process was authorized in the original proposal requests, which was subsequently incorporated into the contract and as such, had all the appropriate and necessary approvals. It is by this Change Order process that "strong," not "weak" management controls were exercised over each and every change request, thus enabling the OA to be legally responsive to the changing business needs of the Commonwealth agencies.

The auditor's note on the "total effect" that resulted from this finding cannot be substantiated because the "effect" did not occur.

The few minor deficiencies are noted and will be rectified. With the *de minimus* exceptions that have been noted, the OA has followed proper business practices within the procurement code to achieve results that make the best use of taxpayer dollars.

It is difficult to provide requested information to the auditor when such requests for information do not provide adequate time for proper OA assembly and review. For many years the auditor has made "eleventh hour" requests for material, without sensitivity to the business, priorities, and critical functions of the OA. The OA recommends that in the future, the auditor and the OA agree on a mutual delivery date which both determine is practical and realistic for requested materials. The OA also requests as it has many times in the past that requests for information be issued in writing, and that an electronic copy of that request support them.

Auditors' Conclusion: OA's argument that key procurement documents are not subject to release for our audit because they are "proprietary and confidential to the Commonwealth" is being presented unilaterally without any reference to legal authority or legal precedent as support. OA's position is also a clear violation of the Procurement Code as indicated in the finding. Furthermore, the industry audit standards which we (both the Department of the Auditor General and Ernst & Young) operate under include a set of rules which specifically govern confidential or proprietary information received in an audit conducted in accordance with those standards. Because these industry standards have been in existence and have governed our auditor responsibilities vis-à-vis confidential information for many years past, OA's position that we are not entitled to review procurement documents simply because they are confidential makes no sense for this audit. We did not formally request some of the documentation, as OA asserts in its response, because we were aware in our current-year follow-up that the Commonwealth had not changed its position from our prior-year finding (as OA states). Furthermore, OA had the opportunity to provide the documents in its agency response to the finding, but as noted above, refuses to provide them to us.

Comment 01 – 5: (continued)

Regarding OA's responses on the internal control weaknesses over the awarding of the two ERP contracts, we have the following comments:

Regarding the "Lexus Check" described by OA, no documentation was maintained in the contract files as required to demonstrate that subcontractor responsibility was checked prior to awarding the consultant contract, so management could not demonstrate that this control was in place.

Our review of the contract files for the ERP software and ERP SI consultant contracts demonstrated that the additional outside consultant was involved in virtually all key aspects of the ERP procurement and selection process. This is also supported by our review of the services described in the additional outside consultant's two contracts with OA. Furthermore, numerous documents in the ERP software and SI contracts were on this additional consultant's letterhead and/or appeared to be developed or reviewed and approved by the consultant. While we found no actual evidence, if such evidence exists, that this additional consultant's outside relationships with these vendors influenced the Commonwealth's procurement and selection process, the potential conflict of interest should have been identified, investigated, and documented by OA officials before awarding the ERP contracts.

Strong internal controls should properly and timely document management's approval process for procurements, especially the large dollar contracts we tested in our audit. Management's claim that it saved a substantial amount of funds in its negotiation process has no relevance to the lack of documented approvals, or the untimely sole source justification, noted in the finding for the ERP contracts, or to our conclusion that internal controls need to be strengthened. The final negotiated price with a sole source vendor does not impact the timeliness of management's preparation, review, and approval of the sole source justification document itself. Furthermore, because OA refused to provide all key procurement documents for these two ERP contracts, we were given virtually no evidence in our audit to demonstrate that management had adequate controls over the contract review and approval process. OA did not respond to the CS Comptroller memo dated February 16, 2001 mentioned in the finding, which indicates Comptroller staff was actually prevented from reviewing the ERP software contract during this process.

Regarding the inaccuracies in contract payments and encumbrances recorded on the Commonwealth's accounting systems, management was not aware of these significant errors and did not appear to be tracking amounts recorded on their own systems for these contracts. OA's response does not address these errors, and our conclusion that accounting controls need improvement remains unchanged. Furthermore, OA should not be liquidating the $540,000 in encumbrances identified in the finding with contractor invoices for training that were not covered in the original encumbrance.

Regarding OA's response on the performance bond issue, we are not disputing or questioning management's negotiation tactics for the software contract, which the OA response implies. As the finding indicates, Chapter 37 of the Procurement Code applied to this procurement since management required the signing of a performance bond as part of this software contract. Management then dropped this provision without properly documenting or following up on protecting the Commonwealth's best interests, and apparently chose to ignore Chapter 37 of the Procurement Code. While OA explains some of management's reasoning on this issue in its response, officials cannot demonstrate adequate controls were in place at the time the software contract was reviewed, approved, and awarded by management. Furthermore, OA's statement about the "ultimate reduction and/or elimination of risk to the Commonwealth" without actually obtaining a performance bond on the ERP software is clearly questionable at best. In fact, our office recently completed an audit of another state contract in which another Commonwealth agency negotiated away significant recoupment rights in order to come to an agreement to purchase land from a private company. The Commonwealth then lost funds when state officials chose to back out of the deal, but could not recoup any of the deposit monies because of management's abrogation of its recoupment rights in the original contract. We think management is placing significant Commonwealth funds at risk for the ERP software contract and should have stronger controls in place to document the propriety of management's actions.

Regarding OA's responses on the internal control weaknesses over contract amendments, we have the following additional comments:

Comment 01 – 5: (continued)

OA's explanations of these amendments do not resolve the weaknesses in internal controls over evaluating and documenting contract amendments noted in the finding. While OA states that the amendments which increased costs for the four sampled contracts were all justified and necessary, officials are not properly documenting this in the amendments at the time of management's review and approval. We judgmentally directed our sampling to larger dollar contracts operating during our current period and found that significant costs are being added to these contracts with poor documentation and weak internal controls. Furthermore, as noted in the finding, for the $515.5 million data powerhouse contract amendments, we also found evidence that the Commonwealth may be paying $4.9 million in increased contract costs for less service, which was not addressed in OA's response. Management is not properly documenting the increased contract costs for these amendments and Commonwealth funds may be unnecessarily placed at risk.

OA's arguments about the use of the term "change orders" versus "amendments" has no relevance to our conclusions regarding internal controls. In fact, when there is an increase in contract costs, the Procurement Code characterizes the change as an amendment, not a change order. We are not "deliberately" or "falsely" attempting to misrepresent the nature of contracts we tested, and we acknowledge OA's description of these contracts in its response. Our concern is the lack of documentation to adequately support increases in contract costs, regardless of the terminology employed. Controls need to be strengthened over the commitment of increased funding by the Commonwealth, especially for large contracts such as these.

The significant number of amendments or "change orders" to the telecommunications contract adds further support to the concern we expressed in a finding in the prior year's audit about the lack of controls in the process used to award this contract. We noted that OA estimated the cost for the first year of the contract to be $80 million and the winning vendor submitted a bid of $46 million – a bid that was 42 percent below estimate. OA provided an explanation that reduced the difference to a still significant 28 percent. Given this significant difference between estimated cost and bid cost, we were concerned as to whether a documented analysis was properly performed by management to ensure the vendor submitted a reasonable bid and could provide the needed services at the proposed price. In addition, since we were not provided access to the losing cost proposal, we were not able to determine whether that vendor's base proposal included the services the Commonwealth is now paying additional cost for, or whether the awarded vendor truly did submit the lowest priced proposal.

OA's response stated that we did not give management enough time to provide additional documentation on the five amendments we tested for the data powerhouse contract. We first submitted documentation requests as far back as June of 2001 related to this contract testwork. OA's response time for our current audit requests was slow, ranging from 4 weeks to 1½ months, so our testwork in this area was delayed as a result. After completing testwork, we made an additional documentation request on February 5, 2002, for a portion of this testwork, namely the sample of 5 amendments to the data powerhouse contract. Management had over three weeks from February 5 to February 27, 2002, to provide the additional documentation for one, more than one, or all of the five sampled amendments, but nothing was provided. We consider this time period to be reasonable to locate any additional documentation for only 5 of the 72 amendments to this contract, if such additional documentation exists. We would also point out that routine delays by management in providing documentation to us does not enable us to complete our audit in a timely manner.

Our finding and recommendations, with the above clarifications, remain as stated above.

The corrective action plan for this comment, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

COMMONWEALTH OF PENNSYLVANIA

Index to Federal Award Findings and Questioned Costs - June 30, 2001

Finding No.	CFDA No.	CFDA Name	Finding Title	Questioned Costs	Impacted State Agency	Finding Page	CAP Page
01-1**	10.551 93.558 93.778	Food Stamps Temporary Assistance for Needy Families Medical Assistance	DPW Did Not Have Adequate Internal Controls at the County Assistance Offices Over Eligibility Determinations		DPW	**119**	198
01-2 **	14.228	Community Development Block Grants/ State's Program	Performance/Evaluation Report Submitted to HUD Was Not Supported by Adequate Documentation (A Similar Condition Was Noted in Prior Year Finding #00-1)		DCED	**121**	197
01-3**	14.228 14.239	Community Development Block Grants/ State's Program HOME Investment Partnerships	Internal Control Weakness Over Information Reported from the Integrated Disbursement and Information System		DCED	**123**	197
01-4 *	14.239	HOME Investment Partnerships	DCED Did Not Perform On-Site Monitoring of Community Housing Development Organization Operating Grants (A Similar Condition Was Noted in Prior Year Finding #00-2)		DCED	**125**	197
01-5 *	15.250	Regulation of Surface Coal Mining	Unallowable Personnel Charges Result in Questioned Costs of $1,220	$1,220	DEP	**127**	197
01-6 *	17.245	Trade Adjustment Assistance – Workers	Overpayment of TRA Benefits Results in Questioned Costs of $264 (A Similar Condition Was Noted in Prior Year Finding #00-4)	$264	L&I	**129**	197
01-7 *	17.245	Trade Adjustment Assistance – Workers	Weakness in L&I's Controls Over Preparation and Submission of the Trade Act Participant Report		L&I	**131**	197
01-8 **	20.205 23.003	Highway Planning & Construction Appalachian Dev. Highway System	Internal Control Weakness Over Expenditure Information Reported on the SEFA		OB	**133**	196
01-9 **	83.548	Hazard Mitigation Grant	PEMA Did Not Properly Report Federal Expenditures on the SEFA		OB	**134**	197

CAP - Corrective Action Plan
* - Reportable Condition
** - Material Weakness

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Index to Federal Award Findings and Questioned Costs - June 30, 2001

Finding No.	CFDA No.	CFDA Name	Finding Title	Questioned Costs	Impacted State Agency	Finding Page	CAP Page
01-10 *	84.126	Rehabilitation Services - Vocational Rehabilitation Grants to States	A Weakness Exists in L&I's Procurement System Related to Debarment and Suspension (A Similar Condition Was Noted in Prior Year Finding #00-8)		L&I	**136**	198
01-11 *	84.126	Rehabilitation Services – Vocational Rehabilitation Grants to States	Inadequate Documentation to Support $33,276 in Unallowable Personnel Costs	$33,276	L&I	**138**	198
01-12 *	84.126	Rehabilitation Services – Vocational Rehabilitation Grants to States	Weaknesses Exist in L&I's Monitoring of RSBS Subgrantees (A Similar Condition Was Noted in Prior Year Finding #00-9)		L&I	**140**	198
01-13 **	93.558	Temporary Assistance for Needy Families	Lack of Documentation to Support Compliance with Federal Welfare Reform Regulations (A Similar Condition Was Noted in Prior Year Finding #00-12)		DPW	**144**	198
01-14 **	93.558	Temporary Assistance for Needy Families	Inaccurate Reporting on the TANF ACF-199 Data Report (A Similar Condition Was Noted in Prior Year Finding #00-11)		DPW	**145**	198
01-15 **	93.563	Child Support Enforcement	Noncompliance and Internal Control Weakness Over the Process of Responding to Interstate Registry Cases		DPW	**150**	198
01-16 **	93.575	Child Care and Development Block Grant	Weakness in DPW Monitoring Procedures Results in Over $32 Million in Excess Subgrantee Federal Cash at June 30, 2001 (A Similar Condition Was Noted in Prior Year Finding #00-13)		DPW	**152**	199
	93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund					
	93.667	Social Services Block Grant					
01-17 *	93.575	Child Care and Development Block Grant	Internal Control Weaknesses and Noncompliance With Federal Earmarking Requirements Result in Questioned Costs of $1,381,114	$1,381,114	DPW	**157**	199

CAP - Corrective Action Plan
*   - Reportable Condition
**   - Material Weakness

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Index to Federal Award Findings and Questioned Costs - June 30, 2001

Finding No.	CFDA No.	CFDA Name	Finding Title	Questioned Costs	Impacted State Agency	Finding Page	CAP Page
01-18 *	93.658	Foster Care – Title IV-E	DPW Office of Children, Youth and Families Should Renew Licensing of Foster Care Agencies in a More Timely Manner		DPW	**159**	199
01-19 **	17.246 17.250 17.253 17.255	Job Training Partnership Act Cluster Welfare-to-Work Grants to States Workforce Investment Act	Weaknesses in L&I's Internal Controls Over Subrecipients		L&I	**161**	198
01-20 **	Various	All Major Programs Covered by CMIA	The Commonwealth's Statewide Cash Management System Needs Improvement (A Similar Condition Was Noted in Prior Year Finding #00-17)		OB	**165**	197
01-21 *	93.558 93.667 Various	Temporary Assistance for Needy Families Social Services Block Grant All Major Programs Covered by CMIA	The CMIA Interest Liability Was Understated by a Minimum of $83,212 (A Similar Condition Was Noted in Prior Year Finding #00-18)		OB	**168**	197
			Total Questioned Costs	$1,415,874			

CAP - Corrective Action Plan
* - Reportable Condition
** - Material Weakness

Finding 01 – 1:

CFDA #10.551 – Food Stamps Program
CFDA #93.558 – Temporary Assistance for Needy Families
CFDA #93.778 – Medical Assistance

DPW Did Not Have Adequate Internal Controls At The County Assistance Offices Over Eligibility Determinations

Condition: As part of our audit of the MA, TANF, and FS programs, we are required to determine if the Department of Public Welfare's (DPW) procedures are adequate to ensure that payments are made only to eligible recipients for these programs. Based on our audit procedures, we found that DPW has a statewide mandatory Comprehensive Supervisory Review (CSR) at the County Assistance Office (CAO) level that monitors and improves the delivery of services to recipients. This CSR also includes a section to document a review of the propriety of the initial eligibility determinations made by the CAO caseworkers. The review of the propriety of eligibility determinations is to be performed on a monthly basis by an individual independent of the CAO caseworker who initially determined eligibility.

We randomly selected a sample of 25 CAOs to ensure that these CSRs were performed by DPW for the period under audit. For each CAO in our sample, we haphazardly selected one month and requested a certain number of CSRs based on the number of CSRs required to be completed by the CAO for the month. Our testing disclosed the following:

- Two of the 25 CAOs in our sample did not perform any CSRs for the month selected as follows:

CAO	Month Selected
Perry County	January 2001
Wyoming County	June 2001

- Three of the 25 CAOs did not respond to our request for the CSRs and, therefore, we were unable to determine if the CAOs performed the required reviews as follows:

CAO	Month Selected
Eastern District of Allegheny	July 2000
Liberty District of Allegheny	July 2000
Chester County	September 2000

Criteria: OMB Circular A-133 - Subpart C.300 (b) provides that the auditee shall:

Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs..

Cause: With respect to Perry County and Wyoming County, we were informed that the CSRs were not completed for the months in question due to staffing constraints. DPW was unable to explain why the three CAOs did not provide the CSRs for the months indicated above.

Effect: The lack of adequate internal controls over eligibility determinations could lead to inaccuracies in determining eligibility and improper benefit payments. As a result, errors could occur in MA, TANF and FS eligibility determinations that would not be detected by DPW on a timely basis.

Recommendation: We recommend that DPW's CAOs comply with the requirements mandating that all CAOs perform CSRs on a monthly basis.

Finding 01 – 1: (continued)

Agency Response: The Office of Income Maintenance (OIM) agrees with the intent of the recommendation that the DPW comply with the requirements mandating that all CAOs perform Comprehensive Supervisory Reviews (CSRs) on a monthly basis, but wishes to clarify certain aspects of the cited "Condition" which led to the Finding "Recommendation."

The statement in the Condition that cited the Allegheny CAO, Eastern District and Liberty District, and the Chester CAO for failure to respond to the request for the Targeted Supervisory Reviews (TSRs) requires further clarification. Both District Offices of the Allegheny CAO did submit TSR data summary reports for the month of July 2000 in lieu of the CSRs to the auditors. OPS Memorandum #980303 provides that when a TSR is completed, a CSR is not required. Unfortunately, the TSR review data was unable to be transmitted to the auditors until immediately after the conclusion of the audit fieldwork. The Chester CAO also completed a CSR for the month of September 2000, but also was unable to transmit the data timely.

The OIM concurs that Perry County and Wyoming County did not complete CSRs for the month of January 2001 and June 2001. However, corrective action plans have been developed to ensure that future CSRs are completed by these respective CAOs.

Auditors' Conclusion: The Eastern District and Liberty District Offices of the Allegheny CAO did subsequently provide us with the TSR data summary reports for the month of July 2000. We agree that these offices would not have been required to complete the CSRs for the month of July 2000 if the TSRs were completed. However, the offices were unable to provide the individual TSRs in support of the summary reports. Accordingly, we were unable to determine if the required TSRs were completed. With respect to the Chester CAO, we did not receive any CSRs for the month of September 2000.

Our finding and recommendation, with the above clarification, remain as stated above. We will review any corrective action in our subsequent audit.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 2:

CFDA #14.228 – Community Development Block Grants/State's Program

Performance/Evaluation Report Submitted to HUD Was Not Supported by Adequate Documentation (A Similar Condition Was Noted in Prior Year Finding #00 – 1)

Condition: DCED is required to file a Performance/Evaluation Report with HUD for each grant that was open during the year. The report must be submitted to HUD by March 30 of the following year. We haphazardly selected the Performance/Evaluation Report for Federal Grant Number B-99-DC-42-0001 which covered the period from January 1, 2000 to April 20, 2000 to determine if the data presented on the Performance/Evaluation Report was accurate. It should be noted that DCED did not submit any data to HUD for the period from April 21, 2000 to December 31, 2000 due to the conversion to HUD's Integrated Disbursement and Information System (IDIS) in April 2000. We were informed by HUD that the Performance/Evaluation Report should have covered the entire period from January 1, 2000 to December 31, 2000 but that HUD was waiving this requirement since HUD did not communicate this requirement to DCED until after DCED had submitted the report.

Our testing of the Performance/Evaluation Report revealed the following:

- DCED was unable to provide supporting documentation for the total reported in Section 1 - Financial Status, Line B – Amount Obligated to Recipients (which is also the total of Lines B(1) through B(5) in Section 2 - National Objectives) and for the total reported in Section 1 - Financial Status, Line C-Amount Drawn Down.

- The total reported by DCED in Section 1, Line B was $10,650,124 versus the allotment total recorded on the LECS Comptroller Office federal project accounting system of $54,982,019. This results in a difference of $44,331,895.

- The total reported by DCED in Section 1, Line C was $5,357,652 versus the paid to date total recorded on the LECS Comptroller Office federal project accounting system of $14,388,395. This results in a difference of $9,030,743.

In addition, we noted that DCED does not have adequate procedures for the supervisory review and approval of the Performance/ Evaluation Reports submitted to HUD.

Criteria: 24 CFR 91.520 states, in part:

(a) *General. Each jurisdiction that has an approved consolidated plan shall annually review and report, in a form prescribed by HUD, on the progress it has made in carrying out its strategic plan and its action plan. The performance report must include a description of the resources made available, the investment of available resources . . .*

(b) *Affordable housing. The report shall include an evaluation of the jurisdiction's progress in meeting its specific objective of providing affordable housing . . .*

(c) *CDBG. For CDBG recipients, the report shall include a description of the use of CDBG funds during the program year and an assessment by the jurisdiction of the relationship of that use to the priorities and specific objectives identified in the plan . . .*

Further, HUD's adoption of the Common Rule, 24 CFR 85.20(b)(1), provides:

Financial reporting. Accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant.

In addition, an adequate internal control structure related to ensuring accurate financial reporting would require supervisory review and approval of data reported.

Finding 01 – 2: (continued)

Cause: DCED personnel did not retain any of the supporting documentation used to prepare the Performance/Evaluation Report and could not explain the significant discrepancies between the amounts reported on the Performance/Evaluation Report and the amounts reported on the LECS Comptroller Office project accounting system.

Effect: Since DCED could not provide supporting documentation for two key line items on the Performance/Evaluation Report and since there are significant discrepancies between amounts reported for these key line items and amounts reported by the LECS Comptroller Office project accounting system, there is limited assurance that the amounts reported by DCED to HUD are accurate. Additionally, since DCED does not have adequate procedures in place for the review and approval of the Performance/Evaluation Reports, the reports could be significantly misstated in the future.

Recommendation: We recommend that DCED, in consultation with HUD officials, consider revising their most recent Performance/Evaluation Reports to correct any inaccurate amounts. We understand that DCED may be required to submit the Performance/Evaluation Reports for the year 2001 if the IDIS system is not capable of producing these reports. Accordingly, we recommend that DCED stay in close communication with HUD as to the specific reporting requirements for the year 2001. If DCED is still required to submit the Performance/Evaluation Reports, we recommend that DCED implement procedures for a separate supervisory review and approval of the Performance/Evaluation Reports and formalize these procedures in writing. These procedures should ensure that the reports are complete and accurate in accordance with federal regulations.

Agency Response: When the Commonwealth went live on IDIS and with the reduction in staff that had occurred, it was felt that all required information would be maintained in IDIS and that HUD would be able to retrieve this data. Instructions regarding the submission of paper reports were not received from HUD until the end of July 2001. This did not allow us any time to update the reports. Therefore, that is why the FY 1999 report only shows a partial listing of all the grants that had been awarded. HUD to date has still not provided states with detailed instructions regarding the preparation of the Performance and Evaluation Report. HUD did send out information to its entitlement grantees and to states regarding a couple of reports from IDIS that can be used to prepare the Performance and Evaluation Report. But again no detail was given showing how those reports are to be utilized. HUD is still expecting that paper reports be submitted. We have asked HUD if the report from IDIS can be used with some modification instead of re-inputting the information into our database, which would be a duplication of effort. We are still awaiting their response. This response from HUD will determine how we complete not only this year's report, but reports in the future.

Auditors' Conclusion: Based on the agency response noted above, the finding and recommendation remain as stated.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 3:

CFDA #14.228 – Community Development Block Grants/State's Program
CFDA #14.239 – HOME Investment Partnerships Program

Internal Control Weakness Over Information Reported From the Integrated Disbursement and Information System

Condition: DCED prepares a quarterly spreadsheet of drawdowns made directly by CDBG and HOME subrecipients from the HUD Integrated Disbursement and Information System (IDIS). The quarterly totals on this spreadsheet are summarized for the state fiscal year and provided to the LECS Comptroller's Office for inclusion on the SEFA. During our testing of the spreadsheet of subrecipient drawdowns for the CDBG and HOME Programs we noted the following:

- Several clerical errors were made by DCED personnel when preparing the spreadsheet of subrecipient drawdowns from IDIS for the CDBG Program. These clerical errors went undetected and caused the SEFA to be overstated by $4,095,921 for SFYE June 30, 2001. The SEFA was corrected as a result of our audit.

- The spreadsheet of subrecipient drawdowns from IDIS for the HOME Program included amounts for PHFA. Expenditures for PHFA are to be excluded from the SEFA since PHFA receives its own single audit. The PHFA amounts were mistakenly included in the summary of drawdowns provided to LECS resulting in an overstatement of the SEFA of $8,559,762 for SFYE June 30, 2001. The SEFA was corrected as a result of our audit.

We also noted that DCED prepares quarterly reports from the IDIS system for inclusion in the statewide A-133 Subrecipient Audit Universe which is used by OB-BOA to track subrecipient audit submission for each federal program on an overall statewide basis. However, there is no supervisory review by DCED or the LECS Comptroller's Office of these reports submitted to OB-BOA.

Criteria: 24 CFR Part 85.20 provides the following standards for financial management:

(b) (1) Financial reporting. Accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant.

(b) (3) Internal control. Effective control and accountability must be maintained for all grant and subgrant cash, real property and personal property, and other assets.

Additionally, OMB Circular A-133, Section 310 (b) regarding the Schedule of Expenditures of Federal Awards states in part that:

(b) The auditee shall also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements. At a minimum, the schedule shall:

(3) Provide total federal awards expended for each individual Federal program.

In addition, an adequate internal control system would ensure that federal awards expended would be properly recorded on the SEFA.

Cause: The errors noted above went undetected because there is no supervisory review or oversight by the agency or LECS Comptroller's Office of the drawdown information prepared by DCED from the IDIS system that is used for reporting of expenditures on the SEFA and the OB-BOA Subrecipient Audit Universe.

Finding 01 – 3: (continued)

Effect: The amounts reported by DCED on the SEFA for the CDBG and HOME Programs were overstated by $4,095,921 and $8,559,762, respectively. As a result, adjustments to the SEFA were necessary for the SFYE June 30, 2001. Additionally, the lack of supervisory review or oversight of the reports prepared by DCED from the IDIS system provides limited assurance that the information on the SEFA and the OB-BOA Subrecipient Audit Universe is accurate.

Recommendation: We recommend that both DCED and the LECS Comptroller's Office implement supervisory reviews of the subrecipient drawdown information prepared and reported by DCED from the IDIS system. This would provide better assurance that the subrecipient drawdown information used to prepare the Commonwealth's SEFA and OB-BOA Subrecipient Audit Universe is accurate.

Agency Response: DCED staff and the LECS staff met on January 28, 2002 and have agreed to implement supervisory reviews of subrecipient drawdown information prepared and reported by the DCED from the Integrated Disbursement and Information (IDIS) System. This will provide better assurances that the subrecipient drawdown information used to prepare the Commonwealth's SEFA and the OB Bureau of Audits subrecipient universe is accurate.

Auditors' Conclusion: Based on the agency response, the finding and recommendation remain as previously stated. We will review any corrective action in our subsequent audit.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 4:

CFDA #14.239 – HOME Investment Partnerships Program

DCED Did Not Perform On-Site Monitoring of Community Housing Development Organization Operating Grants (A Similar Condition Was Noted in Prior Year Finding #00 – 2)

Condition: Our review of DCED's subrecipient project close out procedures for the Home Investment Partnerships (HOME) program disclosed that DCED does not perform on-site monitoring for Community Housing Development Organization (CHDO) operating grants. During SFYE June 30, 2001 CHDO operating grants were $409,494 or 2.3 percent of total DCED HOME program expenditures of $17,588,056.

DCED stated that their procedures for reviewing CHDO operating grants include: 1) Review of initial application to ensure all costs are allowable; 2) Review of Fiscal Status Report submitted at contract closeout by the subgrantee to ensure that all costs are recorded as CHDO operating expenditures; and 3) Obtain and review a single audit if required to be submitted by the subgrantee. DCED does not review actual expenditure invoices and supporting documentation at the CHDO to ensure that expenditures are for allowable activities.

Although DCED officials prepared a proposed corrective action plan to our prior-year finding for this same issue, they failed to implement this plan in our current audit period ended June 30, 2001.

Criteria: Regarding subrecipient monitoring, 24 CFR Section 92.201(b)(3)

(i) A State that uses State recipients to perform program functions shall ensure that the State recipient uses HOME funds in accordance with the requirements of this part and other applicable laws. The State may require the State recipient to comply with requirements established by the State or may permit the State recipient to establish its own requirements to comply with this part.

(ii) The State shall conduct such reviews and audits of its State recipients as may be necessary or appropriate to determine whether the State recipient has committed and expended the HOME funds in the United States Treasury account as required by §92.500 and has met the requirements of this part, particularly eligible activities, income targeting, affordability, and matching contribution requirements.

In addition, HUD personnel stated to us that, at a minimum, monitoring of CHDO operating grants should occur during the on-site monitoring of the CHDO housing project following the completion of the operating grant.

Cause: DCED personnel stated that the decision was made not to perform any on-site monitoring of CHDO operating grants due to a lack of staff. Also, they feel no on-site monitoring is necessary since the grants are entirely for operating expenditures and do not involve housing project costs.

Effect: With no on-site monitoring of CHDO operating grants, HOME funds could be used in violation of regulations or for unallowable activities which would not be detected by DCED.

Recommendation: We recommend that DCED implement on-site monitoring of CHDO operating grants. HUD personnel stated to us that, at a minimum, this should include reviewing actual expenditures and invoices of the CHDO operating grant during the on-site monitoring of the CHDO housing project following the completion of the operating grant.

Agency Response: DCED has new procedures outlined below that are effective January 29, 2002. DCED does not agree that the regulations require on-site monitoring and feels that the new procedures now in place will meet the HUD guidelines regarding subrecipient monitoring.

Finding 01 – 4: (continued)

Effective as of January 29, 2002, all HOME funded CHDO operating grants must provide the following documentation to accompany the Final Fiscal Status Report, and be submitted to DCED 30 days after the final draw of HOME funds:

1. 24 CFR Section 92.300(f) states that a CHDO may not receive HOME funding for any fiscal year in an amount that provides more than 50 percent or $50,000, whichever is greater, of the CHDO's total operating expenses in that fiscal year. To verify this, grantees must submit a copy of the CHDO's actual total operating costs for the fiscal year, to document that the HOME funds received by the CHDO did not exceed these limits.

   The grantee must submit to DCED some expenditure invoices and supporting documentation that will be reviewed to verify the eligibility of a sampling of the operating costs. For sampling purposes, the documentation must include two invoices, if applicable, from each of the categories of travel, training and equipment purchases.

2. The HOME Program requires that a CHDO housing project be completed in order to justify receiving a CHDO operating grant. Virtually every CHDO operating grant request to DCED has included in the application evidence of a housing project that is underway or has the commitment of funding to undertake it. In limited instances DCED is funding the CHDO housing project from its allocation of HOME funds, and in most instances, PHFA is funding the housing project from its allocation of HOME funds given to them by DCED.

To put into practice a methodology to verify compliance with this requirement at closeout, the grantee must provide evidence of a housing project that has been completed or is underway. This should include the HOME grant approval letter from DCED and/or PHFA loan agreement and description of the project's construction progress or completion.

This documentation will be reviewed by your assigned Grant Manager in the Office of Community Development, and any questions about eligibility will be resolved through phone and/or correspondence.

Auditors' Conclusion: The corrective action described by DCED in their agency response above was implemented on January 29, 2002, subsequent to our audit for the year ended June 30, 2001. This corrective action will be reviewed by us in our subsequent audit. As a result, the finding and recommendation remain as stated above.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 5:

CFDA #15.250 – Regulation of Surface Coal Mining

Unallowable Personnel Charges Result in Questioned Costs of $1,220

Condition: During the state fiscal year ended June 30, 2001, $5,232,000 in salaries and benefits were allocated by DEP to the Regulation of Surface Coal Mining (RSCM) program using the Automated Cost Distribution System (ACDS). Under this system, salaries and benefits are initially charged to "holding accounts" and are then allocated once a month using ACDS. ACDS utilizes financial data from the Commonwealth's Payroll Operations System and time/hour data from the Activity Management Information System (AMIS) to allocate these personnel costs. We tested 5 employees who charged 5,610 hours to the RSCM program during SFYE June 30, 2001 out of a total population of 393,260 hours charged for the year. Our testing disclosed several discrepancies between the number of hours reported on the respective employees' timesheets and the hours reported on the AMIS yearly summary report. These errors caused 91.75 hours to be charged to RSCM that were not supported by the timesheets, which calculates to $1,220 in unallowable costs.

We also noted an additional discrepancy in our testwork in that one employee's supervisor did not sign-off on 17 of the 26 timesheets prepared during the fiscal year to support review and approval of the hours charged to RSCM.

Criteria: OMB Circular A-87, Attachment A, Section C.1., regarding the factors affecting allowability of costs states, in part:

a. Be necessary and reasonable for proper and efficient performance and administration of Federal awards.
j. Be adequately documented.

In addition, OMB Circular A-87, Attachment B, Section 11(h), pertaining to the support of salaries and wages states, in part:

(4) Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation . . .

Furthermore, good internal controls dictate that personnel charges to a federally funded program are uniform, adequately supported, and contain appropriate review and approval signatures.

Cause: DEP personnel stated that the discrepancies between the timesheets and the AMIS system appeared to be clerical errors due to the high volume of timesheets processed and the illegibility of some timesheets. DEP personnel indicated that the lack of a standard timesheet form, the untimely submission of timesheets, and the lack of adequate supervisory reviews could have contributed to these discrepancies. Regarding the lack of a standard timesheet form, our testing disclosed that the timesheets for some employees did not include a section for the employee to input the AMIS work code for the hours incurred. The employees included a project/contract number in the comment section to identify the hours pertaining to RSCM, and the timekeeper assigned an AMIS work code based on the description of the project. The timekeeper did not always assign the proper code.

Effect: The RSCM program was overcharged by $1,220 which are questioned as unallowable. In addition, due to the control weaknesses noted above, there is limited assurance that salary and benefit costs will be properly allocated to the RSCM program in the future.

Recommendation: DEP should pursue appropriate settlement with USDOI for the $1,220 in questioned costs identified above. DEP should strengthen controls to ensure that all timesheets are signed-off as reviewed and approved by appropriate supervisors in a timely manner before being input into AMIS. In addition, DEP should consider standardizing employee timesheet forms to include a section for the employee to record the applicable AMIS work code worked by that employee.

Finding 01 – 5: (continued)

<u>Agency Response</u>: The Department of Environmental Protection concurs with the finding and will pursue settlement with the Department of Interior for the $1,220 in questioned costs. We also agree that the business rules established for the recording, approval and input of data into the Activity Management Information System (AMIS) are not being applied uniformly. We believe the long-term solution to be an upgraded system developed in or in conjunction with the implementation of Imagine PA, the Commonwealth's enterprise resources plan. In the short term, we will remind employees and supervisors of the correct AMIS procedures.

<u>Auditors' Conclusion</u>: Based on the agency response, the finding and recommendation remain as previously stated. We will review any corrective action in our subsequent audit.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 6:

CFDA #17.245 – Trade Adjustment Assistance-Workers

Overpayment of TRA Benefits Results in Questioned Costs of $264 (A Similar Condition Was Noted in Prior Year Finding #00 – 4)

Condition: As part of our testing of program expenditures, we randomly selected 25 Trade Readjustment Assistance (TRA) payments made to claimants during SFYE June 30, 2001 and determined whether claimants were eligible for TRA and whether they received the correct benefit amount.

Our testing of program expenditures revealed that L&I improperly overpaid TRA benefits to one of 25 claimants tested as follows:

Claimant	Weekly Benefit Amount	Weeks in Question	Amount of Overpayment	Total Questioned Costs
A	$264	1	$264	$264

Claimants who are entitled to UI are ineligible for TRA payments. Claimant A received payments from both UI and TRA for the week noted above.

The total amount of the 25 benefit payments tested was $6,955 which consisted of 21 payments for basic TRA totaling $5,968 and 4 payments for additional TRA benefits totaling $1,027. During the period under audit, there were TRA benefit payments made totaling $16,671,280.

Criteria: 20 CFR 617.11(a)(2)(c)(v) states in part that:

The individual must . . . (A) have exhausted all rights to any UI to which the individual was entitled and (B) not have an unexpired waiting period applicable to the individual for any such UI.

Cause: There are two separate computer systems that make payments for UI and TRA benefits. These two systems do not interface. TAA personnel manually set up the TRA benefit period based on when UI should be exhausted. Generally, the benefits are set up after the UI is exhausted, so TAA personnel can ensure the periods do not overlap. Since this is done manually, errors may occur. TAA personnel indicated that they try to ensure duplicate payments are not made by reviewing the claimant's files; however, since there is no computer interfacing, it is done manually and duplicate payments could be missed.

Effect: Since TRA benefits were overpaid to Claimant A, there are questioned costs of $264. Furthermore, with TAA's manual internal control process, a system weakness exists since inappropriate payments are being made.

Recommendation: We recommend that L&I repay the questioned costs or pursue appropriate settlement with the U.S. Department of Labor. We further recommend that L&I, upon receipt of the initial request for TRA payment from the claimant, review the UC system to ensure that the UI has been exhausted for the claimant.

Agency Response: The attached finding under CFDA #17.245 regarding Claimant A is correct, and we do not dispute that there was a processing error due to UC and TRA computer programs that do not interface. The finding states that the applicant received UC and TRA payments for the same week. On February 6, 2002, a determination was issued establishing a nonfraud overpayment in the amount of $310.00, which is subject to the repayment, recovery and waiver provisions of Section 243(a) of the Trade Act. Further corrective actions are not warranted since the UC and TRA programs will be interfaced under the UC Services IT Roadmap project.

Finding 01 – 6: (continued)

Auditors' Conclusion: Based on the agency response, the finding and recommendation remain as previously stated. We will review any corrective action in our subsequent audit.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 7:

CFDA #17.245 – Trade Adjustment Assistance-Workers

Weakness in L&I's Controls Over Preparation and Submission of the Trade Act Participant Report

Condition: L&I is required to submit a Trade Act Participant Report (TAPR) to USDOL on a quarterly basis. The TAPR tracks program performance and participant outcomes for the TAA and NAFTA-TAA programs. Each report is to consist of 49 fields of information for each TAA participant who exited the program during a particular quarter. L&I electronically submits a file to USDOL that contains the aforementioned data.

In order to test the accuracy of the data submitted to USDOL, we obtained the file which reported on TAA participants who had exited TAA during the quarter October 1, 1999 through December 31, 1999. We selected ten participants from the TAPR and compared the key data for each participant to supporting documentation. Our testing revealed that certain data did not agree with or could not be supported by TAA records. Although certain individual differences did not appear significant in our current audit, we noted the following weaknesses in L&I's controls over preparation and submission of the TAPR:

- The preparation of the TAPR is a manual process. The data is accumulated from three separate databases and manually entered onto a data sheet for each participant. The information from the data sheet is then manually input into a temporary database used to create the transmission file to USDOL. Additionally, a manual process is also used to identify the participants who have exited the programs for the quarter. There is no supervisory review of the information that is manually accumulated and input into this database prior to submission to USDOL.

- L&I does not have any internal edit checks in place to verify that the data to be transmitted to USDOL is valid. L&I relies on the USDOL edit checks. However, USDOL edit checks are not configured to reject all invalid data.

- L&I does not retain documentation at the time the TAPR is prepared to support the information manually entered onto the individual data sheets.

Criteria: The General Instructions in USDOL's Training and Employment Guidance Letter No. 11-00, state in part:

1. TAPR reports must be submitted each quarter. Each report is to consist of records for Trade Act participants who have exited during a particular quarter…. The quarter of exit is the quarter in which the participants, whose records are in the report, exited the Trade Act program. The reporting quarter is the quarter during which the records for the exiters should be completed and the report assembled…. The reporting quarter is five quarters after the quarter of exit.

Good internal controls should ensure that the data included on the TAPR is accurate and complete and supported by adequate documentation.

Cause: L&I has not developed a formal system to collect and report the data that is required for the TAPR. We were informed by L&I that a new multi-state system is scheduled to replace the current TAPR process in May 2002.

Effect: Due to the weaknesses cited above, there is limited assurance that the information reported for the TAA participants on the TAPR is accurate and that all participants who exited the program are included on the report.

Recommendation: Since the new system for the TAPR is not scheduled to be in place until May 2002, we recommend that L&I implement procedures in the interim to verify the accuracy of the TAPR information that is transmitted to USDOL. Additionally, we recommend that L&I ensure that supporting documentation is retained for each participant's data sheet.

Finding 01 – 7: (continued)

Agency Response: We concur with the fact there is no computer system to collect and report the data required for the TAPR. A computer system has been in the planning stages for several years and is expected to be in place in the spring of 2002. Bureau of Workforce Investment staff have developed the best system possible given the lack of a computer system in order to fulfill DOL's reporting mandates.

We currently retain the data sheets, which included the date of separation within the report period and the participants individual information that was used to complete the TAPR. The information in the computer database is also available for review. Error documents were not retained as they indicated a field that had to be corrected. There was no purpose for their retention.

All support documentation for the manual collection of the data, including error documents, will be retained both on paper forms and electronically for subsequent TAPR reports.

Auditors' Conclusion: Based on the agency response, the finding and recommendation remain as previously stated. We will review any corrective action in our subsequent audit.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 8:

CFDA #20.205 – Highway Planning and Construction
CFDA #23.003 – Appalachian Development Highway System

Internal Control Weakness Over Expenditure Information Reported on the SEFA

Condition: The PADOT Comptroller Office prepares spreadsheets for each program reported on the SEFA. In our testing of these spreadsheets, we noted that clerical errors were made by Comptroller personnel when preparing the summary spreadsheet which resulted in a $24,621,936 net understatement on the SEFA for the HPC cluster. These clerical errors went undetected by Comptroller personnel in their preparation and review procedures for the SEFA. The SEFA was corrected as a result of our audit.

Criteria: 49 CFR 18.20 provides the following standards for financial management:

(b) (1) Financial reporting. Accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant.

(b) (3) Internal control. Effective control and accountability must be maintained for all grant and subgrant cash, real property and personal property, and other assets.

Additionally, OMB Circular A-133, Section 310 (b) regarding the Schedule of Expenditures of Federal Awards states in part that:

(b) The auditee shall also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements. At a minimum, the schedule shall:

(3) Provide total federal awards expended for each individual Federal program.

In addition, an adequate internal control system should ensure that federal awards expended are properly reported on the SEFA.

Cause: The errors noted above went undetected because there were Comptroller personnel changes made during the current year which directly impacted the SEFA preparation. Also, the SEFA review process lacked adequate quality control to detect the above understatement.

Effect: The amounts reported by PADOT on the SEFA for the HPC cluster were understated by $24,621,936. As a result, adjustments to the SEFA were necessary for the SFYE June 30, 2001. Also, weak internal controls may cause additional SEFA misstatements in the future.

Recommendation: We recommend that PADOT Comptroller Office strengthen supervisory review of the spreadsheets prepared to calculate the SEFA for the HPC cluster and other PADOT federal programs. This would provide better assurance that the federal awards reported on the SEFA are accurate.

Agency Response: An additional review of all Excel spreadsheets and spreadsheet calculations used in the preparation of the SEFA will be implemented for the June 30, 2002 SEFA, and all future SEFAs.

Auditors' Conclusion: Based on the agency response, the finding and recommendation remain as previously stated. We will review any corrective action in our subsequent audit.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 9:

CFDA #83.548 – Hazard Mitigation Grant

Pennsylvania Emergency Management Agency Did Not Properly Report Federal Expenditures on the Schedule of Expenditures of Federal Awards

Condition: Pennsylvania Emergency Management Agency (PEMA) reported federal expenditures totaling $13,667,000 on the Schedule of Expenditures of Federal Awards (SEFA) under CFDA #83.548 for the year ended June 30, 2001. The amount reported by PEMA included $7,392,000 in expenditures under a supplemental grant for Hurricane Floyd. Based on our review of the related grant agreement and subsequent discussions with PEMA and PPR Comptroller Office personnel, we determined that the expenditures for this particular grant should have been reported on the SEFA under the "Miscellaneous" category as no CFDA number was assigned to the grant. PEMA subsequently confirmed this method of reporting with FEMA. The SEFA was adjusted as a result of our audit.

Criteria: OMB Circular A-133, Section 310 (b) regarding the Schedule of Expenditures of Federal Awards states in part that:

(b) The auditee shall also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements. At a minimum, the schedule shall:

(3) Provide total federal awards expended for each individual Federal program and the CFDA number or other identifying number when the CFDA information is not available.

In addition, an adequate internal control system would ensure that federal awards expended would be properly recorded on the SEFA.

Cause: The funding data section of the grant agreement with FEMA indicated that the CFDA number was not applicable for this particular award. PPR indicated that due to an oversight, this information was missed and, therefore, the award information was not properly reported on the SEFA.

Effect: The amount reported by PEMA on the SEFA under CFDA #83.548 was overstated by $7,392,000. As a result, an adjustment to the SEFA was necessary for the SFYE June 30, 2001.

Recommendation: We recommend that PEMA and PPR carefully review the information contained in each grant agreement received from FEMA to ensure that expenditures of federal awards are properly reported on the SEFA. Additionally, if no CFDA number is identified in the grant agreement, PEMA or PPR should contact FEMA to determine how the award is to be reported on the SEFA.

Agency Response: We concur with the finding. Expenditures for grant EMP-2000-GR-3224 were incorrectly reported on the Schedule of Expenditures of Federal Awards under CFDA #83.548, Hazard Mitigation Grants.

This award was to provide supplemental funding for the Hurricane Floyd Hazard Mitigation Program. We established the grant on the accounting system using the same information, including the CFDA number, as the original disaster 1294 Hazard Mitigation Grant. While compiling documentation for the audit, we discovered that the grant had no CFDA number assigned to the program by FEMA. The funding was established by separate federal legislation instead of the normal disaster assistance program. Therefore, the CFDA number was incorrect on the SEFA.

We have procedures in place to review and verify the CFDA numbers for all federal grants. Due to the unusual circumstances of this award, the CFDA number was reported incorrectly due to clerical error.

Finding 01 – 9: (continued)

Auditors' Conclusion: Based on the agency response, the finding and recommendation remain as previously stated.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 10:

CFDA #84.126 – Rehabilitation Services – Vocational Rehabilitation Grants to States

A Weakness Exists in L&I's Procurement System Related to Debarment and Suspension (A Similar Condition Was Noted in Prior Year Finding #00 – 8)

Condition: In response to a prior audit finding, OVR personnel indicated that procedures were established to manually check the List of Parties Excluded from Federal Procurement and Nonprocurement Programs and to verify that new vendors were not debarred or suspended by the federal government. However, our testing during the current audit disclosed that there was no documentation available for the auditors to confirm that these procedures were actually being followed.

Criteria: USDE Regulation 34 CFR 85.510, regarding participants' responsibilities for debarment and suspension, states in part:

(b) Certification by participants in lower tier covered transactions.

> *(1) Each participant shall require participants in lower tier covered transactions to include the certification in Appendix B to this part for it and its principals in any proposal submitted in connection with such lower tier covered transactions.*
>
> *(2) A participant may rely upon the certification of a prospective participant in a lower tier covered transaction that it and its principals are not debarred, suspended, ineligible, or voluntarily excluded from the covered transaction by any Federal agency, unless it knows that the certification is erroneous . . . In addition, a participant may, but is not required to, check the Nonprocurement List for its principals and for participants . . .*

34 CFR 80.36(a) states:

When procuring property and services under a grant, a State will follow the same policies and procedures it uses for procurements from its non-Federal funds. The State will ensure that every purchase order or other contract includes any clauses required by Federal statutes and executive orders and their implementing regulations.

Commonwealth Management Directive 215.9, Section 7.a.(2)(B), dated 4-16-99, states:

If the agency makes a written determination of responsibility, the determination shall contain a statement that the contractor was determined to be responsible pursuant to this directive. This statement shall be included in the agency's contract file.

Cause: A letter written by USDE personnel in August 2000 regarding resolution of a similar prior year finding stated that USDE accepted OVR's corrective action, which was to manually verify that all new vendors were not on the List of Parties Excluded from Federal Procurement and Nonprocurement Programs before these vendors were entered into OVR's computerized vendor file.

However, OVR personnel stated that although the check of the List of Parties Excluded from Federal Procurement and Nonprocurement Programs was performed during our audit period, OVR personnel were undecided about the best way to document this check. Therefore, no documentation was maintained by OVR during our audit period to support that these procedures had, in fact, occurred.

Finding 01 – 10: (continued)

Effect: Since L&I personnel did not document their verification that new service providers were not on the List of Parties Excluded from Federal Procurement and Nonprocurement Programs, there was no evidence that L&I complied with federal regulations. There is limited assurance that RSBS funds were not paid to service providers who have been debarred or suspended from participating in federal programs.

Recommendation: We recommend that OVR document their verification that new service providers are not on the List of Parties Excluded from Federal Procurement and Nonprocurement Programs prior to allowing these providers to participate in the RSBS program. Documentation of this verification is required by Management Directive 215.9.

Agency Response: This audit finding acknowledges that OVR has manual procedures in place to check the List of Parties Excluded From Federal Procurement and Nonprocurement Programs to verify that new vendors are not debarred or suspended by the federal government. The problem is however that we currently have no way of physically documenting such a review has occurred. This matter has been discussed with the employee conducting the review and the employee's supervisor and we are looking at a couple of possibilities. The solution that appears to look the best at this point would be to add another field to the computer screen where the vendor information is entered. This field would be labeled Debarment/Suspension Check and would require a date be entered or a block be checked before a new vendor would be accepted into our computerized vendor listing. Our feeling is that a solution such as this should correct this problem and our plan is to proceed with implementation.

Auditors' Conclusion: Based on the agency response, the finding and recommendation remain as previously stated. We will evaluate the corrective action in our subsequent audit.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 11:

CFDA #84.126 – Rehabilitation Services – Vocational Rehabilitation Grants to States

Inadequate Documentation to Support $33,276 in Unallowable Personnel Costs

Condition: During the state fiscal year ended June 30, 2001, OVR incurred personnel expenditures of $26,995,000 in salaries and $7,821,000 in fringe benefits, or $34,816,000 in total for the RSBS program. Our review of $353,808 in salaries and benefits (federal portion) paid to a sample of seven employees disclosed that L&I could not provide adequate documentation to support the salary and fringe benefits of one employe who was charged 100 percent to the RSBS program.

Time distribution records were not available and the job description for this employe was not adequate to provide assurance that job duties were 100 percent related to the RSBS program. The job description and assigned duties for this employe, an Administrative Officer I working in the L&I press office, included designing L&I's internet website. The job description did not include any mention of OVR or the RSBS program.

As a result, the salary and fringe benefits (federal portion) claimed under RSBS for this employe during the fiscal year ended June 30, 2001 are questioned as follows:

Salary	Benefits	Total Questioned Costs
$24,478	$8,798	$33,276

Criteria: OMB Circular A-87, Attachment A, Section C.1., regarding the factors affecting allowability of costs states in part:

a. *Be necessary and reasonable for proper and efficient performance and administration of Federal awards.*

j. *Be adequately documented.*

In addition, OMB Circular A-87, Attachment B, Section 11(h), pertaining to the support of salaries and wages states, in part:

(3) *Where employees are expected to work solely on a single Federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi-annually and will be signed by the employee or supervisory official having first hand knowledge of the work performed by the employee.*

(4) *Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation . . .*

Cause: OVR personnel were not aware of the charging of this employee's salary and benefits to the RSBS program until it was brought to their attention by the auditors. OVR personnel stated that the employee was hired by the press office, not OVR, and OVR did not authorize charging the employee's salary and benefits to the RSBS program. There is an internal control weakness over individuals not actually employed within OVR, but charging all or a portion of their personnel costs to the RSBS program.

Effect: Since adequate documentation was not available as required by federal regulations, $33,276 in salary and fringe benefits are questioned. In addition, based on our review of OVR's payroll complement report for our audit period, we noted that two percent of OVR's 878 employees statewide were actually employed outside of OVR, but charging all or a portion of their salary and benefits to the RSBS program for RSBS-related work. Although the internal control weakness reported above is limited to this two percent of employees charging time to RSBS, OVR's lack of an adequate system in place to ensure the allowability of these personnel costs charged to RSBS is significant to the program.

Finding 01 – 11: (continued)

Recommendation: L&I should pursue appropriate settlement with USDE for the $33,276 in questioned costs identified above. In addition, OVR management should strengthen internal controls to ensure that personnel costs charged to RSBS for employees doing RSBS-related work, but not actually employed within OVR, are allowable and properly documented.

Agency Response: OVR was cited for not being able to provide adequate documentation to support the salary and benefits of one employee who was charged 100 percent to our program. Upon investigating this matter, we found it to be true; however, we also discovered circumstances surrounding the situation that could influence settlement regarding questioned costs. The employee in question was hired by and placed on the complement of the L&I's Press Office. The employee who was hired for this position was a 30-year-old OVR client, and due to his severe disability (a quadriplegic with severe speech problems) it was not practical or reasonable for him to relocate to Harrisburg since his established support system was in his hometown of Pittsburgh. Since the work he would be doing for the Press Office was website development there was no reason he could not remain in Pittsburgh and do the work as long as State office space could be found. OVR volunteered space in their Pittsburgh District Office and for on-site supervision it was decided that an OVR field office supervisor could take care of that. It seemed the least we could do after having sponsored him for his BS degree in Computer Programming and his MS Degree in Rehab Science and Technology.

He received his BS degree from Edinboro University and only after three years of not being able to find suitable employment did he decide to enter the Master's degree program at the University of Pittsburgh (Pitt). He landed this job about five months after graduating from Pitt. Since the Press Office has no revenue of its own, OVR agreed to pay this employee's salary with the understanding that he would complete timesheets and any time not spent on OVR work would be charged against the indirect cost rate and then be deducted from OVR's outlay. The problem was this employee was not in Harrisburg as other press office employees and the press office thought OVR was making sure he completed timesheets. This message had never been communicated to the OVR supervisor who was working with him and he was not familiar with timesheets since it is unnecessary for employees in OVR field offices to complete them. In speaking with this OVR supervisor he felt quite comfortable in stating that this employee only work 50 percent of his time on press office website development and the other 50 percent was spent working for OVR linking a Microsoft drawing program with an Excel program and also converting a filemaker pro database into an access database. The conclusion is, therefore, that proper documentation was supposed to have been completed for this employee but was not done due to inadequate communications. Also, if we had written this case up as an on the job training work experience, **which could have legitimately been done**, we could have paid this client's salary and benefits and have been within the allowable scope of our regulations and would not have been cited with this audit finding. Shortly after the end of this audit period, this individual left this position for a computer programming job in the private sector. His new job is in his chosen field of computer programming and he feels his work experience with the Commonwealth provided him with the edge he needed to obtain this new position. Since OVR is no longer paying for this position, the problem that resulted in this finding corrected itself and should carry no future implications. No further action should be necessary at this time, although OVR is looking into a better method to determine that all individuals who need timesheets are completing them.

As far as questioned costs are concerned, we feel that the technically incorrect fashion in which we spent these funds is overshadowed by the fact that the questioned funds were spent on an eligible client enabling him to reach his goal of suitable competitive employment and avoid having to go back on the SSI roles. We are asking that our federal partner, the Rehabilitation Services Administration, consider forgiving the questioned costs in view of the circumstances.

Auditors' Conclusion: OVR's contention that the questioned costs should be forgiven is an audit resolution issue which, as stated in the recommendation, should be pursued with USDE for appropriate settlement. Since no timesheets or additional documentation was provided to support the charging of this individual's salary and benefits to the RSBS program, the finding and recommendation remain as stated. We will evaluate any corrective action taken by OVR in our subsequent audit.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 12:

CFDA #84.126 – Rehabilitation Services – Vocational Rehabilitation Grants to States

Weaknesses Exist in L&I's Monitoring of RSBS Subgrantees (A Similar Condition Was Noted in Prior Year Finding #00 – 9)

Condition: Job creation grants are provided by L&I/OVR to various RSBS subgrantees in order to create employment opportunities for persons with disabilities. These employment opportunities are created by providing area businesses with job-related equipment that is to be primarily operated by OVR-eligible individuals. In exchange for the granted equipment, the respective businesses agree to employ OVR-eligible individuals while OVR maintains a lien on the equipment for a period of five years.

During our prior year audit (year ended June 30, 2000), we noted several weaknesses in OVR's system related to the monitoring of job creation subgrantees. Specifically, we noted the following:

- OVR's five-year liens on job creation equipment provided to participating businesses were not being properly established. As a result, the proper title to some equipment was never obtained by OVR and the equipment was lost when, in the prior year, it was inappropriately sold at auction by a bankrupt business, and funds were never returned to the RSBS program.

- Equipment that was purchased with RSBS funds and provided to participating businesses remained idle for extended periods of time, with no employment benefit to OVR's disabled clients. OVR was not refilling vacancies which occurred when those clients who were initially hired to use the equipment did not retain their jobs. We noted the extended idle time for this equipment was significant to OVR's limited five-year lien period in which to employ its clients with disabilities.

- RSBS funds were being used to purchase job creation equipment for persons who were not properly determined by OVR to be eligible to participate in the program.

Our follow-up for the current year ended June 30, 2001, disclosed that OVR had developed several corrective action steps to address these weaknesses. However, at the time of our audit, OVR had not implemented these corrective action steps, and the weaknesses remained throughout our current audit period.

Criteria: 34 CFR 80.20 provides the following standards for financial management:

(3) Internal control. Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.
(4) Allowable cost. Applicable OMB cost principles, agency program regulations, and the terms of grant and subgrant agreements will be followed in determining the reasonableness, allowability, and allocability of costs.

The standard grant agreement for Job Creation grantees states the following regarding equipment:

Equipment purchased by employers with OVR-granted funds provided through the Grantee must be operated primarily by OVR-eligible persons with severe disabilities. This provision is in effect throughout the life of such equipment or, if the equipment life is in excess of five years, for a period not to exceed the expiration date of OVR's registered lien against that equipment.

OVR shall hold first lien purchased under this grant, including equipment purchased by employers with funds subgranted by the Grantee, as described in the final approved budget, for a period of five (5) years….

Finding 01 – 12: (continued)

Ownership of such equipment will revert to OVR in the event the conditions of the Grant or employer subgrant, as appropriate, have been violated or the project has terminated while OVR holds title. Likewise, during the five (5) year period, purchased equipment which is no longer utilized for the intended purpose, or its appraised cash value at the time, will be returned to OVR. The Grantee/subgrant employer, as appropriate, agrees that it will not encumber such equipment in any manner with debts or other legal claims.

Cause: OVR personnel indicated that they are currently in negotiations with UDSE to develop an acceptable corrective action plan to resolve these weaknesses. As a result, OVR had not implemented this corrective action in the current year.

Effect: Without adequate oversight of RSBS subgrantees, there is limited assurance that equipment purchased with RSBS funds is being reasonably utilized for the intended purpose and being used by eligible individuals.

Recommendation: OVR should implement procedures to adequately safeguard all equipment purchased with RSBS funds, ensure that all purchased equipment is being timely and fully utilized by OVR clients during the five-year lien period, and ensure that all individuals receiving assistance under job creation grants are appropriately determined to be eligible.

Agency Response: The following three paragraphs summarize the essence of prior year finding 00 – 9.

- A passenger van costing $24,524 (federal share $19,300) was purchased in October 1999 and was provided to a Pittsburgh area business for use in the job creation program. Our procedures disclosed that the van was sold at auction in June 2000 for the price of $14,000 and the business in question then filed for bankruptcy in July 2000. OVR personnel indicated that they were unable to recover any of the van costs and are not pursuing the matter further.

- An excavator costing $17,225 (federal share $13,556) was purchased in December 1999 and was provided to an area construction company. One OVR client/operator was employed to operate the excavator for four months from December 6, 1999 to April 5, 2000. Another OVR client was hired to operate this piece of equipment on June 19, 2000 and worked only 10 days. OVR personnel indicated that no further OVR client was hired as of our January 2001 test date to operate this equipment. The equipment, therefore, had not been utilized by an OVR client for approximately nine months.

- Our review of eligibility documentation revealed that OVR placed three individuals into jobs under this grant, but their eligibility for RSBS funds was not established. None of these three individuals had an application on file with OVR and none were recorded on OVR's client database as eligible to participate in the RSBS program. Two of these individuals were employed by an area restaurant, which received cooking and restaurant equipment in June 2000 costing $38,560 (federal share $30,347). We noted that this business did not employ any other OVR eligible individuals to operate the equipment provided.

In view of the circumstances surrounding part 1 of this finding, there is little that can be done to bring this matter to resolution other than to repay the federal share of the depreciated value of this van, which the State Agency (OVR) calculates to be $11,018. This is based on a depreciated value of $14,000 at the time of the van's sale, which is in line with its Kelley Blue Book value. The State Agency agrees to such a repayment in accordance with the terms to be specified by the Rehabilitation Services Administration (RSA). In regard to parts 2 & 3 of this finding, efforts have been and continue to be made to place appropriately qualified VR eligible clients into the jobs in question. Good faith efforts are clearly being made to comply with the terms of the grant and the intentions of the Rehabilitation Act, and in view of this it is felt that repayment of funds is not indicated.

Finding 01 – 12: (continued)

In addition the State agency will also take the following measures to improve it's grant monitoring procedures to make certain it is doing the best possible job to determine that funds are being spent appropriately:

- OVR Job Creation grantees and the respective OVR District Offices in which they were located were verbally instructed to purchase no job creation equipment for any participating job creation employers without first having identified one or more qualified job candidates who would be acceptable and available for the created employment positions. Most of the offices/grantees that were contacted had initiated that practice some time earlier, based upon their own experience. As of August 22, 2001, there were six OVR job creation grantees working in conjunction with six different OVR offices. Two of the six job creation grants were inactive because of the impending expiration of their contracts and lack of funds. There are presently four active OVR Job Creation grants, with two of them (in Philadelphia and Pittsburgh) due to expire at the end of January and February 2002, respectively.

- OVR Job Creation grantees have been verbally advised of the requirement to register OVR's interest in equipment with the Department of State (or with the Department of Transportation in the case of vehicle purchases). A letter is being prepared for issuance to all OVR grantees, not restricted to job creation grantees, regarding mandatory lien registration of OVR granted equipment.

- OVR's standard grant contract is undergoing revision, incorporating a variety of requirements, including re-instatement of equipment filing provisions, prohibitions against using granted equipment for collateral, expanded equipment disposal provisions/instructions. Those and other provisions as reviewed and found appropriate by legal counsel will clarify/strengthen the accountability, and conditions for accountability, assumed by OVR and OVR grantees.

- Beginning calendar year 2002, on-site grant monitoring will be conducted on a six-month cycle. That is, formal OVR review of grantee program activity and contract administration will occur no less than twice a year. Prior to 2002, insufficient staff resources and high numbers of grants made that frequency impossible. The number of OVR-awarded grants (all types) has been significantly reduced through attrition. Also, two new rehabilitations specialists will join the Contract and Grants Management Section complement, effective January 28, 2002. Statewide grant administration previously covered by two full-time specialists and the section supervisor will become the responsibility of four full-time specialists, beginning next week.

- An internal work group was formed to review OVR's grant monitoring process/protocols, etc. Recommendations for improvement have been made and are under advisement. In addition to workgroup recommendations, OVR is interested in adopting a review model similar to that used by the federal Rehabilitation Services Administration when reviewing federal awards. Additionally, recommendations/findings arising from the various audits OVR has commissioned, or which have been conducted on OVR grants, will also be reviewed in an effort to incorporate into OVR's grant monitoring process some of the tests and procedures used by those auditors.

- An equipment recovery protocol has been outlined, not as a freestanding activity, but as part of a broader equipment management/administration process. OVR will be working with its Rehabilitation Advisory Council in developing and formalizing all aspects of that process. The finished product will include, but not be limited to, some of the requirements mentioned earlier, i.e., equipment registration, prohibition on using granted equipment for loan collateral, etc. Additional areas to be addressed will include grantee insurance liability, equipment replacement responsibilities, grantee responsibilities regarding theft and other criminal activity in which equipment may be involved, grantee responsibilities regarding legal action pertaining to granted equipment and/or grant funded operations, etc.

- There has been no discussion to date between OVR and L&I legal counsel regarding establishment of uniform protocols for the Commonwealth to assist and/or cooperate with grantees in pursuit of equipment through bankruptcy and/or criminal or civil court. That effort has not been discarded, but activities in that regard have not, yet, taken place.

Finding 01 – 12: (continued)

Auditors' Conclusion: OVR management stated that it is in the process of hiring more staff and implementing policies and procedures to improve controls over RSBS job creation grants. Since these policies and procedures were not in place during our audit period of SFYE June 30, 2001, the internal control weaknesses still existed during our audit period, and the finding and recommendation remain as stated. We will review any corrective action during our subsequent audit.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 13:

CFDA #93.558 – Temporary Assistance for Needy Families

Lack of Documentation to Support Compliance with Federal Welfare Reform Regulations (A Similar Condition Was Noted in Prior Year Finding #00 – 12)

Condition: Our review of a sample of 25 active TANF cases during our prior audit period (SFYE June 30, 2000) disclosed that, except for those individuals determined to be disabled and therefore exempt from federal work requirements, case file records provided by DPW did not contain documentation supporting DPW's initial assessment of the skills, prior work experience, and employability of each TANF recipient. Our follow-up of the prior year finding disclosed that the same condition existed during our current audit period (SFYE June 30, 2001).

Criteria: Federal regulation 45 CFR 261.11(a) states:

(a) The State must make an initial assessment of the skills, prior work experience, and employability of each recipient who is at least age 18 or who has not completed high school (or equivalent) and is not attending secondary school.

In addition, 45 CFR 74.53(b) states:

(b) Financial records, supporting documents, statistical records, and all other records pertinent to an award shall be retained for a period of three years from the date of submission of the final expenditure report or, for awards that are renewed quarterly or annually, from the date of submission of the quarterly or annual financial report.

Cause: DPW personnel disagree with our finding and stated that the Department's assessments consist of the RESET Participant Guide to Success (Guide - PW 1680) and the job search process. RESET, which stands for Road to Economic Self-Sufficiency through Employment and Training, is the process by which the recipient and the caseworker together prepare a plan of action using the RESET Guide. However, RESET procedures located in the OIM's Cash Assistance Handbook in Section 135, Appendix C, do not require retention of the RESET Guide (PW 1680) in the case file. Although DPW officials believe the RESET Guide properly documents compliance with applicable TANF regulations, they cannot demonstrate this since these documents are not retained.

Effect: Since DPW did not require that a copy of the completed RESET Guide (PW 1680) form be maintained in the client case file, it cannot support compliance with federal regulation 45 CFR 261.11. Further, since the documented assessments are not maintained, we could not determine whether TANF recipients received the appropriate training and/or employment placement guidance required by TANF regulations and the federal Welfare Reform Act of 1996.

Recommendation: DPW should strengthen its procedures to ensure that the assessment of skills, prior work experience, and employability of each recipient is properly documented within a RESET Guide (PW 1680) and retained in each case file as required.

Agency Response: The DPW, Office of Income Maintenance, will issue an Operations Memorandum to remind caseworkers of the requirement to file and retain the completed Participant Guide to Success, PA-1680, as part of the client's case record for a period of three years.

Auditors' Conclusion: Based on the agency response, the finding and recommendation remain as stated. We will review any corrective action as part of our subsequent audit.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 14:

CFDA #93.558 – Temporary Assistance for Needy Families

Inaccurate Reporting on the TANF ACF-199 Data Report (A Similar Condition Was Noted Within Prior Year Finding #00 – 11)

Condition: Within the TANF program, DPW is required to submit the TANF Data Report, or Form ACF-199, on a quarterly basis. The ACF-199 Report provides HHS with various types of data on Pennsylvania's TANF participants including family type, work participation status, subsidized and unsubsidized employment activity, job search and job readiness activities, etc. Each quarter, DPW electronically submits a file to HHS that contains the aforementioned data. This file consists of three individual monthly files (one for each month of the quarter) of all TANF participants contained on DPW's Client Information System (CIS). In order to test the data on the file submitted to HHS, we obtained the data for the sampled month of March 2001. Our analytical review of aggregated data revealed significant inconsistencies in totals reported under three different categories with little or no DPW review and follow up to ensure the accuracy of totals reported.

In particular, under person-level data-marital status (item #37), the March 2001 CIS file reported 14,218 adults as married, living together. Under person-level data-relationship to head of household status (item #38), CIS reported only 4,245 spouses. CIS also reported only 2,512 two-parent families in the aggregate. Because of the wide disparities in these totals, we inquired at DPW about the reasons for these inconsistencies. While DPW responded with some general explanations about how differences *could* occur in these categories, we found that DPW could provide no evidence to support the actual difference since officials had not properly reviewed the CIS file to determine its completeness and accuracy before submitting it to HHS as the ACF-199 Report. Based on HHS's report format, all or some of these category totals appear to be in error.

In addition, we randomly selected 25 cases from the March 2001 CIS data file, performed analytical review procedures, and attempted to trace certain data, as required by the federal compliance supplement, to documentation in the participant's case file. This testing disclosed the following:

- Out of the 25 case files reviewed, 12 cases had no work activity for the period and 13 cases included work activity. However, for 9 of the 13 cases with work activity, or 69.2 percent, the number of unsubsidized weekly employment hours (item #49) reported from CIS did not agree with, or could not be supported by, the case file as follows:

Case Number	Number of Hours Reported on the ACF-199 Report	Number of Hours Worked Per the Case File	Difference
020590044	9	*	*
170083879	18	*	*
360178096	18	*	*
360193781	46	48	2
511656396	27	*	*
512010871	28	15	13
512029177	98	40	58
512148648	18	7	11
512176774	19	*	*

* The hours worked could not be determined since the check stubs supporting number of hours the participant worked were not included within the case file.

We also noted that case #512010871 listed above was also classified on the ACF-199 Report as disabled and exempt from work requirements, which is inconsistent reporting.

Finding 01 – 14: (continued)

- Two of the 25 sampled cases included job search and job readiness (item #54) activity on CIS; however, for both cases, the case file documentation did not support any hours for job search activities. The cases were as follows:

Case Number	Number of Hours Reported on the ACF-199 Report
250225593	2
400253992	8

- Three of the 25 sampled cases included work experience (item #52) activity on CIS; however, for all three cases, the case file documentation did not support any hours for work experience activities. These cases were as follows:

Case Number	Number of Hours Reported on the ACF-199 Report
400253992	16
510893094	22
512176774	15

- For 5 of the 25 case files reviewed, or 20 percent, the case file indicated that the TANF participant received subsidized day care (item #17) while the ACF-199 report (i.e., CIS) indicated that the participants did not receive subsidized day care. In addition, the amount of subsidized day care reported on the ACF-199 Report for one case did not agree with the case file documentation showing the amount of day care funds paid.

- Three of the 25 case files reviewed, or 12 percent, included an individual who was under 18 years of age as a family member on the ACF-199 Report. However, family members under 18 years of age should not be reported on the ACF-199 Report under person-level data unless the person is a minor head of household.

In addition, since DPW's CIS data files are also used for other TANF data reports submitted to HHS (i.e., the ACF-202 Report), our testwork calls into question the accuracy of the CIS data reported to HHS in these other federal reports.

Criteria: Section 411(a)(1) of the Social Security Act states, in part:

(A) CONTENTS OF REPORT.—Each eligible State shall collect on a monthly basis, and report to the Secretary on a quarterly basis, the following disaggregated case record information on the families receiving assistance under the State program funded under this part:

(iv) The number of individuals in the family, and the relation of each family member to the head of the family….

(ix) Whether the family received subsidized housing, medical assistance under the State plan approved under title XIX, food stamps, or subsidized child care, and if the latter 2, the amount received.

(x) The number of months that the family has received each type of assistance under the program.

(xi) If the adults participated in, and the number of hours per week of participation in, the following activities:

(I) Education.
(II) Subsidized private sector employment.
(III) Unsubsidized employment.
(IV) Public sector employment, work experience, or community service.

Finding 01 – 14: (continued)

(V) Job search.
(VI) Job skills training or on-the-job training.
(VII) Vocational education

(xii) Information necessary to calculate participation rates under section 407.

In addition, 45 CFR Part 265.3 states:

(b) TANF Data Report. The TANF Data Report consists of three sections. Two sections contain disaggregated data elements and one section contains aggregated data elements.

(1) Disaggregated Data on Families Receiving TANF Assistance – Section one. Each State must file disaggregated information on families receiving TANF assistance.[2] *This section specifies identifying and demographic data such as the individual's Social Security Number; and information such as the type and amount of assistance received, educational level, employment status, work participation activities, citizenship status, and earned and unearned income. The data apply to adults and children.*

(2) Disaggregated Data on Families No Longer Receiving TANF Assistance – Section two. Each State must file disaggregated information on families no longer receiving TANF assistance.[3] *This section specifies the reasons for case closure and data similar to the data in section one.*

(3) Aggregated Data – Section three. Each State must file aggregated information on families receiving, applying for, and no longer receiving TANF assistance.[4] *This section of the Report requires aggregate figures in such areas as: The number of applications and their disposition; the number of recipient families, adult recipients, and child recipients; the number of births and out-of-wedlock births for families receiving TANF assistance; the number of noncustodial parents participating in work activities; and the number of closed cases.*

[2] See Appendix A for the specific data elements and instructions.
[3] See Appendix B for the specific data elements and instructions.
[4] See Appendix C for the specific data elements and instructions.

Cause: DPW officials cannot explain the major inconsistencies between the number of two-parent families versus the number of spouses classified as heads of households, or the number of married adults living together. While DPW disagrees with our conclusion regarding the aggregate data on two-parent families and spouses (Item #38), DPW cannot explain the 70 percent variance between the reported totals disclosed above, which appears unreasonable without further explanation and follow-up.

Since the TANF case files are prepared and maintained at the CAOs, DPW central office personnel could not explain the variances between the case files and ACF-199 Report regarding the classifications of certain individuals. Regarding the variances in work activity hours, DPW personnel indicated that estimated hours were used instead of actual in order to meet the federal reporting deadline. For hours that were not documented at all, pay stubs were not available because there is no policy requiring the retention of pay stubs or other documents that could support work hours after the hours are entered on to CIS.

With regard to the documentation supporting work experience, job search, and job readiness activities, DPW personnel indicated that these hours are entered into the Automated Interface Management System (AIMS) by outside contractors who are subject to program monitoring. AIMS is then supposed to interface with CIS, from which the applicable participant's hours for work experience, job search, and job readiness activities are calculated. However, DPW cannot demonstrate that these contractors are being monitored or that the hours they are reporting are correct.

Finding 01 – 14: (continued)

With regard to the discrepancies for subsidized day care, DPW personnel indicated that day care payments each month are typically retroactive to the prior month. Therefore, the March 2001 payments in the case files should actually be reported in the April 2001 ACF-199 Report, and February 2001 payments should appear in the March report. However, our testing disclosed that this is not the case since no retroactive payments from February 2001 were included on the March 2001 ACF-199 Report. There appears to be a system weakness in OIM's process to identify and report subsidized day care payments.

Effect: Based on the error rates and the nature of the errors noted in the condition, DPW did not comply with federal reporting requirements. DPW also provides little assurance that the information submitted to HHS on the ACF-199 Report is accurate. In addition, the accuracy of CIS data for other TANF reports submitted to HHS is also questionable. As a result, HHS may not be accurately calculating and evaluating Pennsylvania's work participation rates within the TANF program. Furthermore, as in the prior year, Pennsylvania's work participation rate for FFY 2000 may be materially incorrect.

Recommendation: DPW should evaluate the feasibility of submitting revised ACF-199 reports for the FFY 2000. Also, DPW should review and evaluate its procedures and controls to accumulate, review, and report its TANF information on the ACF-199 Report and make the necessary revisions to ensure that future information reported is complete, accurate, and properly supported by the participants' case files. Further, DPW should ensure any other TANF reports prepared using CIS data are accurate.

Agency Response: The DPW, Office of Income Maintenance (OIM), agrees with most of the condition as stated and concurs with the recommendation. Several of the issues raised are addressed separately below:

Marital Status, Relationship, and Two-Parent Families Are Inconsistent

The OIM only reports a two-parent case when a child has two parents recorded on the CQ Comp. It is not a function of the adult's relationship to each other or their marital status. However, the number of two-parent families does appear to be consistent with the number of spouses. Intuitively, one would assume that there would be about twice as many spouses as two-parent families. That is what you found. The OIM agrees that the number of adults reported as married and living together does appear to be inconsistent with the other two counts. In that regard, the OIM will investigate this issue further using the Data Warehouse and the Client Information System (CIS).

The OIM does not believe it is necessary to resubmit the data since a high degree of confidence in the parent line number information exists.

Employment Hours Reported Could Not Be Supported By Case File

The OIM believes it is in compliance with the federal requirement not to maintain pay stubs in the client case file. Wages, salaries, commissions, or income in-kind are maintained in the CIS. The CQWAGE screen in the CIS provides detail about individuals in the budget who have wages, salaries, commissions, or income in-kind and how income was verified. It also provides the number of hours. Verification codes are used when income and hours are verified and recorded in the CIS by the Income Maintenance caseworker. Verification codes can be found in the PA-601P Supplementary Codes. Pay stubs are not required to be maintained in the case record once information and verification is recorded in the CIS.

In accordance with 55 Pa. Code, §142.23(e), a Monthly Reporting Form (MRF) is complete if all the questions are answered, the payment name has signed the form, and the required verifications are attached. Eligibility and the amount of the assistance payment are determined by the information **on the MRF** in accordance with 55 Pa. Code, §142.23(f). The MRF is the documentation on the client's income, resources, household composition, and any other relevant circumstances or changes that effect eligibility (55 Pa. Code, §142.21).

Finding 01 – 14: (continued)

Employment and Training Activity Hours Could Not Be Supported By Case Number

The case file documentation, which is the CIS, documents the correct number of hours. The hours are entered through the AIMS system by the employment and training contractor, which becomes the official record. Documentation is not kept in the CAOs. Attendance sheets are maintained by the employment and training contractors. The OIM's Division of Policy and Implementation, within the Bureau of Employment and Training Programs, monitors time and attendance. The hours listed on the report are correct as stated. This has been supported by the CIS case file information previously provided to the auditors.

An Exempt Individual Was Found To Be Working

This is appropriate. Individuals that are exempt from the work requirements can get jobs on their own. The individual in question found a job on her own and did not volunteer to participate in employment and training. Entry into a training program or employment does not mean that a client is no longer disabled.

Child Care Data Did Not Agree With Information In The Case File

The OIM agrees that this is incorrect and is currently rerunning the childcare data for resubmission for all of fiscal year 2000.

Family Members Under 18 Years Of Age Should Not Be Reported

All persons (adults and children) are required to be reported. The OIM assumes that the problem is the family affiliation (item number 30) and is checking into that possibility.

Auditors' Conclusion: Regarding the data inconsistencies between marital and head of household status, and the number of two-parent families, DPW needs to establish controls to properly review its data prior to submission of the ACF-199 Report to HHS to ensure completeness, accuracy, and consistency among the totals reported. These controls should include obtaining reasonable evidence to support that a proper review and analysis was performed.

Regarding DPW's statement that the number of hours reported for work activity (item #49), work experience (item #52), and job search/readiness (item #54) do not need to be supported by case file documentation, we disagree with DPW's position since we cannot test this data for accuracy and completeness without supporting documents. DPW needs to pursue appropriate settlement with HHS on this issue.

Regarding the exempt individual reported as working, the agency response does not explain the appropriateness of this inconsistent reporting and its inclusion in DPW's work activity data for HHS's calculation of DPW's work participation rate. DPW needs to pursue settlement with HHS on this issue also.

Regarding the remaining disclosures in the finding, any corrective action will be reviewed in our subsequent audit. Our finding and recommendation, with the above clarifications, remain as stated above.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 15:

CFDA #93.563 – Child Support Enforcement

Noncompliance and Internal Control Weakness Over the Process of Responding to Interstate Registry Cases

Condition: Federal regulations require that DPW establish an interstate central registry for CSE which is responsible for receiving, distributing, and responding to inquiries on all incoming IV-D cases within established timeframes. Our test of 10 responding interstate cases during our test month of March 2001 disclosed that DPW did not meet the 10-day timeframe for processing the case for any of the items tested as follows:

Case ID	Date Case Received	Date Case Processed	# of Days Between Receipt And Processing
799103322	3/02/01	4/05/01	34
616103326	3/05/01	4/04/01	30
878103324	3/05/01	4/05/01	31
129103346	3/05/01	4/11/01	37
407103357	3/19/01	4/13/01	25
303103355	3/19/01	4/12/01	24
807103354	3/23/01	4/13/01	21
459103373	3/26/01	4/20/01	25
301103395	3/29/01	4/24/01	26
305103391	3/29/01	4/25/01	27

In addition, we noted that for the 344 responding interstate cases received during March 2001, only nine cases were processed within the 10-day timeframe.

Criteria: 45 CFR, Part 303.7(a), states:

(a) Interstate central registry. (1) The State IV-D agency must establish an interstate central registry responsible for receiving, distributing and responding to inquiries on all incoming interstate IV-D cases.

(2) Within 10 working days of receipt of an interstate IV-D case from an initiating State, the central registry must:

(i) Ensure that the documentation submitted with the case has been reviewed to determine completeness;

(ii) Forward the case for necessary action either to the State PLS for location services or to the appropriate agency for processing;

(iii) Acknowledge receipt of the case and ensure that any missing documentation has been requested from the initiating State; and

(iv) Inform the IV-D agency in the initiating State where the case was sent for action.

Cause: DPW officials stated that the delay in processing the cases was due to a shortage of staff. In addition, DPW officials stated that in June 2001, they began to more strictly monitor their processing of the responding interstate cases to ensure compliance with the 10 day timeframe, and that as of July 2001, after our current audit period, they had achieved compliance in processing the cases within the established timeframe.

Finding 01 – 15: (continued)

Effect: Since DPW did not process the responding interstate cases within the required timeframe, they were not in compliance with federal regulations. In addition, DPW could not enforce support obligations on behalf of the requesting state on a timely basis.

Recommendation: DPW should strengthen its existing controls to ensure that all responding interstate cases received are processed within the established timeframes.

Agency Response: The DPW agrees in principle with the finding. During the time period of the audit, the Bureau of Child Support Enforcement (BCSE) had incurred difficulty meeting the ten-working day federal requirement due to the continued problem of employee turnover. In March 2001, the Division of Central Operations (DCO) was operating at 40 percent of its approved staffing level. However, as of June 2001, the number of staff assigned Central Registry duties was increased from one to four employees. Additionally, a database was established to track incoming petitions, providing the DCO with the ability to monitor the flow of cases to the counties. As a result, processing time has been reduced, on average, to 13.2 days.

Auditors' Conclusion: Based on the agency response, the finding and recommendation will remain as stated above. We will review any corrective action in our subsequent audit.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 16:

CFDA #93.575 – Child Care and Development Block Grant
CFDA #93.596 – Child Care Mandatory and Matching Funds of the Child Care and Development Fund
CFDA #93.667 – Social Services Block Grant

Weakness in DPW Monitoring Procedures Results in Over $32 Million in Excess Subgrantee Federal Cash at June 30, 2001 (A Similar Condition Was Noted in Prior Year Finding #00 – 13)

Condition: Our examination of DPW's procedures for monitoring SSBG, CCDBG, and CCDF Mandatory and Matching subgrantees for compliance with cash management standards revealed that DPW advanced funds to certain CCDBG and CCDF subgrantees, and to SSBG subgrantees in 6 of 11 SSBG program areas, representing approximately 84 percent and 71 percent of total CCDBG/CCDF and SSBG program expenditures, respectively. However, DPW did not adequately monitor these subgrantees for excess cash during the fiscal year ended June 30, 2001.

In particular, for the Emergency Shelter, Legal Services, and Child Care components of the SSBG program, DPW advanced funds to subgrantees on a monthly basis. For Mental Health, Mental Retardation, and Child Welfare, DPW advanced funds to subgrantees on a quarterly basis. Our inquiries with applicable DPW program administrators disclosed that DPW did not monitor the subrecipients within these six SSBG program areas for excess cash either at the time of payment or at any other time during the current state fiscal year.

For CCDBG and CCDF, between July 1 and December 31, 2001, subgrantees returned $32.5 million in year-end excess cash to DPW from advance payments made monthly but not monitored by DPW during SFYE June 30, 2001. Further, our review of DPW's worksheet to support refunds from subgrantees disclosed that 25 of 60 refunds were received after August 31, 2001, and refunds totaling $8.655 million for six subgrantee contracts were received on or after November 30, 2001, five or more months after the year-end. These refunds are not being made by the subrecipients timely.

Criteria: Advances by a state to secondary recipients shall conform substantially to the same standards of timing and amount which apply to the state.

31 CFR 205, Subpart B governs cash advances by federal agencies to their grantees. Specifically, 31 CFR 205.20 states:

Cash advances. Cash advances to a State shall be limited to the minimum amounts needed and shall be timed to be in accord only with the actual, immediate cash requirements of the State in carrying out a program or project. The timing and amount of cash advances shall be as close as is administratively feasible to the actual cash outlay by the State for direct program costs and the proportionate share of any allowable indirect costs.

In addition:

In discussions with our office, federal agencies have stated that cash advance balances on hand at subrecipients are reasonable if they approximate the grantee's (state's) payment cycle to the subgrantee. In light of the (state agencies) administrative system of making (daily, weekly or monthly) payments by check to subrecipients, a (daily, weekly or up to one month) cash advance on hand monitored at least quarterly is reasonable.

DPW subgrantee contract Rider 1, Section 3.F., states:

The Grantee must submit the final utilization report by August 31st or 90 days after the effective date established by any party canceling this Grant. If monies are due the Department, A CHECK IN THIS AMOUNT MUST BE SUBMITTED BY AUGUST 31ST WITH A COPY OF THE FINAL RECAP PACKAGE. This check is payable to the Department of Public Welfare. No future or current Grant payment will be made until this requirement is satisfied.

Finding 01 – 16: (continued)

Cause: DPW personnel indicated that for child care payments under CCDBG/CCDF and SSBG, utilization reports from subgrantees were being reviewed for cash management purposes and payments to subgrantees were adjusted if necessary. To support the above statement, DPW provided evidence of checks totaling $5.8 million in CCDBG/CCDF and SSBG funding to child care subgrantees for March 2001 that were not sent to certain subgrantees in order to reduce cash balances. However, given the fact that refunds for the year were in excess of $30 million, DPW did not adequately implement subgrantee cash management monitoring procedures during SFYE June 30, 2001. Further, DPW did not withhold payments to subgrantees that did not submit expenditure reports by August 31, 2001 as required by subgrantee contract provisions because DPW personnel felt it would negatively impact the delivery of child care services. However, this is questionable since the six subgrantee contracts at issue were found to have revenues in excess of expenditures of 10 percent or more.

Regarding the Emergency Shelter, Legal Services, Mental Health, Mental Retardation and Child Welfare components of SSBG, DPW personnel indicated that they provide subgrantees with advances in part to comply with Commonwealth law and also to ensure that adequate funds are available to provide services to participants on a timely basis. They believe that their payment procedures for the five components of the SSBG program mentioned above are as efficient as is administratively feasible and that controls exist in each of the program areas cited. We found, however, that although there are monitoring procedures within the SSBG subrecipient payment process, such as the periodic submission of subgrantee activity reports, these procedures do not identify excess cash on hand or adjust subsequent payments to the subgrantees.

As stated in the prior year findings, DPW is waiting for HHS resolution of this issue. DPW again contacted HHS in writing in March 2000, but still has not received a response from HHS on this issue. Also, as stated in the prior year finding, our last contact with HHS officials in the Division of Payment Management was during SFYE June 30, 1998. At that time, HHS officials stated that, in order to resolve this finding, DPW must either change their payments from advances to reimbursements or set up a system to at least quarterly monitor cash balances throughout the fiscal year.

Effect: DPW is not adequately monitoring subgrantee cash on hand to ensure cash is being limited to immediate needs as required by federal regulations. Furthermore, day care subgrantees refunded $32.5 million in excess funds to DPW at year-end. As a result, DPW provides little assurance of subrecipient compliance with cash management standards. In addition, since DPW did not withhold payments to subgrantees that did not submit reports on time, $8.655 million in refunds were not received until November 30, 2001 or later. Also, the large amount of refunds ($32.5 million), which is over 17 percent of program expenditures for the fiscal year, may indicate that subgrantees are not serving as many eligible families as possible.

Recommendation: As recommended in previous Single Audits and supported by HHS, DPW should either consider changing their current subrecipient payment procedures from advancement basis to reimbursement basis or establish procedures to adequately monitor subrecipient activities and ensure that subrecipient cash on hand is limited to immediate needs, but no longer than one month. The implementation and strengthening of these controls should provide DPW with reasonable assurance as to compliance with cash management requirements at the subgrantee level. Also, DPW should follow its procedures for obtaining subrecipient expenditure reports to ensure that refunds are received more timely.

Agency Response: The DPW disagrees, in part, with this finding, especially with the auditors' assumptions in both the Cause and Effect of the finding. The finding addresses three different issues: general cash management; childcare program refund totals; and timeliness of childcare refunds and expenditure reports. Each of those issues is addressed separately.

Issue 1 – Subrecipient Cash Management

While it is true that final settlement of these grants/contracts occurs after the close of the program year, it is not true that the DPW has failed to adequately monitor the agreements. These programs are monitored throughout the period from budget to final settlement. The auditors have been briefed repeatedly on the methods used.

Finding 01 – 16: (continued)

The auditors appear to believe that only a full reconciliation can serve to control the amount of Social Services Block Grant (SSBG) funding in the hands of subrecipients. In fact, long years of experience and recent decreases in the level of the SSBG funding by the Department of Health and Human Services (DHHS) have combined to limit the amount of the SSBG allocated to these programs in the first place. Further, the SSBG often provides only a very small part of a combination of funding streams that would have to be reconciled. Finally, the fact that it is extremely rare for any SSBG funds to be returned as the result of year-end settlements goes to show that this issue is not material to the program. To the best of our knowledge, the auditors have never looked at the level of refunds in the SSBG, or recognized the fact that any funding returned to the DPW may be eligible for reuse and not due back to the DHHS at all.

On March 28, 2000, a detailed report addressing the management of the SSBG was mailed to the DHHS Payment Management Branch (DHHS/PMB). As of February 8, 2002, no acknowledgement or response has been received from the DHHS/PMB. A copy of that correspondence was provided to the auditors on several occasions.

While the DPW report to the DHHS/PMB details the management of SSBG programs, the controls in the Child Care and Development Fund/Child Care and Development Block Grant programs (CCDF/CCDBG) are essentially the same. One of the most important points to be made is that the funds issued in connection with these agreements are carefully controlled at the outset to prevent overpayments. Audits of the various programs show that there is very little, if any, excess SSBG funds in the field.

The DPW is currently in the development and implementation stages of a massive Child Care Management Information System (CCMIS). The CCMIS is designed to provide a state-of-the-art program to perform subsidy management functions, including funds and payment management and monitoring, for the Office of Children, Youth and Families (OCYF) and subgrantee staff. The CCMIS will provide the OCYF with the tools to provide a more timely and accurate management of funds beginning in FY 2003-04.

Issue 2 – Child Care Program Refunds

First, it is very important to note that these childcare contracts are indeed monitored. During the audit period, funds were often transferred between contractors to optimize coverage of the program. During fiscal year (FY) 2001-02, the OCYF has been even more aggressive. The payments are monitored and adjusted, where necessary, based on the prior months' activity and the judgment of program staff. The DPW is refining the process of withholding checks to subgrantees based on activity levels. The amount of Fund C funds initially allocated to subgrantees is being reevaluated based on usage levels. In previous years, under spending on these contracts had been held to only two or three percent because the waiting lists absorbed any excess funds. Note that such refunds are not necessarily due back to the federal government, but are often eligible to be reused in the daycare program.

While the $31.4 million in refunds does pertain to the childcare program, only $16.3 million is subsidized childcare for low-income families. The other $15.1 million consists of funding for families moving from the Temporary Assistance for Needy Families (TANF) program into the workforce. Contractors are required to track these two sources of childcare funds separately. Subsidized childcare for low-income families is identified as Fund A, and subsidized childcare for families moving from the TANF program into the workforce is identified as Fund C.

The DPW's ultimate goal is to stabilize a much higher standard in the daycare program. To this end, certain changes were made to the Commonwealth's childcare regulations in an effort to reduce the waiting lists and accommodate an expected increase in demand. Corresponding increases in Fund A allocations were intended to provide for double the number of daycare enrollments, but in fact, actually provided for triple the number of enrollments due in part to the increase in the eligible income level and co-pay requirements. These changes introduced families with a higher level of resources into the program, thus reducing the level of funding needed for daycare assistance and increasing the rate of program attrition. An aggressive outreach campaign was in place to increase the enrollment rate for services to Fund A families. As an update in 2002, the enrollment for low-income working families has increased and matches the resources available as a result of the outreach campaigns.

Finding 01 – 16: (continued)

Allocations for Fund C were calculated to meet an expected surge in the number of families moving from the TANF program into the workforce, thus becoming eligible for Fund C childcare assistance. This surge was expected to begin in March 1999 when the first TANF recipients were made ineligible for that program. The surge actually began much later and the rate of TANF program attrition was much higher than expected, causing significant under spending in Fund C. Note that sufficient funds must be allocated to Fund C because services to families leaving the TANF program are essentially an entitlement.

Spending patterns are now beginning to stabilize and daycare program average length of stay, which historically was at 24 months, is much lower. Future allocations take this into account. This, combined with the OCYF's more aggressive approach to monitoring and adjusting available contract funds, should result in less overfunding during the FY 2001-02 program year. However, it must be recognized that these are maximum cost contracts whereby the contractor is fully responsible for all overspending. Further, funds must be kept available for the annualization of children already in the program. Therefore, it is almost impossible for a contractor to exactly match enrollment with allocations.

Finally, the DPW strenuously objects to the last sentence in the Effect section as inappropriate for inclusion in an objective, independent audit report. This is conjecture on the part of the Auditor General, who is on record as opposing certain changes made to the program. In fact, on November 23, 1999, the Auditor General issued a press release alleging that "millions of dollars appropriated for child care are being stockpiled by the [current elected] Administration." In addition, on February 1, 2002, another press release was issued alleging that "millions in stockpiled federal child care funds are available to help low-income working families waiting for subsidy."

Issue 3 – Timeliness of Child Care Refunds

The DPW acknowledges that some refunds and expenditure reports were received after the contracted deadline of August 31, 2001, and the DPW did not withhold payments to those tardy subgrantees. The DPW maintains that withholding payments to some subgrantees could impair their ability to provide for the delivery of childcare services. The DPW has reviewed the existing contract language and intends to revise and enforce the section in subgrantee contract Rider 1 to read, "Future or current Grant payments, in whole or in part, will not be made until this requirement is satisfied." The change will allow the OCYF discretion in withholding payments to subgrantees whose ability to deliver childcare services may be harmed.

Auditors' Conclusion: DPW states that SSBG provides relatively small amounts of funding to the various programs, and year-end refunds are "extremely rare." However, we noted over $890,000 in SSBG refunds during our audit period. This is clear evidence of SSBG funds that should not have been paid out. Furthermore, DPW's year-end settlement process does not measure subrecipient cash throughout the year and is, by itself, inadequate as a subrecipient cash management monitoring tool. Poor cash management may or may not result in year-end refunds from subrecipients. DPW's assertions that refunds may be eligible for reuse by DPW and not due back to HHS have no impact on our finding since, without proper monitoring of subrecipient cash management, unneeded funds could be drawn down by DPW from HHS, or excess subrecipient cash may not be returned timely to DPW and used to reduce subsequent drawdowns from HHS. The points made by DPW in their agency response do not relieve DPW from complying with federal cash management standards for 71 percent of SSBG funds.

Also, as stated in their response, since DPW is waiting for HHS resolution of this issue, we contacted HHS officials in the Division of Payment Management as to their resolution of this finding during a prior audit. HHS officials stated that, in order to resolve this finding, DPW must either change their payments from advances to reimbursements or set up a system to at least quarterly monitor SSBG cash balances throughout the fiscal year.

Finding 01 – 16: (continued)

Regarding the DPW response related to the return of over $32 million in child care funding to DPW, we consider the material amount of funds returned to be substantive evidence of the need for adequate monitoring of subrecipient cash management activities; however, the response does not address corrective action for this weakness. Also, DPW's statement that prior-year underspending on child care contracts "had been held to only two or three percent" is not accurate or relevant here. Our prior-year audits disclosed that year-end refunds continue to increase each year. During SFYE June 30, 1999, year-end refunds were $15.7 million or 8.5 percent of program expenditures. For SFYE June 30, 2000, year-end refunds increased to $30.1 million or 14.1 percent of program expenditures. During the current year refunds were $32.5 million or 17.3 percent of program expenditures. Based on the most recent data, therefore, the weakness in DPW's procedures is material and needs to be addressed.

Regarding DPW's objection to our statement in the effect section of the possibility that CCDF/CCDBG subrecipients may not be serving all eligible families, DPW provided no evidence that DPW personnel were monitoring subgrantees on a timely basis to ensure that all eligible individuals applying for child care assistance were in fact receiving assistance. Monthly activity reports submitted to DPW were not used to adjust overall subgrantee funding levels and do not report or analyze the number of children served vs. unserved. Further, on-site reviews of subgrantee waiting lists and funding levels versus child care needs are only performed once every two years, which is not timely considering the material amounts of refunds each year. Furthermore, subrecipient entities are not within the scope of our state-level audit, which is limited to testing of DPW's monitoring of these entities. As such, we recommend that DPW ensure proper and timely monitoring of the situation to make sure this is not occurring and subgrantee child care programs are open to all eligible individuals. In addition, where monitoring results deem it necessary, DPW should adjust their subgrantee budgets and/or payments to avoid the above noncompliance in the future.

Accordingly, the finding and recommendation, with the above clarifications, remain as stated above.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 17:

CFDA #93.575 – Child Care and Development Block Grant

Internal Control Weaknesses and Noncompliance With Federal Earmarking Requirements Result in Questioned Costs of $1,381,114

Condition: Federal regulations applicable to the Discretionary Fund portion of the CCDF program established an earmark within each annual federal award requiring minimum funding levels to increase the supply of quality child care for infants and toddlers. Our test of expenditures charged to the FFY 1999 grant which closed out during our audit period on September 30, 2000, disclosed that DPW did not meet the minimum earmark requirement as follows:

Required Infant/Toddler Earmark	$1,653,448
Actual Earmark Expenditures Posted to ICS	272,334
Expenditure Amount Under Required Earmark	$1,381,114

DPW and PHHS Comptroller officials stated that they were not aware of the infant and toddler earmark requirement until we inquired about it during our audit. Subsequently, DPW officials requested the PHHS Comptroller Office to make an expenditure adjustment of $1,381,114 in an attempt to satisfy the earmark requirement. This adjustment was completed retroactively on November 1, 2001, even though the grant was fully expended and closed out as of September 30, 2000.

In addition, the child care contracts included in the expenditure adjustment did not appear to have qualifying expenditures to satisfy the earmarking requirement. For example, Contract #ME971971600 claimed $89,288 in child care costs, but no funding was budgeted for infant and toddler projects in this contract. Also, Contract #ME972171600 claimed $1,291,826 for child care, but only $362,600 was budgeted for infant and toddler projects. No support was provided to show how much, if any, of the costs in these contracts was actually expended for infants and toddlers.

Criteria: The terms and conditions issued with the FFY 1999 grant award state:

Earmarks associated with the Discretionary Fund Made Available by Passage of Public Laws 105-78 and 105-277

With the passage of Public Laws 105-78 and 105-277, funds were earmarked for resource and referral, school-age activities and activities to increase the supply of quality care for infants and toddlers. Lead agencies must spend earmarked amounts to increase the supply of quality child care for infants and toddlers (infant and toddler earmark) or on planning, establishing, operating, expanding, developing, and improving resource and referral activities and child care services for school-age children. These earmarked funds must be spent in addition to the 4 percent minimum expenditure on quality required by CCDBG Act as amended by PRWORA and applicable regulations.

In addition, HHS Information Memorandum No. ACYF-IM-CC-98-02 regarding the FFY 1999 Final Allotments and Earmarked Funds established Pennsylvania's infant and toddler earmark as $1,653,448.

Cause: Compliance with the infant and toddler earmark was overlooked and was not properly tracked and monitored by DPW.

Effect: Since DPW did not meet the requirements of the infant and toddler earmark, DPW was not in compliance with federal regulations. In addition, $1,381,114 in expenditures were charged in the FFY 1999 CCDF grant for purposes which were not related to infants and toddlers as required by federal regulations, and are therefore questioned. Furthermore, the retroactive expenditure adjustment which DPW made after the close-out of the 1999 CCDF grant did not appear to include valid expenditures to satisfy the infant and toddler earmark.

Recommendation: We recommend that DPW pursue appropriate settlement with HHS regarding the $1,381,114 of questioned costs. In addition, DPW should establish procedures to ensure that infant and toddler earmarks are met within future CCDF grants.

Finding 01 – 17: (continued)

Agency Response: The DPW agrees that we were unaware of the infant and toddler earmark requirement until the auditors inquired about it during the audit. Subsequently, DPW officials requested that the Office of Comptroller make an expenditure adjustment of $1,381,114 to satisfy the earmark requirement. This adjustment was completed retroactively on November 1, 2001.

However, the DPW disagrees with the auditor's assertion that the childcare resource developer contracts included in the expenditure adjustment did not have qualifying expenditures to satisfy the earmarking requirement. Contract #ME971971600 claimed $89,288 and Contract #ME972171600 claimed $1,291,826 in qualifying expenditures for infant and toddler projects. The amounts claimed represent quality initiative grants to providers. The grants were specifically earmarked for infant and toddler projects.

The DPW would have provided the auditors with support for the qualifying expenditures for the infant and toddler projects if the DPW had been asked.

Auditors' Conclusion: On January 18, 2002, we specifically asked DPW for documentation to support qualifying expenditures for infant and toddler projects. No supporting documentation was provided by DPW to substantiate that any of the expenditure adjustment of $1,381,114 was actually expended on infant and toddler projects. Accordingly, the finding and recommendation remain as stated above.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 18:

CFDA #93.658 – Foster Care – Title IV-E

DPW Office of Children, Youth and Families Should Renew Licensing of Foster Care Agencies in a More Timely Manner

Condition: Prior to the expiration of each license term, DPW is required to inspect and relicense all 67 Foster Care County Children and Youth Agencies with which DPW contracts to perform Foster Care services. Our review of the DPW OCYF administrative controls over 14 of these Foster Care agencies funded during the year under audit disclosed that for two of the 14 (14 percent) agencies, the OCYF license renewal inspection of the agencies commenced after the expiration of the prior license term as follows:

Children and Youth Agency	License Expiration Date	Start Date of On-Site License Renewal Inspection	Number of Days Inspection Commencement Late
Elk County	11-30-00	12-19-00	19
Luzerne County	12-22-00	5-30-01	158

As a result, license renewals for these two county agencies were untimely in violation of federal regulations.

Criteria: The Compliance Supplement for Single Audits of State and Local Governments under Section B regarding Foster Care eligibility and 42 United States Code, Sections 671 and 672 provide, in part:

The provider must be licensed by the proper State foster care licensing authority. (42 U.S.C. 671(a)(10); 42 U.S.C. 672(c))

In addition, 42 U.S.C., Section 671(a)(7) pertaining to the state agency responsibilities states in part:

. . . the State agency will monitor and conduct periodic evaluations of activities carried out under this part. . . .

Furthermore, DPW Foster Care licensing process procedures Section III.C., Step 1, require that inspections be scheduled so that they can be completed and the license issued prior to the expiration date of the existing Certificate of Compliance.

Cause: OCYF personnel stated that the above Foster Care agencies could not be inspected prior to the expiration of the prior license term due to a shortage of staff. OCYF personnel also indicated that they have hired additional staff, which is enabling them to get caught up on any overdue licenses, which in turn should allow them to ensure that all Foster Care agencies are inspected prior to the expiration of the prior license.

Effect: Since DPW OCYF did not renew licenses for two of the 14 (or 14 percent) Foster Care agencies reviewed prior to the expiration of their current license, DPW did not comply with federal regulations and county agencies could be operating that are not in compliance with federal regulations.

Recommendation: DPW OCYF should follow their established procedures to ensure timely license renewal of Foster Care agencies.

Agency Response: OCYF personnel stated that the above Foster Care agencies could not be inspected prior to the expiration of the prior license term due to a shortage of staff. OCYF personnel also indicated that they have hired additional staff, which is enabling them to get caught up on any overdue licenses that, which in turn should allow them to ensure that all Foster Care agencies are inspected prior to the expiration of the prior license.

Finding 01 – 18: (continued)

Auditors' Conclusion: The finding and recommendation remain as stated above.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 19:

CFDA #17.246 and 17.250 – Job Training Partnership Act Cluster
CFDA #17.253 – Welfare-to-Work Grants to States
CFDA #17.255 – Workforce Investment Act

Weaknesses in L&I's Internal Controls Over Subrecipients

Condition: Our review of L&I's oversight of its JTPA Cluster and WIA subrecipients disclosed the following weaknesses in internal controls:

1) L&I did not adhere to its remedial action plan to ensure these subrecipients received annual Single Audits required by OMB Circular A-133 and submitted the reports to the Commonwealth in a timely manner. One of L&I's subrecipients, the Southcentral Employment Corporation or SEC (formerly Susquehanna Employment and Training Consortium or SETCO) did not have a Single Audit performed for four straight years from July 1, 1996 to June 30, 2000, while receiving $4 to $6 million in JTPA/WIA funds each year. L&I's remedial action plan for nonsubmission called for L&I officials to begin taking action in 1998, including notifying the subrecipient that the audit is due immediately and, for continued noncompliance, declaring the subrecipient to be in default and possibly terminating the entity from its programs. However, no action was taken by L&I at that time. By January of 2001, because of L&I's continuing inaction, SEC had not submitted Single Audits for a total of four years. From January of 2001 to January of 2002, all four delinquent Single Audit reports were submitted by SEC to the Commonwealth, ranging from 10 months to 2 ½ years late. We also noted in our prior Commonwealth Single Audits that this subrecipient exhibited the same pattern of refusal to obtain and submit Single Audits to the Commonwealth with little or no L&I follow-up. For nine straight fiscal years, from 1985 to 1994, SEC failed to submit annual Single Audit reports, and the situation was not corrected until December 1995 when nine audit reports were submitted by SEC to L&I, all at the same time with the same fieldwork date.

   We also noted a similar situation for another subrecipient, Northwest PA Training Partnership Consortium (NPTPC), who received $3.1 million in JTPA/WIA funds in the fiscal year ended June 30, 2000. The Single Audit report of NPTPC for this fiscal year was due March 31, 2001 but as of January 2002, the audit report has not yet been submitted and is ten months late. No remedial action has been implemented by L&I during the current year to correct this. Like SEC, we noted in our prior Commonwealth Single Audits that NPTPC exhibited the same pattern of refusal to obtain and submit Single Audits to the Commonwealth with no remedial action by L&I. For five straight years, from 1991 to 1996, NPTPC failed to submit annual Single Audit reports, but continued to receive significant funding from JTPA. The situation was not resolved until 1997 when delinquent reports were submitted by the subrecipient.

2) L&I's subrecipient monitoring procedures were not adequate to ensure that high-risk subrecipients not submitting audit reports were administering JTPA/WIA programs in compliance with federal regulations. Our review of the four Single Audit reports submitted by SEC in 2001 (see above) disclosed major violations of federal regulations by SEC and material weaknesses in internal controls within L&I's programs for all four years audited. Because of the subrecipient's poor record-keeping, federal program records had to be reviewed and amounts had to be reconstructed by an outside accounting firm before financial statements could be prepared and an audit could be performed. The audits disclosed major control weaknesses in accounting and financial reporting (i.e., lack of segregation of duties), and material error rates in participant case file documentation supporting eligibility and training. These audits also disclosed noncompliance with program financial reporting and cash management requirements and questioned costs for unallowable expenditures. It was also disclosed that SEC had not submitted payroll tax withholdings for its employees to the IRS for 1 ½ years.

   As a result of these audit findings, we reviewed L&I's on-site program monitoring of SEC under JTPA/WIA. Our review disclosed that these instances of noncompliance and internal control weaknesses were not identified by L&I during program monitoring. While we recognize that program monitoring may not detect all the issues reported in a Single Audit, we believe that certain discrepancies (e.g., case file documentation, program reporting) should have

Finding 01 – 19: (continued)

been detected during program monitoring and timely L&I follow-up should have been in place to correct them. Instead, L&I waited until the untimely Single Audits were performed. Furthermore, L&I made no changes in their oversight of SEC in response to the subrecipient's refusal to obtain the required Single Audits. There were no enhancements to the scope or frequency of L&I's program monitoring procedures for SEC, and no audits of SEC were scheduled or performed by Commonwealth officials (i.e., by L&I, OB, the LECS Comptroller's Office, or an outside auditor) for the years not being audited. We also noted that there are no enhanced monitoring, auditing, or other oversight procedures currently included in L&I's remedial action plan for nonsubmission of subrecipient Single Audit reports. As a result, JTPA/WIA program funds were being misspent by SEC without proper and timely oversight by L&I.

In addition to the JTPA/WIA programs, we also noted that these weaknesses in controls over subrecipients also impact the WTW program administered jointly by L&I and DPW.

Criteria: The Single Audit Act Amendments of 1996 require state and local governments to adhere to the audit provisions of OMB Circular A-133.

OMB Circular A-133, Section ___.320, states the following:

(a) General. The audit shall be completed and . . . submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit. (However, for fiscal years beginning on or before June 30, 1998, the audit shall be completed and . . . submitted within the earlier of 30 days after receipt of the auditor's report(s), or 13 months after the end of the audit period) . . .

OMB Circular A-133, Section ___.400, states the following related to L&I's responsibilities as the pass-through agency:

(d) Pass-through entity responsibilities. A pass-through entity shall perform the following for the federal awards it makes:

(4) Ensure that subrecipients expending $300,000 or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.

(5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.

(6) *Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records.*

To ensure Commonwealth enforcement of OMB A-133 for subrecipient noncompliance with the above audit requirements, Commonwealth Management Directive 325.8, Remedies for Recipient Noncompliance With Audit Requirements, Section 5 related to policy states, in part:

(a) Agencies must develop and implement a progressive series of remedial actions to be taken when recipients exhibit a continued inability or unwillingness to comply with performance, reporting and resolution requirements for audits of Commonwealth-funded programs . . .

(d) The progressive series of remedial actions should be tailored to the unique aspects of each program. . . . Such actions should be implemented in a timely and judicious manner to ensure that those entities who exhibit an inability or unwillingness to comply with the requirements of Circulars A-128 or A-133, and/or Commonwealth policy, rules and regulations relating to audit performance, reporting and resolution are promptly brought into compliance or are properly sanctioned.

Finding 01 – 19: (continued)

Overall timeframes for the implementation of the series of remedial actions should not exceed six months from the date the first remedial action is initiated. At the end of the six-month time period, either the appropriate corrective action should be taken by the subrecipient or the final stage of progressive remedial action should be imposed on the subrecipient.

Cause: Per discussion with L&I personnel, L&I was reluctant to follow the steps in L&I's remedial action plan which were limited only to withholding funding or terminating the contract with SEC since this would deny services to the needy participants in a nine-county area served by SEC. L&I personnel stated that in late 2000, they verbally threatened SEC with the withholding of administrative funding which SEC uses to pay its staff. At that point, SEC submitted an audit report for the FYE June 30, 1997 and then prepared a letter of corrective action (dated March 16, 2001) which outlined when the remaining overdue audit reports would be submitted. L&I took no further action since they believed SEC would make a good faith effort to comply with federal audit submission requirements.

Regarding NPTPC, L&I personnel stated that NPTPC and Erie Area Job Training Partnership Inc. merged during the audit period, and this is causing the issuance of the audit report to be delayed. L&I personnel stated that they were not aware that the audit report was late until OB-BOA, who runs the statewide tracking system for subrecipient audit submission, formally notified them in January 2002. L&I personnel then contacted NPTPC via telephone and requested that the audit be submitted. We noted that, to provide more timely notification during the fiscal year, BOA also sends a quarterly list of audit reports received to each Commonwealth agency subgranting federal funds, including L&I. L&I should have timely reviewed this quarterly listing to track the non-receipt of these particular audits in order to implement a more timely follow-up.

Because L&I's written remedial action plan includes no steps for enhanced Commonwealth oversight of subrecipients not submitting Single Audits, internal controls are weak over these high-risk entities receiving federal funds.

Effect: Since L&I did not obtain and review audit reports from NPTPC and SEC on a timely basis, federal funds under the JTPA Cluster, WIA, and WTW Programs were not being audited in violation of federal regulations. As a result, noncompliance and internal control weaknesses disclosed in SEC audit reports have gone uncorrected for extended periods of time. Since L&I's written remedial action plan includes no steps for enhanced Commonwealth oversight (in program monitoring or auditing activities) of subrecipients not submitting Single Audits, L&I is not monitoring these subrecipients in a timely and reasonable manner.

Recommendation: We recommend that L&I amend its written remedial action plan to include timely and enhanced oversight of subrecipients not submitting Single Audits. Such oversight procedures should include increasing the scope and/or frequency of program monitoring and the possibility of performing or scheduling timely independent audits for the years not being audited. We also recommend that L&I adhere to the progressive series of steps and timeframes in its written remedial action plan to help ensure the timely submission of subrecipient audit reports in the future. Increased oversight should be placed on the two entities noted above due to the habitual noncompliance with audit submission requirements. L&I should be prepared to follow through with its written remedial action steps for noncompliant subrecipients if necessary.

Agency Response: We concur with the auditors' findings that the monitoring of the Susquehanna Employment and Training Corporation (SETCO) was insufficient during the period July 1, 1997 through June 30, 1999. During this period, the Bureau of Workforce Investment (BWI) had not performed the required fiscal and procurement monitoring. Staff time was dedicated to preparing for the change from the Job Training Partnership Act to the Workforce Investment Act. During this time the number of local areas was reduced from 28 Service Delivery Areas (SDAs) to 23 Workforce Investment Boards (WIB). In those areas that were merged, relationships were not always cordial and required considerable staff time to assist in the mergers. In February 2000, the Bureau reestablished the Technical Assistance Coordination Services unit to monitor and provide technical assistance to the newly formed Workforce Investment Areas. All 23 Workforce Investment Areas were monitored by June 30, 2000.

Finding 01 – 19: (continued)

During this monitoring, it was noted that Southcentral Employment Corporation (SEC), (formerly SETCO), was behind schedule for submitting Single Audit Reports, but the audit firm had staff performing the required audits during our monitor's visits. SEC's Executive Director for Administration was contacted on several occasions regarding the late reports. He informed us that the auditors were engaged and that a report would be forthcoming shortly. Early in 2001, BWI requested a meeting to discuss this situation and the possible withholding of future funding. On March 16, 2001, BWI met with representatives of SEC, including the Chairperson of the Board of Directors, the auditors, and a firm hired by SEC to assist in preparing their books for audit. At that meeting, a Corrective Action Plan was presented with specific deadlines for submission of the required audit reports. These deadlines were being met and corrective action was occurring, until the report due September 15, 2001 for FY 2000 was delayed by the discovery that a report for the Franklin Adams Employment Training Consortium had not been prepared for the period during the consolidation of the three SDAs. The auditor requested that they be allowed to claim a disclaimer for this entity for that period. BWI informed them that the period would have to be included or a separate report issued. They were to include the information but requested an extension for submission until the end of December, which BWI granted. SEC submitted this report on January 25, 2002. It was determined that, since corrective action was occurring, BWI would not implement remedial action by withholding funding to the area. It was felt that this would be detrimental to the constituents of the eight-county consortium. It would disrupt their training schedule and possibly result in the drop out of many of these participants.

As for the recent situation with the Northwest Training Partnership Consortium, the merger of the Northwest Training Partnership Consortium with the Erie Area Job Training Partnership may have caused much of the delay. This was a very contentious situation. Northwest has a different management from the one which had the earlier audit problems. Further, the audit report that was received by the Bureau of Audits in January 2002 for FY 2000 contained no findings, and the Bureau of Audits had been informed by Northwest of the delay.

In order to ensure that we are aware of any delays in future audit reports, BWI, in conjunction with the Department's Bureau of Financial Management, is establishing a log which includes the entity's name and address, the name of the firm performing the audit, the period covered by the audit, the due date of the audit report and the anticipated delivery date to the Bureau of Audits. This will be utilized to ensure timely submission of the reports. Further, the monitoring guide used by BWI staff for onsite field visits has been revised to ask the specific question as to the date the last audit report was submitted and for what period. This will serve as a double check to ensure the submission of audit reports.

Auditors' Conclusion: The agency response did not address any of our recommendations in the finding. Our finding and recommendations remain as stated.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 20:

CFDA # Various – All Major Programs Covered by CMIA

The Commonwealth's Statewide Cash Management System Needs Improvement (A Similar Condition Was Noted in Prior Year Finding #00 – 17)

Condition: The Commonwealth of Pennsylvania has entered into an agreement with the U.S. Treasury Department in order to comply with the provisions of the Cash Management Improvement Act of 1990 (CMIA). In order to fulfill the requirements contained in the Treasury-State Agreement, the Commonwealth has developed policies and procedures contained in Comptroller Operations Directive #540.1 and has developed the CMIA Drawdown System (CDS) which calculates and provides recommended drawdown amounts using the Average Daily Clearance (ADC) method.

As provided by the Treasury-State Agreement, all checks associated with all voucher transmittals (VTs) for CMIA-covered programs were utilized for the period of February 1, 1999 through May 31, 1999 to determine the ADC check clearance pattern implemented on April 13, 2000. The clearance time of each check in the study was dollar-weighted to produce the dollar-weighted average day of clearance from the time the VT was posted to ICS (the Commonwealth's general ledger) until the checks associated with the VT cleared the state bank account. We tested the propriety of the Commonwealth's check clearance patterns during the prior Single Audit for SFYE June 30, 2000, and disclosed the following deficiencies with the Commonwealth's check clearance studies which remain unresolved for the SFYE June 30, 2001:

- The Commonwealth does not reconcile expenditure totals from the check clearance study (BFM Report 833) to the ICS general ledger to ensure the accuracy and completeness of data used in the ADC study.

  Further, as noted in previous Single Audits, each VT can only be captured in the study under one appropriation, regardless of how many appropriations are present on the VT. Since some appropriations are used for more than one program, but are assigned to only one program for the ADC study, some programs could have significantly less or significantly more expenditures in the study than were actually incurred.

- The ICS posting dates per the February 1, 1999 through May 31, 1999 clearance study did not always agree to the actual ICS general ledger posting dates.

  As a result, the prior-year material weakness regarding incorrect posting dates for the study caused material noncompliance with CMIA during SFYE June 30, 2001 since the Commonwealth is still using ADC patterns established from the February 1, 1999 through May 31, 1999 clearance study.

- A disproportionate amount of payroll cost was included in the clearance study for CFDA #20.205, Highway Planning and Construction (HPC). We believe this occurred due to the fact that appropriations other than HPC related appropriations were included on the payroll VTs included in the HPC study.

Criteria: 31 CFR 205.8 provides the following regarding clearance patterns:

(a) Use and basis of development. When required by a funding technique, a clearance pattern will be used to schedule the transfer of funds to a State and to support the calculation of interest. A State may:

(1) Develop a separate clearance pattern for an individual program; or

(2) Develop a composite clearance pattern for a logical group of programs that have the same disbursement method and that reasonably can be expected to have comparable clearance activity. A composite clearance pattern for a group of programs must be applied separately to each program in the group when scheduling funds transfers or calculating interest;

Finding 01 – 20: (continued)

(b) *Standards for clearance patterns. A State shall ensure that a clearance pattern accurately represents the flow of Federal funds and that a clearance pattern reflects seasonal or other periodic variations in clearance activity. A State shall ensure that a clearance pattern is auditable.*

Cause: Regarding the accuracy and completeness of the data used in the ADC study, BFM personnel stated that the current system in place to calculate the ADC can only sort expenditures by appropriation. Therefore, each voucher transmittal can only be included in the study under one appropriation, regardless of how many appropriations are included on the voucher. Since some appropriations are used for more than one program, in these instances, the appropriation must be assigned to one program for ADC purposes.

For the differences noted between the actual ICS post date and the post date per the ADC study, we found that the date used for the ADC study was the date on which magnetic tapes were forwarded to Treasury for payment, not the date the expenditures were actually posted to ICS. As in prior years, the Commonwealth has no controls in place to make sure the correct ICS post date is included on these magnetic tapes and incorporated into the check clearance study.

With respect to the payroll costs for the HPC program included in the clearance study, BFM stated no changes were made from prior years to change the study to ensure the appropriate amount of payroll was included in the study.

Effect: As a result of the weaknesses noted, the Commonwealth is not in compliance with the regulations and procedures for clearance pattern requirements in 31 CFR 205. We consider this noncompliance to be material to all major programs subject to CMIA.

In addition, the Commonwealth is receiving federal funds earlier than they should for the HPC program at PADOT. Because of the overall pervasiveness of the check clearance discrepancies involving incorrect posting dates, we cannot determine the overall impact of these weaknesses on major program check clearance patterns.

Recommendation: For future audit periods, we recommend BFM personnel implement a system to ensure the clearance patterns developed accurately represent the flow of federal funds as required by 31 CFR 205.8(b).

In addition, BFM personnel should determine the additional amount of interest due to the federal government as a result of all of the above noted discrepancies for all CMIA-covered programs and report and remit this additional interest liability to the U.S. Treasury.

Agency Response: The following is the Office of the Budget's agency response:

- Because CFDA numbers are not on VTs or checks, we must identify the VTs paid from appropriations that are linked to a CFDA number. Therefore, the Treasury Department can link only one appropriation to one VT because the checks cleared are not identified to an appropriation.

  Treasury must assign the entire VT to the first appropriation that matches to our appropriation/CFDA list. This process of assigning a VT to only one appropriation when other appropriations on the same VT are posted to the general ledger removes the link between BFM Report 833 and the general ledger, thus making the reconciliation between the two reports unrealistic.

  CMIA regulations require that we do a check clearance study for only three consecutive months. Our February 1, 1999 to May 31, 1999 study involved four consecutive months, which exceeds CMIA requirements. Based on these facts and the system restrictions noted above, a detailed reconciliation to the general ledger does not appear to be justified.

- We have noted the differences between the ADC study posting dates and the actual ICS posting dates. We will review our system changes used in our last ADC study and implement additional system modifications to correct future check clearance studies.

Finding 01 – 20: (continued)

- For payroll in CFDA No. 20.205, the Commonwealth has historically selected appropriations that contain payments to CFDA No. 20.205. In the future, we will continue to ensure that only appropriations pertaining to CFDA No. 20.205 are used in our check clearance study for Highway Planning and Construction. For this reason, it is appropriate that we continue to include payroll costs in our ADC study.

Overall, we believe that our current check clearance study accurately represents the flow of federal funds and exceeds the standards set forth by 31 CFR 205.8 (b).

We are confident that the solution to this finding is the Commonwealth's implementation of an Enterprise Resource Planning that will impact all Commonwealth business functions. The Commonwealth has chosen SAP software and has contracted with KPMG Consulting, LLC to serve as the integrator for this project. Implementation is scheduled to begin in July 2002. Upon completion, this new software should correct the remaining issues in this finding.

Auditors' Conclusion: In order to ensure the accuracy of the population used for the check clearance study, BFM should perform an overall analysis or reconciliation to determine that the total check amounts cleared in the study reasonably agree to amounts recorded on the general ledger and reported to the federal government for each CFDA # in the ADC study. Although certain major programs (e.g., TANF and MA) may get close to 25% coverage in a four-month check clearance study, we noted in our current and prior audits that other major programs would get significantly less coverage (e.g., SSBG). Also, because of the weakness in the Treasury's inability to assign more than one appropriation to each VT, certain expenditures recorded under one CFDA # on the 833 Report were actually made under another CFDA # on ICS. Therefore, we have little assurance that the dollar value covered in the check clearance study as recorded on the 833 Report by major program is correct. We believe BFM should analyze this overall weakness, evaluate its impact on check clearance for the major programs covered by CMIA, and work with the federal government to implement a reasonable solution to this problem for future check clearance studies.

While the differences between the ADC study posting dates and the actual ICS posting dates disclosed in our testing could cause the Commonwealth to receive federal funds later than necessary, our prior audits have shown that ADC study dates could also be after ICS post dates, which would cause the Commonwealth to draw federal funds too early. Consequently, the Commonwealth has no controls in place to ensure the accuracy of post dates and there is a significant internal control weakness in the system used to calculate ADC patterns.

Regarding CFDA #20.205, BFM personnel need to ensure that the amount of payroll costs included in any future ADC studies is proportionate to the amount of payroll claimed for reimbursement under CFDA #20.205 in order to ensure the accuracy of the ADC study. If payroll checks typically clear the bank sooner than non-payroll checks, the Commonwealth could be drawing down HPC funds in violation of CMIA.

Any corrective action for the weaknesses in the finding will be reviewed in our subsequent audit. Therefore, based on the agency response, our finding and recommendation remain as stated above.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

Finding 01 – 21:

CFDA #93.558 – Temporary Assistance for Needy Families
CFDA #93.667 – Social Services Block Grant
CFDA # Various – All Major Programs Covered by CMIA

The CMIA Interest Liability Was Understated By a Minimum of $83,212 (A Similar Condition Was Noted in Prior Year Finding #00 – 18)

Condition: The interest liability on the CMIA Annual Report for SFYE June 30, 2000 which was submitted to the U. S. Treasury during our audit period SFYE June 30, 2001, was understated by a minimum of $83,212 as follows:

- DPW received a refund check totaling $772,264 on February 11, 2000 related to SFYE June 30, 1999 SSBG child care overpayments which were erroneously posted to a state appropriation (#170) via document RE 97010949. However, the posting error was not corrected and, therefore, the funds were not returned to the federal government until June 19, 2000, or 128 days after the original posting to the Commonwealth's account. Our review of the CDS-301 Report disclosed that the Commonwealth only paid interest of $1,261 for 11 days instead of the 128 days the cash was actually on hand (February 11 – June 19, 2000). As a result, the state's interest liability was understated by $13,417.

- DPW paid interest of $7,670 on 20 days excess cash of $2,582,557 in TANF funds which posted to CDS on June 27, 2000 (via document #AM96501817) and which were returned to HHS on July 17, 2000. Our review of #AM96501817 disclosed that these funds were applicable to interagency Memorandum of Understanding (MOU) #ME987781134 between DPW and L&I for the period July 1, 1998 to June 30, 1999. Since DPW's final drawdown of TANF funds from HHS (totaling $4,770,777) for this MOU was received on December 28, 1999 (via document RTRR98037835), the $2,582,557 June 27, 2000 cash balance existed at least as far back as December 28, 1999. Therefore, interest on the balance should have been reported for an additional 182 days, and the CMIA interest liability for TANF was understated by $69,795. Further, since L&I was not properly invoicing TANF costs to DPW under this MOU, there may have been cash balances prior to December 28, 1999 under this MOU for which an interest liability was not calculated by the Commonwealth and reported as required.

In addition, the following weaknesses, the interest effect of which we could not determine, were noted in prior years and remain unresolved pertaining to the CMIA interest calculation:

- CDS only identifies refund transactions with an R transaction code, such as an RE or RC transaction (Refund of Expenditure or Refund Correction), as interest generating and is not programmed to calculate interest on refund transactions processed with Expenditure Adjustments (EA), Correction Vouchers (CV), or similar documents. As a result, excess cash on hand can result due to the rejection of VTs by the PA Department of Treasury since CVs are posted to ICS to cancel rejected VTs. Therefore, as a result of the use of CVs or EAs to refund cash on hand, interest due to the federal government for such transactions is not recorded by CDS. While the Commonwealth has improved its system by modifying CDS to record CVs and EAs immediately and not subject them to a draw delay, Comptroller Office personnel are not consistent in posting CVs and EAs to the Commonwealth accounting system, so unrecognized interest liabilities still occur.

- Funds posted to Federal Revenue Collected in Advance accounts are not included in the CMIA interest calculation because CDS does not recognize these federal revenues in excess of federal expenditures as interest generating transactions. Therefore, an interest liability is not assessed by CDS, and the Commonwealth interest liability may be understated as a result.

Finding 01 – 21: (continued)

Criteria: 31 CFR 205.11, pertaining to federal interest liabilities, states:

(a) General. The Federal Government will incur an interest liability to a State if the State pays out its own funds for program purposes with valid obligational authority under Federal law, Federal regulation, or Federal-State Agreement. A Federal interest liability will accrue from the day a State pays out its own funds for program purposes to the day Federal funds are credited to a State account.

31 CFR 205.12 states the following pertaining to state interest liabilities:

(a) General. A State will incur an interest liability to the Federal Government if Federal funds are in a State account prior to the day the State pays out funds for program purposes. A State interest liability will accrue from the day Federal funds are credited to a State account to the day the State pays out the Federal funds for program purposes.

(b) Refunds. A State will incur an interest liability to the Federal Government on a refund transaction of Federal funds. A State interest liability will accrue from the day the refund is credited to a State account to the day the refund is either paid out for program purposes or credited to a Federal Government account.

31 CFR 205.17(l) states the following regarding compliance and oversight:

(1) Failure to request funds. If a State repeatedly or deliberately fails to request funds in accordance with the procedures established for its funding techniques, as set forth in section 205.7 or in a Treasury - State Agreement, the FMS may deny the State payment or credit for any resultant Federal interest liability, notwithstanding any other provision or this part.

Further, 31 CFR 205.15 related to the Annual Report states:

(a) A State shall submit an Annual Report to the FMS by December 31 accounting for the interest liabilities of the State's most recently completed fiscal year. The format of the Annual Report will be prescribed by the FMS and will include, at a minimum, the following:

(d) An authorized State official shall certify the accuracy of a State's Annual Report.

The Commonwealth's CMIA Agreement with the U.S. Treasury Department Section 6.1.4 states:

With several programs subject to the Act, the primary Commonwealth agency administering a program will subgrant portions of the program to secondary Commonwealth agencies. As costs in support of the program are incurred, the secondary agency charges the primary agency, which in turn draws down Federal funds.

In all such cases, the secondary agency shall charge the primary agency no earlier than the day transactions post to the accounts of the secondary agency. The procedures governing the request for funds from the primary agency, and the payment of such requests, shall be in accordance with the agreement between the primary and secondary agencies.

The agreement between DPW (primary agency) and L&I (secondary agency) for ME987781134 under Accounting and Fiscal Monitoring clause d. requires L&I and its Comptroller Office to:

Invoice the Department of Public Welfare on a monthly basis for Federal funds expended.

Finding 01 – 21: (continued)

<u>Cause</u>: Regarding the posting of refunds, CVs, EAs, and other adjustments causing unrecognized interest liabilities, BFM personnel have indicated that the implementation of a new accounting system using SAP software during SFYE June 30, 2003 will correct this issue. Also, the issue of Treasury rejecting VTs is outside the control of BFM and is an inherent limitation within the CDS system because the draw delay is based on ICS general ledger postings and not check issuance. Therefore, when Treasury cancels a VT, excess cash will always result under the current system; however, management has indicated that this should be corrected with the implementation of the SAP software during SFYE June 30, 2003.

For other items addressed in the condition relating to weaknesses in the CMIA interest calculation, Commonwealth personnel indicated they either did not agree that the transactions created an interest liability or the transactions arose outside of CDS and were not considered when preparing the Annual Report of CMIA interest liabilities.

<u>Effect</u>: As a result of the weaknesses and errors noted above, the Commonwealth is not in compliance with regulations for the interest calculation in the Annual Report as stated in 31 CFR 205. Therefore, we cannot ensure that the state and federal interest liability amounts reported on the CMIA Annual Report for SFYE June 30, 2000, are accurate. Further, our testing disclosed a minimum of $83,212 in understatements to the state interest liability to the federal government.

Also, various transactions that create interest liabilities, such as adjustment transactions (i.e., EA, CV, etc.), cancelled VTs, transactions incurred under interagency MOUs, and revenue collected in advance are not recognized by CDS as interest-generating transactions. Since manual adjustments are not made to compensate for this system weakness, the Commonwealth's CMIA interest calculation is inaccurate by an undetermined amount.

<u>Recommendation</u>: We recommend the Commonwealth repay the interest liability to the federal government and follow CMIA policy and regulations when determining which transactions should incur federal interest liabilities.

In addition, we recommend that BFM modify the CDS system or have Comptroller personnel review possible interest generating transactions occurring outside of CDS so that all transactions that generate interest are accurately included in the interest calculation.

Further, we recommend that BFM calculate any additional interest due to the U. S. Treasury as a result of the system weaknesses disclosed above and repay the amount calculated or pursue appropriate settlement with FMS.

<u>Agency Response</u>:

- The Commonwealth agrees with the first item under condition. We will adjust our next Annual Report for the $13,417 understatement of interest liability for CFDA 93.667. This interest was caused by an unintentional coding error. We feel that the number, frequency and dollar amount of these types of errors is extremely low. It does not justify a system modification or policy change.

- The Commonwealth did not draw down federal funds in advance. The funds drawn down on December 28, 1999 were paid out for valid program purposes as certified by the general invoice. However, when the Memorandum of Understanding (MOU) between DPW and L&I was settled, it was determined that federal funds needed to be returned in order to meet the MOU's state fund matching requirements. This was accomplished via Adjustment Memorandum and subsequently the federal funds were returned through the draw down system.

  In accordance with 31 CFR 205.12, (b) Refunds, a State will incur an interest liability to the Federal Government on a refund transaction of Federal funds. A State interest liability will accrue from the day the refund is credited to a State account to the day the refund is either paid out for program purposes or credited to a Federal Government account. The Commonwealth complied with this regulation by paying interest from the date the refund transaction was credited to a Commonwealth account, to the date the refund was paid out for program purposes.

Finding 01 – 21: (continued)

- The number of VTs rejected by the State Treasury is minimal and the effect is further reduced by the State Treasury only rejecting incorrect line item entries. In addition, CDS processes CVs and EAs immediately, thus alleviating this problem.

- The final section of the finding is related to "Federal Revenue Collected in Advance" (RCIA). The Commonwealth does not transfer any "Federal drawdown" to RCIA. Any revenue, which happens to reside in the revenue code entitled "Federal Revenue Collected in Advance," at any point in time, including on June 30, is the result of DPW budgetary considerations and/or fiscal year closing instructions and requirements. If for any reason we have "excess cash," it would be the result of a minus expenditure adjustment or refund of expenditure posting to the ICS Grant Accounting records. Excess funds in these situations would be "returned" as part of the regular daily drawdown process by offsetting the amount against a drawable amount. Any resulting Commonwealth interest liability is already appropriately included in the interest reports.

Auditors' Conclusion: We disagree with the response regarding TANF funds received under the DPW MOU with L&I. L&I overstated the amount of TANF Federal expenditures by $2,582,557 for the period July 1, 1998 to June 30, 1999. The overstatement was not detected by L&I until June 2000, then an adjustment was posted on June 27, 2000 to refund the $2,582,557 to HHS. However, since the Commonwealth maintained the TANF Federal funds in excess of TANF Federal expenditures from December 28, 1999 to June 27, 2000 without recording a transaction to return the funds to HHS, an unrecorded interest liability as noted in the condition above exists.

While modifying CDS to process CVs and EAs immediately should reduce the unreported interest liability due to the State Treasury Department rejecting VTs, the Commonwealth may still receive federal funds from rejected VTs prior to CVs or EAs being posted to CDS. Further, since BFM did not track the number and dollar amount of VTs rejected by the State Treasury Department relating to CMIA covered programs, the unreported interest liability related to this issue cannot be determined, but may be significant.

We disagree with the response on Federal Revenue Collected in Advance (RCIA). OB's statement that amounts in the RCIA account have no CMIA interest impact is not supported by detailed analysis at the major program level. Our program level testing in prior years disclosed that, in certain cases (e.g., Aging Parts B and C programs), refunds are being posted to RCIA throughout the year and are not being included in interest calculations. Also, for large refunds which are transferred to RCIA at year end until the next draw is made, no interest effect is being considered since RCIA accounts are not on CDS. Although the agency response may be correct in that federal drawdowns are not directly posted to RCIA, in many cases, the amounts in these accounts represent federal revenues in excess of federal expenditures on the accounting system, which, according to the Treasury-State Agreement, should be the source of all CMIA interest calculations.

Therefore, we believe that BFM should develop and implement policies and procedures to properly address the CMIA interest impact of RCIA on the accounting system.

For all other issues in the finding, we will evaluate any corrective action in our subsequent audit. Based on the agency response, our finding and recommendation, with the above clarifications, remain as stated above.

The corrective action plan for this finding, if any, has not been reviewed by the auditors. See Corrective Action Plans located elsewhere in this Report.

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Summary Schedule of Prior Audit Findings as of December 31, 2001
Single Audit Findings for Fiscal Year Ended June 30, 1994

	STATE AGENCY / FINDING	*RESPONSIBLE FEDERAL AGENCY*	*COMMENTS*
OFFICE OF THE BUDGET (OB)			
Finding 62	PPR Comptroller Office Did Not Limit Drawdowns to its Immediate Cash Needs	FEMA	Unresolved – OB PPR has implemented procedures to correct the timing of drawdowns. OB is now utilizing executive authorizations instead of the former restricted account to disburse federal disaster funds. OB PPR believes no further corrective action is necessary and awaits a final determination letter from FEMA.
DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT (DCED)			
Finding 26	DCA Contracts Did Not Contain Required Debarred and Suspended Parties Provisions (A Similar Condition Was Noted in Prior Year Finding #31)	HUD	Closed – Over two years have passed since the audit report was issued, HUD is not currently following up on this finding, and a management decision was not issued.
Finding 27	For 1 of 25 Contracts Tested, DCA Made Payments to an Administering Agency Instead of the Contractual Subgrantee (A Similar Condition Was Noted in Prior Year Finding #32)	HUD	Unresolved – DCED spoke to HUD on January 27, 1999. HUD indicated that they would check to see if a response had been prepared. DCED is awaiting a final determination from HUD.
Finding 29	Performance/Evaluation Reports Submitted to HUD Were Not Accurate and Were Not Supported by Adequate Documentation (A Similar Condition Was Noted in Prior Year Finding #33)	HUD	Unresolved – DCED spoke to HUD on January 27, 1999. HUD indicated that they would check to see if a response had been prepared. DCED is awaiting a final determination from HUD.
Finding 93	DCA Should Implement Procedures to Ensure That Subgrantees Are Adequately Monitored (A Similar Condition Was Noted in Prior Year Finding #95)	HHS	Unresolved – DCED has implemented the recommended corrective action and is awaiting a final determination from HHS. No response to date.

Summary Schedule of Prior Audit Findings as of December 31, 2001
Single Audit Findings for Fiscal Year Ended June 30, 1994

	STATE AGENCY / FINDING	RESPONSIBLE FEDERAL AGENCY	COMMENTS
DEPARTMENT OF PUBLIC WELFARE (DPW)			
Finding 103	DPW's Procedures Are Not Adequate to Ensure Subrecipient Cash is Limited to Immediate Needs (A Similar Condition Was Noted in Prior Year Finding #108)	HHS	Unresolved – DPW disagrees with the finding. The current system is necessary for the timely payment to the providers in question. HHS letter of March 21, 1996 requested additional information; however, DPW has not received any other communication on this issue.
Finding 112	DPW Procedures Were Not Adequate With Respect to Monitoring Subgrantees	HHS	Unresolved – DPW disagrees with the finding. Excess cash in the SSBG program is virtually nonexistent. HHS letter of March 21, 1996 requested additional information; however, DPW has not received any other communication on this issue.
DEPARTMENT OF TRANSPORTATION (PADOT)			
Finding 63	Costs Were Incorrectly Accumulated During Preparation of PADOT's Application for Reimbursement of Funds for the Blizzard of 1993 (FEMA 3105-EM-PA) and Severe Winter Weather of 1994 (FEMA 1015-DR-PA) Resulting in Questioned Costs of $2,927	FEMA	Unresolved – PADOT has responded to the discrepancies indicated in the finding. FEMA has closed out the disaster account and all parties have agreed to the amount of federally reimbursable funding. In a letter dated November 7, 2001, FEMA requested additional information on corrective action taken.

Summary Schedule of Prior Audit Findings as of December 31, 2001
Single Audit Findings for Fiscal Year Ended June 30, 1995

	STATE AGENCY / FINDING	*RESPONSIBLE FEDERAL AGENCY*	*COMMENTS*
OFFICE OF THE BUDGET (OB)			
Finding 18	PPR Comptroller Office Has Recorded an Excessive Amount of Revenue Collected in Advance (A Similar Condition Was Noted in Prior Year Finding #24)	USDA	Unresolved – Similar findings in previous years have been resolved. No further corrective action is necessary. OB PPR is awaiting a final determination letter from USDA.
Finding 41	PPR Comptroller Office Did Not Limit Drawdowns to its Immediate Cash Needs (A Similar Condition Was Noted in Prior Year Finding #62)	FEMA	Unresolved – OB PPR has implemented procedures to correct the timing of drawdowns. OB is now utilizing executive authorizations instead of the former restricted account to disburse federal disaster funds. OB PPR believes no further corrective action is necessary and awaits a final determination letter from FEMA.
DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT (DCED)			
Finding 19	DCA Contracts Did Not Contain Required Debarred and Suspended Parties Provisions (A Similar Condition Was Noted in Prior Year Finding #26)	HUD	Closed – Over two years have passed since the audit report was issued, HUD is not currently following up on this finding, and a management decision was not issued.
DEPARTMENT OF EDUCATION (PDE)			
Finding 83	PDE's Procedures Are Not Adequate to Ensure Subrecipient Compliance With Cash Management Standards (A Similar Condition Was Noted in Prior Year Finding #105)	HHS	Unresolved – Effective with FY 1995/96, the working capital payment was reduced to 10 percent of the total contract amount. Interest continued to be collected at the end of the contract period. Quarterly expenditure reports are filed by subgrantees and reviewed by the appropriate PDE fiscal personnel. PDE awaits a response from HHS.
DEPARTMENT OF PUBLIC WELFARE (DPW)			
Finding 77	Unallowable and Undocumented Assistance and Crisis Benefit Payments of $1,035 Are Questioned (A Similar Condition Was Noted in Prior Year Finding #101)	HHS	Unresolved – HHS/ACF letter of September 17, 1999 requires repayment of $1,035 that has been initiated. DPW provided information to HHS on at least two additional occasions; however, no confirmation of closure has been received.

Summary Schedule of Prior Audit Findings as of December 31, 2001
Single Audit Findings for Fiscal Year Ended June 30, 1995

	STATE AGENCY / FINDING	RESPONSIBLE FEDERAL AGENCY	COMMENTS
Finding 79	Internal Control Structure Weakness Exists Over Charging Personnel Costs Resulting in an Undetermined Amount of Salaries and Fringe Benefits up to $475,473 Are Questioned (A Similar Condition Was Noted in Prior Year Finding #100)	HHS	Unresolved – HHS/ACF letter of September 17, 1999 requires repayment of $475,473 that has been initiated. DPW provided information to HHS on at least two additional occasions; however, no confirmation of closure has been received.
Finding 80	DPW Internal Audit Report Discloses Material Weaknesses in the Administration of LIHEAP Resulting in $120,777 in Questioned Costs and $198,446 in Excess Cash on Hand at LIHEAP Vendors (A Similar Condition Was Noted in Prior Year Finding #102)	HHS	Unresolved – The $61,102 due to HHS was repaid prior to issuance of this finding. HHS/ACF letter dated September 17, 1999 requested repayment of the full amount. DPW provided documentation to HHS/ACF in the form of telephone calls, e-mails and letters from September 17 to November 26, 1999. However, no confirmation of closure has been received.
Finding 81	DPW's Procedures Are Not Adequate to Ensure Subrecipient Compliance With Cash Management Standards (A Similar Condition Was Noted in Prior Year Finding #103)	HHS	Unresolved – DPW disagrees with the finding. The current system is necessary for the timely payment to the providers in question. DPW has been in contact with HHS regarding this finding, but no resolution has been reached.
Finding 87	DPW Procedures Were Not Adequate With Respect to Monitoring Subgrantees For Excess Federal Cash (A Similar Condition Was Noted in Prior Year Finding #112)	HHS	Unresolved – DPW agrees with the condition but does not agree with the effect. The nature of the funding makes it improbable that any funding is left at year's end. The programs are administered in a manner as administratively feasible as possible. DPW has been in contact with HHS regarding this finding, but no resolution has been reached.
DEPARTMENT OF TRANSPORTATION (PADOT)			
Finding 40	Costs Were Incorrectly Accumulated During Preparation of DOT's Application For Reimbursement of Funds for the Severe Winter Weather of 1994 (FEMA 1015-DR-PA) Resulting in Questioned Costs of $326 (A Similar Condition Was Noted in Prior Year Finding #63)	FEMA	Unresolved – PADOT has responded to the discrepancies indicated in the finding. FEMA has closed out the disaster account and all parties have agreed to the amount of federally reimbursable funding. In a letter dated November 7, 2001, FEMA requested additional information on corrective action taken.

Summary Schedule of Prior Audit Findings as of December 31, 2001
Single Audit Findings for Fiscal Year Ended June 30, 1996

	STATE AGENCY / FINDING	*RESPONSIBLE FEDERAL AGENCY*	*COMMENTS*
OFFICE OF THE BUDGET (OB)			
Finding 21	PPR Comptroller Office Did Not Comply with CMIA (A Similar Finding Was Noted in Prior Year Finding #38)	EPA	Unresolved – OB PPR implemented procedures to comply with CMIA in October 1995. No further corrective action is necessary. OB PPR has not been contacted by EPA.
DEPARTMENT OF PUBLIC WELFARE (DPW)			
Finding 48	DPW Procedures Were Not Adequate With Respect to Monitoring Subgrantees for Excess Federal Cash (A Similar Condition Was Noted in Prior Year Finding #87)	HHS	Unresolved – DPW agrees in part but believes that the funding is handled in the only way administratively feasible. DPW has contacted HHS regarding this finding; however, no resolution has been reached.
DEPARTMENT OF TRANSPORTATION (PADOT)			
Finding 16	Inadequate Property Management Procedures (A Similar Condition Was Noted in Prior Year Finding #32)	DOT	Unresolved – Since this finding was issued, federal regulations were revised to reduce federal regulatory requirements. PADOT believes it is in compliance with current federal regulations. PADOT will be working with the FHWA in calendar year 2002 to resolve the finding.
Finding 18	Weaknesses in PADOT General Computer Controls (A Similar Condition Was Noted in Prior Year Finding #34)	DOT	Unresolved - A corrective action plan has been implemented. Many of the findings relating to security have been resolved through outsourcing computer room and tape library operations to the Unisys/IBM site at Willow Oak. The lack of adequate security over data files was resolved by June 30, 1999. PADOT estimates completion of the change management system by December 31, 2002.
Finding 19	PADOT District Offices Need Improved Procedures to Ensure Subcontracted Work is Approved in Writing Prior to Commencement of Work	DOT	Unresolved - A corrective action plan has been implemented. The Bureau of Construction & Materials continues to hold labor compliance workshops to inform District personnel of proper procedures.

Summary Schedule of Prior Audit Findings as of December 31, 2001
Single Audit Findings for Fiscal Year Ended June 30, 1996

	STATE AGENCY / FINDING	RESPONSIBLE FEDERAL AGENCY	COMMENTS
Finding 23	PADOT Did Not Properly Report Federal Expenditures on the SEFA for the Flood of 1996 (FEMA 1093-DR-PA)	FEMA	Unresolved – A short-term corrective action plan has been implemented relative to the ID-99 file in MORIS. The long-term measure will involve the implementation of the ERP project over the next several years. PADOT plans to have a disaster recovery manual approved by December 2002. PADOT and FEMA have reached a settlement on the flood of 1996, although the disaster has not been formally closed out. In a letter dated November 7, 2001, FEMA requested additional information on corrective action taken.
Finding 25	An Audit Completed by FEMA Discloses Material Weaknesses in PADOT's System Used to Accumulate and Report Expenditures Eligible for Reimbursement for the Blizzard of 1996 (A Similar Condition Was Noted in Prior Year Finding #40)	FEMA	Unresolved – PADOT has responded to the discrepancies indicated in the finding. FEMA has closed out the disaster account and all parties have agreed to the amount of federally reimbursable funding. In a letter dated November 7, 2001, FEMA requested additional information on corrective action taken.

Summary Schedule of Prior Audit Findings as of December 31, 2001
Single Audit Findings for Fiscal Year Ended June 30, 1997

	STATE AGENCY / FINDING	*RESPONSIBLE FEDERAL AGENCY*	*COMMENTS*
OFFICE OF THE BUDGET (OB)			
Finding 13	The Disaster Assistance Program Did Not Comply With CMIA	FEMA	Unresolved- Corrective action has been taken. Additional explanation provided in a letter to FEMA from PEMA dated June 4, 1999. Requested that PEMA follow-up with FEMA on January 21, 2001. BFM is still awaiting action from FEMA.
Finding 35	The Federal Interest Liability is Overstated by $336,305 on the CMIA Annual Report of Interest Liability Resulting in Interest Due the Federal Government (A Similar Condition Was Noted in Prior Year Finding #63)	HHS	Unresolved – Corrective action has been taken. Additional explanation provided to HHS in a letter dated July 29, 1999. BFM is still awaiting action from HHS.
DEPARTMENT OF EDUCATION (PDE)			
Finding 16	PDE is Not Enforcing Timely Corrective Action	USDE	Unresolved – Thirteen special education advisors have been assigned to assist the Division of Compliance advisors in monitoring subrecipient corrective action. Implementation of the corrective action began March 20, 1998. PDE awaits a program determination letter from USDE.
Finding 17	Internal Control Weakness over PDE's On-Site Monitoring of Subrecipients	USDE	Unresolved – The Bureau of Budget and Fiscal Management and the Bureau of Vocational Technical Education will jointly monitor all outstanding fiscal findings and report monthly to the Division of Perkins Advisory and Approval Services. PDE awaits a program determination letter from USDE.
DEPARTMENT OF LABOR AND INDUSTRY (L&I)			
Finding 8	Internal Control Structure Weakness over the System of Controlling Fixed Assets (A Similar Condition Was Noted in Prior Year Finding #13)	DOL	Unresolved – DOL has not yet contacted the Commonwealth concerning this finding.
Finding 9	Inadequate Follow-Up on the IRS 940 Federal Unemployment Tax Act Tax Information Received From the IRS	DOL	Unresolved – DOL has not yet contacted the Commonwealth concerning this finding.
Finding 10	Overpayment of TRA Benefits Resulted in Questioned Costs of $682 (A Similar Condition Was Noted in Prior Year Finding #14 and #15)	DOL	Unresolved – DOL has not yet contacted the Commonwealth concerning this finding.

Summary Schedule of Prior Audit Findings as of December 31, 2001
Single Audit Findings for Fiscal Year Ended June 30, 1997

	STATE AGENCY / FINDING	RESPONSIBLE FEDERAL AGENCY	COMMENTS
DEPARTMENT OF PUBLIC WELFARE (DPW)			
Finding 18	DPW Did Not Adhere to Contracting and Procurement Requirements Resulting in an Undetermined Amount of Questioned Costs up to $4,727,038 (A Similar Condition Was Noted in Prior Year Finding #32)	USDE	Unresolved – DPW disagrees with this finding. This finding is part of the USDE CAROI process. This program was transferred to L&I as of July 1, 1999. DPW no longer has control over this program.
Finding 26	DPW Procedures Were Not Adequate With Respect to Monitoring Subgrantees for Excess Federal Cash (A Similar Condition Was Noted in Prior Year Finding #48)	HHS	Unresolved – DPW agrees with the condition but not the effect. Administration of SSBG is as efficient as administratively feasible and sufficient controls exist in each program area cited. DPW has been in contact with HHS regarding this finding; however, no resolution has been reached.
Finding 28	DPW Did Not Have Valid Provider Agreements in Effect in Violation of Contracting and Procurement Requirements	HHS	Unresolved – DPW agrees with the finding. The information cited has been corrected. The same finding in subsequent years was resolved by HHS/HCFA e-mail of February 2, 2000; however, no written resolution has been received.
Finding 29	DPW Did Not Adequately Monitor Recipient Complaints and Was Not in Compliance With the Terms of a Managed Care Benefit Consultant Contract	HHS	Unresolved – DPW acknowledges the receipt of the audit of the Benefit Consultant contract and has already implemented improved procedures. The Auditor General audit of the subsequent period was suspended and has not resumed. DPW has not yet been contacted regarding this finding.
DEPARTMENT OF TRANSPORTATION (PADOT)			
Finding 11	Inadequate General Computer Controls (A Similar Condition Was Noted in Prior Year Finding #18)	DOT	Unresolved - A corrective action plan has been implemented. Many of the findings relating to security have been resolved through outsourcing computer room and tape library operations to the Unisys/IBM site at Willow Oak. The lack of adequate security over data files was resolved by June 30, 1999. PADOT estimates completion of the change management system by December 31, 2002.

Summary Schedule of Prior Audit Findings as of December 31, 2001
Single Audit Findings for Fiscal Year Ended June 30, 1997

	STATE AGENCY / FINDING	RESPONSIBLE FEDERAL AGENCY	COMMENTS
Finding 12	Weakness in PADOT Controls Over Davis-Bacon Monitoring	DOT	Unresolved – PADOT has made great strides over the past two years to increase the number of wage rate spot-checks. PADOT visited all 11 district offices and established labor compliance workshops in an effort to meet the requirements of the Davis-Bacon Act. On August 24, 2001, PADOT sent a letter to the FHWA requesting that the finding be closed. The FHWA plans to meet with PADOT in 2002 to discuss any open issues.
Finding 14	PADOT Did Not Properly Report Federal Expenditures on the SEFA For the Floods of 1996 (A Similar Condition Was Noted in Prior Year Finding #23)	FEMA	Unresolved – A short-term corrective action plan has been implemented relative to the ID-99 file in MORIS. The long-term measure will involve the implementation of the ERP project over the next several years. PADOT plans to have a disaster recovery manual approved by December 2002. PADOT and FEMA have reached a settlement on the flood of 1996, although the disaster has not been formally closed out. In a letter dated November 7, 2001, FEMA requested additional information on corrective action taken.
Finding 15	Weaknesses in PADOT's System Used to Accumulate and Report Expenditures for the January Flood of 1996 Resulted in an Undetermined Amount of Questioned Costs (A Similar Condition Was Noted in Prior Year Finding #25)	FEMA	Unresolved – A short-term corrective action plan has been implemented relative to the ID-99 file in MORIS. The long-term measure will involve the implementation of the ERP project over the next several years. PADOT plans to have a disaster recovery manual approved by December 2002. PADOT and FEMA have reached a settlement on the flood of 1996, although the disaster has not been formally closed out. In a letter dated November 7, 2001, FEMA requested additional information on corrective action taken.

Summary Schedule of Prior Audit Findings as of December 31, 2001
Single Audit Findings for Fiscal Year Ended June 30, 1998

STATE AGENCY / FINDING		RESPONSIBLE FEDERAL AGENCY	COMMENTS
OFFICE OF THE BUDGET (OB)			
Finding 18	The Federal Interest Liability Reported on the CMIA Annual Report is Overstated By $1,479,886 (A Similar Condition Was Noted in Prior Year Finding #35)	HHS	Unresolved – Corrective action has been taken. Additional explanation provided to HHS in a letter dated January 11, 2000. BFM is awaiting action from HHS.
DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT (DCED)			
Finding 3	Inaccurate Performance and Evaluation Report Submitted to HUD	HUD	Unresolved – DCED had verbal discussions with HUD. DCED is not going to reconcile the 1998 or 1999 reports but is working to make the 2000 report more accurate. HUD agreed that DCED should spend its time on the current report. The report is an informational report used by HUD to document the value of the program and not used as an audit of funds disbursed.
DEPARTMENT OF LABOR AND INDUSTRY (L&I)			
Finding 4	L&I's On-Site Program Monitoring of SDAs Needs Improvement	DOL	Resolved – Closed as result of DOL final determination letter of March 9, 2001.
Finding 6	Expenditures at the Hiram G. Andrews Center Did Not Comply With OMB Circular A-87 Resulting in $9,297,034 in Questioned Costs (A Similar Condition Was Noted in Prior Year Finding #21)	USDE	Unresolved – Waiting for copy of signed settlement agreement from USDE.
DEPARTMENT OF PUBLIC WELFARE (DPW)			
Finding 2	DPW Did Not Reconcile Food Stamp EBT Transactions Within The Commonwealth's Records to the Daily Reports Provided by the EBT Contractor	USDA	Resolved – Closed per USDA/HHS letter dated October 12, 2001.
Finding 8	DPW Did Not Adhere to Contracting and Procurement Requirements Resulting in an Undetermined Amount of Questioned Costs Up to $5,441,606 (A Similar Condition Was Noted in Prior Year Finding #18)	USDE	Unresolved – This program was transferred to L&I as of July 7, 1999. DPW no longer has control of this program. DPW has not been contacted with regard to this finding.

Summary Schedule of Prior Audit Findings as of December 31, 2001
Single Audit Findings for Fiscal Year Ended June 30, 1998

STATE AGENCY / FINDING		RESPONSIBLE FEDERAL AGENCY	COMMENTS
Finding 12	DPW Procedures Were Not Adequate With Respect to Monitoring Subgrantees for Excess Federal Cash (A Similar Condition Was Noted in Prior Year Finding #26)	HHS	Unresolved – DPW is working with HHS on this finding. No resolution has been reached.
Finding 13	DPW Did Not Have Valid Provider Agreements in Effect in Violation of Contracting and Procurement Requirements (A Similar Condition Was Noted in Prior Year Finding #28)	HHS	Unresolved – DPW disagrees with this finding. Provider agreements are not considered contracts and do not require DPW signatures. Additional information was provided to HHS/HCFA on December 1, 1999. Resolved by HHS/HCFA e-mail of February 2, 2000; however, no written resolution has been received.
DEPARTMENT OF TRANSPORTATION (PADOT)			
Finding 5	Weakness in PADOT Controls Over Davis-Bacon Monitoring (A Similar Condition Was Noted in Prior Year Finding #12)	DOT	Unresolved – PADOT has made great strides over the past two years to increase the number of wage rate spot-checks. PADOT visited all 11 district offices and established labor compliance workshops in an effort to meet the requirements of the Davis-Bacon Act. On August 24, 2001, PADOT sent a letter to the FHWA requesting that the finding be closed. The FHWA plans to meet with PADOT in 2002 to discuss any open issues.

Summary Schedule of Prior Audit Findings as of December 31, 2001
Single Audit Findings for Fiscal Year Ended June 30, 1999

	STATE AGENCY / FINDING	RESPONSIBLE FEDERAL AGENCY	COMMENTS
OFFICE OF ADMINISTRATION (OA)			
Finding 17	Inadequate General Computer Controls (A Similar Condition Was Noted in Prior Year Finding #20)	USDA	Resolved – Closed per USDA/FNS letter of February 28, 2001.
OFFICE OF THE BUDGET (OB)			
Finding 15	The Commonwealth's Statewide Cash Management System Needs Improvement (A Similar Condition Was Noted in Prior Year Finding #19)	USDA	Unresolved – Corrective action has been taken. Additional information provided to USDA in a letter dated May 10, 2001. BFM is awaiting further action from USDA.
Finding 16	The Federal Interest Liability Reported on the CMIA Annual Report is Overstated by $1,791,570 (A Similar Condition Was Noted in Prior Year Finding #18)	HHS	Unresolved - Corrective action has been taken. Additional information provided to HHS in a letter dated August 3, 2000. BFM is awaiting action from HHS.
DEPARTMENT OF ENVIRONMENTAL PROTECTION (DEP)			
Finding 1	DEP Did Not Comply with Contracting and Procurement Requirements and Allowable Cost Principles Resulting in Questioned Costs of $26, 819	DOI	Resolved – Funds were returned to granting agency. Finding closed per DOI letter of July 30, 2001.
Finding 2	Weakness in DEP's System to Allocate Payroll and Benefit Costs Resulting in Noncompliance with Federal Regulations	DOI	Resolved – DEP has agreed to maintain electronic records necessary to document cost distribution calculations. Finding closed per DOI letter of July 30, 2001.
DEPARTMENT OF LABOR AND INDUSTRY (L&I)			
Finding 3	Unallowable Costs Charged to DOL Programs Under the FARS Accounting System Resulting in Questioned Costs of $5,272	DOL	Resolved – Questioned costs waived and finding closed per DOL final determination letter of March 9, 2001.
Finding 4	A TRA Claimant Did Not Make a Bona Fide Application for Training Within the Applicable Time Frame, Resulting in Questioned Costs of $7, 964	DOL	Resolved – Questioned costs waived and finding closed per DOL final determination letter of March 9, 2001.
Finding 5	L&I's On-Site Program Monitoring of Subrecipients Needs Improvement (A Similar Condition Was Noted in Prior Year Finding #4)	DOL	Resolved –Closed per DOL final determination letter of March 9, 2001.

Summary Schedule of Prior Audit Findings as of December 31, 2001
Single Audit Findings for Fiscal Year Ended June 30, 1999

	STATE AGENCY / FINDING	*RESPONSIBLE FEDERAL AGENCY*	*COMMENTS*
INSURANCE DEPARTMENT (INS)			
Finding 11	Weakness in Administration of State Children's Insurance Program Subrecipients	HHS	Unresolved – On July 28, 2000, INS sent a letter to HHS outlining their response to the finding. INS has not yet received a response from HHS.
DEPARTMENT OF PUBLIC WELFARE (DPW)			
Finding 10	DPW Procedures Were Not Adequate With Respect to Monitoring Subgrantees for Excess Federal Cash (A Similar Condition Was Noted in Prior Year Finding #12)	HHS	Unresolved – DPW is working with HHS on this finding. No resolution has been reached. Response was provided to HHS letter of January 3, 2000.
Finding 12	DPW Does Not Ensure Valid Provider Agreements Are Maintained for All MA Providers (A Similar Condition Was Noted in Prior Year Finding #13)	HHS	Unresolved – DPW disagrees with this finding. Provider agreements are not considered contracts and do not require DPW signatures. Additional information was provided to HHS/HCFA on December 1, 1999. Resolved by HHS/HCFA e-mail of February 2, 2000; however, no written resolution has been received.
DEPARTMENT OF TREASURY (TREAS)			
Finding 17	Inadequate General Computer Controls (A Similar Condition Was Noted in Prior Year Finding #20)	USDA	Resolved – Closed per USDA/FNS letter of February 28, 2001.

Summary Schedule of Prior Audit Findings as of December 31, 2001
Single Audit Findings for Fiscal Year Ended June 30, 2000

	STATE AGENCY / FINDING	RESPONSIBLE FEDERAL AGENCY	COMMENTS
OFFICE OF BUDGET (OB)			
Finding 00-6	PADOT Did Not Properly Report Federal Expenditures on the SEFA	FEMA	Unresolved – PADOT and the Comptroller's Office have implemented a corrective action plan established in March 2001. The offices will continue to monitor accounting for federal expenditures to ensure appropriate accounting for future disasters. In a letter dated November 7, 2001, FEMA requested details of the corrective action taken.
Finding 00-17	The Commonwealth's Statewide Cash Management System Needs Improvement (A Similar Condition Was Noted in Prior Year Finding #15)	USDA	Unresolved – Corrective action has been taken. Additional information provided to USDA in a letter dated October 10, 2001. Awaiting implementation of enterprise-wide system for final resolution.
Finding 00-18	The Federal Interest Liability Reported on the CMIA Annual Report is Overstated By $1,326,871 (A Similar Condition Was Noted in Prior Year Finding #16)	HHS	Unresolved – Additional information provided to HHS in a letter dated June 28, 2001. BFM is awaiting action from HHS.
DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT (DCED)			
Finding 00-1	Inaccurate Performance and Evaluation Report Submitted to HUD	HUD	Unresolved – DCED discussed this finding with HUD and has implemented new procedures to correct the problem. HUD agreed with DCED that it was better to work on the current report rather than spend time correcting the old reports. DCED is awaiting final action from HUD.
Finding 00-2	DCED Did Not Perform On-Site Monitoring of Community Housing Development Organization Operating Grants	HUD	Unresolved – DCED believes that it has adequate procedures in place to monitor the operating grants. HUD has not contacted DCED to resolve to this finding.
DEPARTMENT OF ENVIRONMENTAL PROTECTION (DEP)			
Finding 00-3	Weakness in DEP's System to Allocate Payroll and Benefit Costs Resulting in Noncompliance with Federal Regulations (A Similar Condition Was Noted in Prior Year Finding #2)	DOI	Resolved – DEP has agreed to maintain electronic records necessary to document cost distribution calculations. Finding closed per DOI letter of November 30, 2001.

Summary Schedule of Prior Audit Findings as of December 31, 2001
Single Audit Findings for Fiscal Year Ended June 30, 2000

STATE AGENCY / FINDING		RESPONSIBLE FEDERAL AGENCY	COMMENTS
DEPARTMENT OF LABOR AND INDUSTRY (L&I)			
Finding 00-4	Overpayment of TRA Benefits Resulted in Questioned Costs of $1,508 (A Similar Condition Was Noted in Prior Year Finding #4)	DOL	Unresolved – Process to pay was initiated on December 18, 2001. Pay date of check to be January 15, 2002.
Finding 00-7	Internal Control Weaknesses Over Preparation and Submission of the Annual RSA-2 Report (A Similar Condition Was Noted in Prior Year Finding #6)	USDE	Unresolved – OVR is currently in the resolution process with USDE.
Finding 00-8	A Weakness Exists in L&I's Procurement System Related to Debarment and Suspension (A Similar Condition Was Noted in Prior Year Finding #7)	USDE	Unresolved – OVR is currently in the resolution process with USDE.
Finding 00-9	Unallowable Costs Charged to a Job Creation Grant Resulting in $63,203 in Questioned Costs	USDE	Unresolved – OVR is currently in the resolution process with USDE.
INSURANCE DEPARTMENT (INS)			
Finding 00-14	The Department of Insurance Failed to Meet Minimum Maintenance of Effort Requirement by Over $9.6 Million	HHS	Unresolved – CHIP has and will continue to meet the maintenance of effort requirement. This was an issue only for the first two years of the program because of the growth curve. On July 16, 2001, INS sent a letter to HHS outlining their response to the finding. INS has not yet received a response from HHS.
DEPARTMENT OF PUBLIC WELFARE (DPW)			
Finding 00-10	Weakness in DPW's Controls Over Information Reported on ACF-202 TANF Caseload Reduction Report	HHS	Unresolved – DPW is working with the Administration for Children and Families (ACF) on this finding. No resolution has been reached.
Finding 00-11	Inaccurate Reporting on the TANF ACF-198 Data Report (A Similar Condition Was Noted in Prior Year Finding #9)	HHS	Unresolved – DPW is working with the Administration for Children and Families (ACF) on this finding. No resolution has been reached.
Finding 00-12	Lack of Documentation to Support Compliance with Federal Welfare Reform Regulations	HHS	Unresolved – DPW disagrees with this finding. The recipient and caseworker jointly prepare a plan of action using the RESET Guide. After the initial meeting, the recipient must bring the RESET Guide to each of the required follow-up actions.

Summary Schedule of Prior Audit Findings as of December 31, 2001
Single Audit Findings for Fiscal Year Ended June 30, 2000

	STATE AGENCY / FINDING	***RESPONSIBLE FEDERAL AGENCY***	***COMMENTS***
Finding 00-13	Weakness in DPW Monitoring Procedures Results in Over $19 Million in Excess Subgrantee Federal Cash at June 30, 2000 (A Similar Condition Was Noted in Prior Year Finding #10)	HHS	Unresolved – DPW is working with HHS on this finding. No resolution has been reached. DPW provided a response to HHS letter of January 3, 2000.
Finding 00-16	DPW's Subrecipient Audit Resolution Process Needs Improvement (A Similar Condition Was Noted in Prior Year Finding #13)	HHS	Resolved – Closed per HHS/OARCP letter of August 16, 2001.
PENNSYLVANIA EMERGENCY MANAGEMENT AGENCY (PEMA)			
Finding 00-5	Internal Control Weakness Over Preparation and Submission of Progress Reports	FEMA	Resolved – Closed per FEMA letter of November 7, 2001.
PENNSYLVANIA INFRASTRUCTURE INVESTMENT AUTHORITY (PENNVEST)			
Finding 00-15	Material Noncompliance with OMB Circular A-133 Subrecipient Audit Requirements (A Similar Condition Was Noted in Prior Year Finding #14)	EPA	Unresolved – Corrective action has been taken. PENNVEST has obtained the outstanding audit report and is adhering to its remedial action plan. PENNVEST is awaiting final determination from EPA.

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Index to Corrective Action Plans - June 30, 2001
General Purpose Financial Statement Comments

Comment No.	Comment	Impacted State Agency	Comment Page	CAP Page
01-1 **	Improving Financial Reporting – Capital Projects Funds Liabilities (A Similar Condition Was Noted in Prior Year Comment #1)	OB	95	**196**
01-2 **	Improving Financial Reporting – Lottery Fund (A Similar Condition Was Noted in Prior Year Comment #2)	OB	96	**196**
01-3 **	Noncompliance With Pennsylvania Laws Governing Authorized Investments for Participants in the INVEST Program	TREAS	97	**199**
01-4 *	Internal Control Weaknesses in the Physical Inventory at the State Correctional Institution at Graterford	DOC	103	**197**
01-5 **	Lack of Documentation and Internal Control Weaknesses Over Contracting and Procurement (A Similar Condition Was Noted in Prior Year Comment #4)	OA	105	**196**

* - Reportable Condition
** - Material Weakness
CAP - Corrective Action Plan

COMMONWEALTH OF PENNSYLVANIA

Index to Corrective Action Plans - Federal Awards Findings - June 30, 2001

Finding No.	CFDA No.	CFDA Name	Finding Title	Questioned Costs	Impacted State Agency	Finding Page	CAP Page
01-1**	10.551 93.558 93.778	Food Stamps Temporary Assistance for Needy Families Medical Assistance	DPW Did Not Have Adequate Internal Controls at the County Assistance Offices Over Eligibility Determinations		DPW	119	**198**
01-2 **	14.228	Community Development Block Grants/ State's Program	Performance/Evaluation Report Submitted to HUD Was Not Supported by Adequate Documentation (A Similar Condition Was Noted in Prior Year Finding #00-1)		DCED	121	**197**
01-3**	14.228 14.239	Community Development Block Grants/ State's Program HOME Investment Partnerships	Internal Control Weakness Over Information Reported from the Integrated Disbursement and Information System		DCED	123	**197**
01-4 *	14.239	HOME Investment Partnerships	DCED Did Not Perform On-Site Monitoring of Community Housing Development Organization Operating Grants (A Similar Condition Was Noted in Prior Year Finding #00-2)		DCED	125	**197**
01-5 *	15.250	Regulation of Surface Coal Mining	Unallowable Personnel Charges Result in Questioned Costs of $1,220	$1,220	DEP	127	**197**
01-6 *	17.245	Trade Adjustment Assistance – Workers	Overpayment of TRA Benefits Results in Questioned Costs of $264 (A Similar Condition Was Noted in Prior Year Finding #00-4)	$264	L&I	129	**197**
01-7 *	17.245	Trade Adjustment Assistance – Workers	Weakness in L&I's Controls Over Preparation and Submission of the Trade Act Participant Report		L&I	131	**197**
01-8 **	20.205 23.003	Highway Planning & Construction Appalachian Dev. Highway System	Internal Control Weakness Over Expenditure Information Reported on the SEFA		OB	133	**196**
01-9 **	83.548	Hazard Mitigation Grant	PEMA Did Not Properly Report Federal Expenditures on the SEFA		OB	134	**197**

CAP - Corrective Action Plan
*   - Reportable Condition
** - Material Weakness

COMMONWEALTH OF PENNSYLVANIA

Index to Corrective Action Plans - Federal Awards Findings - June 30, 2001

Finding No.	CFDA No.	CFDA Name	Finding Title	Questioned Costs	Impacted State Agency	Finding Page	CAP Page
01-10 *	84.126	Rehabilitation Services - Vocational Rehabilitation Grants to States	A Weakness Exists in L&I's Procurement System Related to Debarment and Suspension (A Similar Condition Was Noted in Prior Year Finding #00-8)		L&I	136	**198**
01-11 *	84.126	Rehabilitation Services – Vocational Rehabilitation Grants to States	Inadequate Documentation to Support $33,276 in Unallowable Personnel Costs	$33,276	L&I	138	**198**
01-12 *	84.126	Rehabilitation Services – Vocational Rehabilitation Grants to States	Weaknesses Exist in L&I's Monitoring of RSBS Subgrantees (A Similar Condition Was Noted in Prior Year Finding #00-9)		L&I	140	**198**
01-13 **	93.558	Temporary Assistance for Needy Families	Lack of Documentation to Support Compliance with Federal Welfare Reform Regulations (A Similar Condition Was Noted in Prior Year Finding #00-12)		DPW	144	**198**
01-14 **	93.558	Temporary Assistance for Needy Families	Inaccurate Reporting on the TANF ACF-199 Data Report (A Similar Condition Was Noted in Prior Year Finding #00-11)		DPW	145	**198**
01-15 **	93.563	Child Support Enforcement	Noncompliance and Internal Control Weakness Over the Process of Responding to Interstate Registry Cases		DPW	150	**198**
01-16 **	93.575 93.596 93.667	Child Care and Development Block Grant Child Care Mandatory and Matching Funds of the Child Care and Development Fund Social Services Block Grant	Weakness in DPW Monitoring Procedures Results in Over $32 Million in Excess Subgrantee Federal Cash at June 30, 2001 (A Similar Condition Was Noted in Prior Year Finding #00-13)		DPW	152	**199**
01-17 *	93.575	Child Care and Development Block Grant	Internal Control Weaknesses and Noncompliance With Federal Earmarking Requirements Result in Questioned Costs of $1,381,114	$1,381,114	DPW	157	**199**

CAP - Corrective Action Plan
* - Reportable Condition
** - Material Weakness

COMMONWEALTH OF PENNSYLVANIA

Index to Corrective Action Plans - Federal Awards Findings - June 30, 2001

Finding No.	CFDA No.	CFDA Name	Finding Title	Questioned Costs	Impacted State Agency	Finding Page	CAP Page
01-18 *	93.658	Foster Care – Title IV-E	DPW Office of Children, Youth and Families Should Renew Licensing of Foster Care Agencies in a More Timely Manner		DPW	159	**199**
01-19 **	17.246 17.250 17.253 17.255	Job Training Partnership Act Cluster Welfare-to-Work Grants to States Workforce Investment Act	Weaknesses in L&I's Internal Controls Over Subrecipients		L&I	161	**198**
01-20 **	Various	All Major Programs Covered by CMIA	The Commonwealth's Statewide Cash Management System Needs Improvement (A Similar Condition Was Noted in Prior Year Finding #00-17)		OB	165	**197**
01-21 *	93.558 93.667 Various	Temporary Assistance for Needy Families Social Services Block Grant All Major Programs Covered by CMIA	The CMIA Interest Liability Was Understated by a Minimum of $83,212 (A Similar Condition Was Noted in Prior Year Finding #00-18)		OB	168	**197**
			Total Questioned Costs	$1,415,874			

CAP - Corrective Action Plan
* - Reportable Condition
** - Material Weakness

OFFICE OF ADMINISTRATION (OA)

Comment 01-5: Lack of Documentation and Internal Control Weaknesses Over Contracting and Procurement (A Similar Condition Was Noted in Prior Year Comment #4)

Summary: The auditors recommended that OA Management change certain processes and procedures to improve monitoring and control of certain contracts. However, the OA believes that except for two minor administrative oversights all other findings were addressed by the OA's prior response to Comment #5.

It should be noted that the statement in the Auditors' Conclusion, "*Comptroller staff was actually prevented from reviewing the ERP software contract during this process*" is not accurate. There was no other vendors' documentation available during the solicitation and selection process because this was a sole source selection of the only contractor that could meet the benchmark system criteria. The Comptrollers Office **did receive** all documentation requested relating to the SAP proposal. The OA has always fully cooperated with the Comptroller's contract review staff and will continue to do so.

OA/OIT Corrective Action Plan to Comment #5: Reference the OA's response to GAAP Comment #5 (dated February 11, 2002) in the body of the finding. **With the exception of the two minor items identified below, OA Management believes no further action is necessary.** Concerning the two minor infractions:

1. Form STD-21, Compliance Review – OA's Management will ensure this form is completed and returned with 15 days after the award of any contract, purchase order, agreement, etc. For the contracts in this audit, this is completed and the OA considers this part of Comment #5 completed.

2. Certificate of Contractor Responsibility - OA's Management will ensure this form is completed timely for future contracts. The OA considers this part of Comment #5 completed.

OFFICE OF THE BUDGET (OB)

Comment 01-1: Improving Financial Reporting – Capital Projects Funds Liabilities (A Similar Condition Was Noted in Prior Year Comment #1)

No further information provided. See agency response in the body of the finding.

Comment 01-2: Improving Financial Reporting – Lottery Fund (A Similar Condition Was Noted in Prior Year Comment #2)

No further information provided. See agency response in the body of the finding.

Finding 01-8: Internal Control Weakness Over Expenditure Information Reported on the SEFA

Condition: The PADOT Comptroller Office prepares spreadsheets for each program reported on the SEFA. In our testing of these spreadsheets, we noted that clerical errors were made by Comptroller personnel when preparing the summary spreadsheet, resulting in a $24,621,936 net understatement on the SEFA for the HPC cluster. These clerical errors went undetected by Comptroller personnel in their preparation and review procedures for the SEFA.

Specific steps taken to correct the situation: The necessary adjustments to correct the June 30, 2001 SEFA have been forwarded to and processed by the Bureau of Financial Management. An additional review of all Excel spreadsheets and spreadsheet calculations used in the preparation of the SEFA will be implemented for the June 30, 2002 SEFA, and all future SEFAs.

Titles of the officials responsible for corrective action: Transportation Comptroller's Office – Assistant Comptroller for Accounting and Assistant Comptroller for Auditing.

Anticipated completion date: June 30, 2002.

Finding 01-9: PEMA Did Not Properly Report Federal Expenditures on the SEFA

No further information provided. See agency response in the body of the finding.

Finding 01-20: The Commonwealth's Statewide Cash Management System Needs Improvement (A Similar Condition Was Noted in Prior Year Finding #00-17)

No further information provided. See agency response in the body of the finding.

Finding 01-21: The CMIA Interest Liability Was Understated by a Minimum of $83,212 (A Similar Condition Was Noted in Prior Year Finding #00-18)

No further information provided. See agency response in the body of the finding.

DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT (DCED)

Finding 01-2: Performance/Evaluation Report Submitted to HUD Was Not Supported by Adequate Documentation (A Similar Condition Was Noted in Prior Year Finding #00-1)

No further information provided. See agency response in the body of the finding.

Finding 01-3: Internal Control Weakness Over Information Reported from the Integrated Disbursement and Information System

No further information provided. See agency response in the body of the finding.

Finding 01-4: DCED Did Not Perform On-Site Monitoring of Community Housing Development Organization Operating Grants (A Similar Condition Was Noted in Prior Year Finding #00-2)

No further information provided. See agency response in the body of the finding.

DEPARTMENT OF CORRECTIONS (DOC)

Comment 01-4: Internal Control Weaknesses in the Physical Inventory at the State Correctional Institution at Graterford

No further information provided. See agency response in the body of the finding.

DEPARTMENT OF ENVIRONMENTAL PROTECTION (DEP)

Finding 01-5: Unallowable Personnel Charges Result in Questioned Costs of $1,220

No further information provided. See agency response in the body of the finding.

DEPARTMENT OF LABOR AND INDUSTRY (L&I)

Finding 01-6: Overpayment of TRA Benefits Results in Questioned Costs of $264 (A Similar Condition Was Noted in Prior Year Finding #00-4)

No further information provided. See agency response in the body of the finding.

Finding 01-7: Weaknesses in L&I's Controls Over Preparation and Submission of the Trade Act Participant Report

No further information provided. See agency response in the body of the finding.

Finding 01-10: A Weakness Exists in L&I's Procurement System Related to Debarment and Suspension (A Similar Condition Was Noted in Prior Year Finding #00-8)

This audit finding acknowledges that OVR has manual procedures in place to check the List of Parties Excluded From Federal Procurement and Nonprocurement Programs to verify that new vendors are not debarred or suspended by the federal government. The problem is, however, that we currently have no way of physically documenting such a review has occurred. The solution we are proceeding with is to add another field to the computer screen where the vendor information is entered (Supplier Master Display). This field will be labeled **Debar Review** and will require a block have a **Y** placed in it before a new vendor can be accepted into our computerized vendor listing. Entering the Y in the vendor creation screen will automatically result in that date (month and year) being placed in the Supplier Master Display. We will then be able to print that screen as our documentation that a debarment review has been conducted. Our feeling is that this solution will correct the problem. We have spoken to our system analyst about setting this process in place and will be sending him a memo the week of February 11, 2002 requesting this be done. We anticipate this process will be in place and completely operational by the end of February 2002.

Finding 01-11: Inadequate Documentation to Support $33,276 in Unallowable Personnel Costs

No further information provided. See agency response in the body of the finding.

Finding 01-12: Weaknesses Exist in L&I's Monitoring of RSBS Subgrantees (A Similar Condition Was Noted in Prior Year Finding #00-9)

No further information provided. See agency response in the body of the finding.

Finding 01-19: Weaknesses in L&I's Internal Controls Over Subrecipients

No further information provided. See agency response in the body of the finding.

DEPARTMENT OF PUBLIC WELFARE (DPW)

Finding 01-1: DPW Did Not Have Adequate Internal Controls at the County Assistance Offices Over Eligibility Determinations

No further information provided. See agency response in the body of the finding.

Finding 01-13: Lack of Documentation to Support Compliance with Federal Welfare Reform Regulations (A Similar Condition Was Noted in Prior Year Finding #00-12)

The DPW, Office of Income Maintenance, issued Operations Memorandum - OPS020202, dated February 13, 2002, to remind caseworkers of the requirement to file and retain the Participant Guide to Success, PA 1680, as part of the client's case record for a period of three years.

Finding 01-14: Inaccurate Reporting on the TANF ACF-199 Data Report (A Similar Condition Was Noted in Prior Year Finding #00-11)

No further information provided. See agency response in the body of the finding.

Finding 01-15: Noncompliance and Internal Control Weakness Over the Process of Responding to Interstate Registry Cases

No further information provided. See agency response in the body of the finding.

Finding 01-16: Weakness in DPW Monitoring Procedures Results in Over $32 Million in Excess Subgrantee Federal Cash at June 30, 2001 (A Similar Condition Was Noted in Prior Year Finding #00-13)

The DPW continues in its efforts to engage the Department of Health and Human Services in a dialog on the general cash management issue.

Finding 01-17: Internal Control Weaknesses and Noncompliance With Federal Earmarking Requirements Result in Questioned Costs of $1,381,114

No further information provided. See agency response in the body of the finding.

Finding 01-18: DPW Office of Children, Youth and Families Should Renew Licensing of Foster Care Agencies in a More Timely Manner

No further information provided. See agency response in the body of the finding.

DEPARTMENT OF TREASURY (TREAS)

Comment 01-3: Noncompliance With Pennsylvania Laws Governing Authorized Investments for Participants in the INVEST Program

No further information provided. See agency response in the body of the finding.