SINGLE AUDIT REPORT

For Fiscal Year Ended June 30, 2002

Commonwealth of Pennsylvania
Edward G. Rendell, Governor

Prepared By:

Office of the Budget
Michael Masch, 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, 2002

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COMMONWEALTH OF PENNSYLVANIA
GOVERNOR'S OFFICE
HARRISBURG

MICHEAEL J. MASCH
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, 2002. 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 basic financial statements and the supplementary schedule of expenditures of federal awards, and the reports on compliance and internal controls are contained in this document.

BASIC FINANCIAL STATEMENTS

The Commonwealth's basic financial statements are prepared in conformity with generally accepted accounting principles, as prescribed by the Governmental Accounting Standards Board (GASB). For the year ended June 30, 2002, the Commonwealth has newly adopted GASB Statement No. 34, which requires government-wide financial statements and fund financial statements. Management's discussion and analysis, which precedes the financial statements, provides an overview of the Commonwealth's financial position and activities. We are pleased to report that the Commonwealth's Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2001 has received the Government Finance Officers Association's (GFOA's) Certificate of Achievement for Excellence in Financial Reporting. This represents the sixteenth consecutive year the Commonwealth of Pennsylvania has received this award. We are confident that the Commonwealth's CAFR for the fiscal year ended June 30, 2002 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 $16.2 billion of federal expenditures by the Commonwealth during the fiscal year ended June 30, 2002. 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 $16.2 billion expended, 92 percent, or $14.8 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, 2002. Most of the $16.2 billion in federal expenditures occurred in seven state agencies, as reflected in the following table:

AGENCY NAME	FEDERAL EXPENDITURES (in thousands)
Public Welfare	$9,030,732
Labor and Industry	3,551,490
Transportation	1,387,764
Education	1,151,094
Health	277,327
Community and Economic Development	154,058
Insurance	101,016
Subtotal	$15,653,481
Other Agencies	506,507
Grand Total	$16,159,988

FINDINGS AND RECOMMENDATIONS - CURRENT YEAR

The accompanying report for the fiscal year ended June 30, 2002 contains various comments and findings. Comments pertaining to the audit of the Commonwealth's basic financial statements are detailed in the Basic 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, 2002 reflects the current status of prior, unresolved findings and recommendations. A total of 47 findings remain unresolved from single audits for the years ended June 30, 1994 through June 30, 2001.

INDEPENDENT AUDIT

The Commonwealth's June 30, 2002 basic 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, the State System of Higher Education and the Philadelphia Shipyard Development Corporation (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 Federal Audit Clearinghouse for distribution to the appropriate federal agencies.

ACKNOWLEDGMENTS

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

Sincerely,

Michael J. Masch

Michael J. Masch
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, 2001

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.

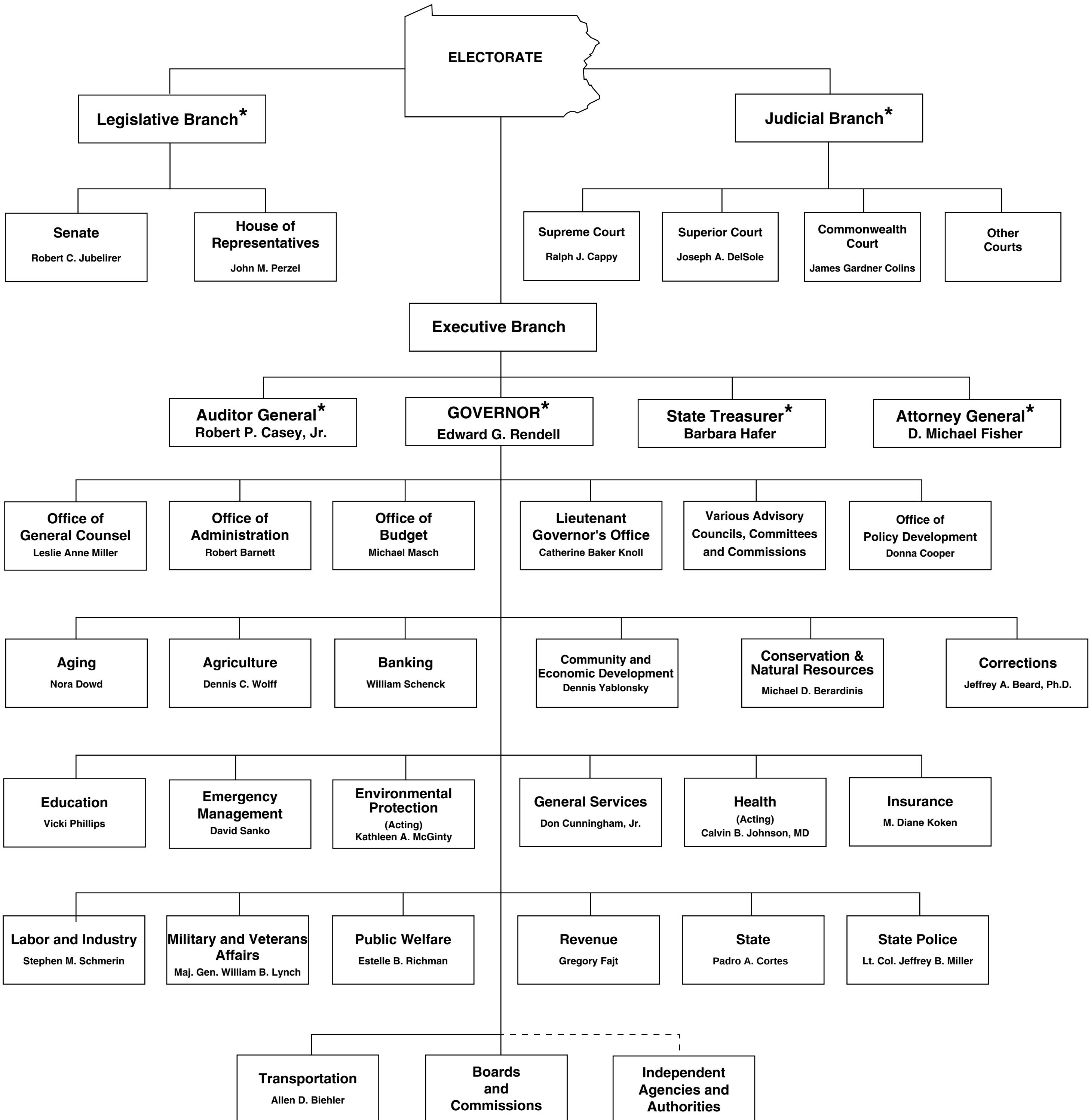
GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA CORPORATION SEAL CHICAGO

President

Executive Director

COMMONWEALTH OF PENNSYLVANIA

ORGANIZATION AND OFFICIALS CHART



* Independently Elected

COMMONWEALTH OF PENNSYLVANIA

Legend of Abbreviations - June 30, 2002

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
APD	Advanced Planning Documents
BCCS	Bureau of Consolidated Computer Services
BCSE	Bureau of Child Support Enforcement
BFD	Bureau of Food Donation
BFM	Bureau of Financial Management
BFS	Basic Financial Statements
BMIS	Bureau of Management Information Systems
BOA	Bureau of Audits
BWI	Bureau of Workforce Investment
CAO	County Assistance Office
CAP	Corrective Action Plan
CAR	Comprehensive Annual Report
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
CV	Correction Voucher
CWSRF	Clean Water State Revolving Fund
DCED	Department of Community and Economic Development
DEP	Department of Environmental Protection
DGS	Department of General Services
DOH	Department of Health
DOI	United States Department of Interior
DOL	United States Department of Labor
DOT	United States Department of Transportation
DPW	Department of Public Welfare
DWSRF	Drinking Water State Revolving Fund
EA	Expenditure Adjustment
EBT	Electronic Benefits Transfer
EPA	Environmental Protection Agency
ERP	Enterprise Resource Planning
FD	Food Donation
FEMA	Federal Emergency Management Agency
FFP	Federal Financial Participation
FFY	Federal Fiscal Year
FHWA	Federal Highway Administration

Legend of Abbreviations - June 30, 2002

ABBREVIATION	DESCRIPTION
FI	Food Instrument
FMS	Financial Management Service
FNS	Food and Nutrition Service
FS	Food Stamps
FY	Fiscal Year
FYE	Fiscal Year Ended
GAAP	Generally Accepted Accounting Principles
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
INS	Department of Insurance
IDIS	Integrated Disbursement and Information System
JTPA	Job Training Partnership Act
LEA	Local Educational Agency
LECS	Labor, Education and Community Services
L&I	Pennsylvania Department of Labor and Industry
MA	Medical Assistance Program
MCH	Maternal and Child Health
MOU	Memorandum of Understanding
NAFTA	North American Free Trade Agreement
OA	Office of Administration
OARCP	Office of Audit Resolution and Cost Policy
OB	Office of the Budget
OCYF	Office of Children Youth and Families
OES	Office of Employment Security
OIG	Office of Inspector General
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
RFI	Redeemed Food Instruments
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
SEFA	Schedule of Expenditures of Federal Awards
SFYE	State Fiscal Year Ended

Legend of Abbreviations - June 30, 2002

ABBREVIATION	DESCRIPTION
SSBG	Social Services Block Grant
SWIF	State Workers' Insurance Fund
TAA	Trade Adjustment Assistance - Workers
TANF	Temporary Assistance for Needy Families
TAPR	Trade Act Participation Report
TRA	Trade Readjustment Assistance
TREAS	Pennsylvania Treasury Department
UI	Unemployment Insurance
USDA	United States Department of Agriculture
USDE	United States Department of Education
VOC ED	Vocational Education
VT	Voucher Transmittal
WIA	Workforce Investment Act
WIC	Women, Infants, and Children
WTW	Welfare to Work

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Financial Section

Commonwealth of Pennsylvania

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

The Honorable Edward G. Rendell, Governor
Commonwealth of Pennsylvania
Harrisburg, Pennsylvania

We have jointly audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Pennsylvania, as of and for the year ended June 30, 2002, which collectively comprise the Commonwealth's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Commonwealth's management. Our responsibility is to express opinions on these financial statements based on our audit.

We did not jointly audit the financial statements of certain component units, which represent 31 percent of total assets and 7 percent of total revenues of the aggregate remaining fund information, 100 percent of the total assets and total revenues of the Pension and Other Employee Benefits Trust Funds, and 99 percent of the assets and 99 percent of the revenues of the aggregate discretely presented component units. We also did not jointly audit the financial statements of two enterprise funds, which represent 1 percent of total assets and 1 percent of total revenues of the aggregate remaining fund information. The financial statements of these component units and enterprise funds were audited by other auditors, including Ernst & Young LLP acting separately, whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those component units and enterprise funds, is based solely on the reports of the other auditors. Ernst & Young LLP has audited separately 6 percent of total assets and 12 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 of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic 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 financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Pennsylvania as of June 30, 2002, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note A to the financial statements, the Commonwealth has implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, "Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments," as of July 1, 2001.

Management's discussion and analysis and budgetary comparison information on pages 5 through 15 and 91 through 99 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report as of and for the year ended June 30, 2002 dated January 17, 2003 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 basic 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 basic 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, the Philadelphia Shipyard Development Corporation, and the State System of Higher Education, component units that were audited in separate OMB Circular A-133 reports required to be 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 basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Robert P. Casey, Jr. Ernst + Young LLP

January 17, 2003

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Management's Discussion and Analysis

Commonwealth of Pennsylvania

Overview and discussion of basic financial statements

For the fiscal year ended June 30, 2002, the Commonwealth of Pennsylvania is presenting "Basic Financial Statements" (BFS) as required by the Governmental Accounting Standards Board's Statement No. 34. BFS replace what were formerly General-Purpose Financial Statements and retain part of what was formerly presented in our financial statements. The Commonwealth's BFS consist of its government-wide and fund financial statements which are supplemented by note disclosures and required supplementary information (such as this Management's Discussion and Analysis). Government-wide statements are being presented for the very first time and will be discussed first.

Government-wide financial statements

Government-wide financial statements portray the Commonwealth's overall financial position at June 30, 2002 and its aggregate revenues and expenses for the fiscal year ended June 30, 2002. Government-wide statements do not report information fund-by-fund (as in General Fund, Motor License Fund, State Lottery Fund, etc.); rather, they reveal information for all governmental activities in a separate column and all business-type activities in a separate column. Governmental activities include those traditionally provided by practically all states: public cash, medical and other assistance, public education, correction and rehabilitation, public works projects, issuing and then retiring general obligation debt, etc. Business-type activities, on the other hand, include activities where individuals and organizations provide resources to the government *in exchange for* a product or service. Typical examples would be customers paying for wine or liquor, parents or others purchasing tuition credits for school-age children or lottery players purchasing instant or other game tickets. In government-wide statements, for both governmental and business-type activities, the economic resources measurement focus and accrual basis of accounting are used, meaning revenues and expenses are recognized when they occur, not when cash is received or paid.

Government-wide statements include a Statement of Net Assets and a Statement of Activities. Whereas the Statement of Net Assets includes an estimate of the total amount of receivables due at June 30, 2002 that are expected to be collected in the future, fund financial statements only include certain receivables collected within 60 days after the fiscal year end. Capital assets, such as highways, bridges, heavy equipment and buildings, are reported on the Statement of Net Assets with acquisition or construction costs being reported when the assets are placed in service. To recognize the cost of using up each capital asset, we report annual depreciation expense over future fiscal years instead of reporting the entire asset cost as a current-year expenditure. In other words, in government-wide statements, we assign a specific portion of capital asset cost (annual depreciation expense) to a specific accounting period, or fiscal year.

The Statement of Net Assets also includes all liabilities regardless of when payment is due. Examples include bond principal payments which may not be due for several years and an employee disability claims liability, much of which will not be payable until years after fiscal year end. Likewise, employee compensated absence liabilities (such as vacation leave) are reported based on the predicted or actual cash payment value at fiscal year-end. In actual practice, however, employees often take accrued leave as "time off work" instead of receiving cash payment.

On the Statement of Activities, both revenues and expenses are reported without considering when the related cash is received or disbursed. The Statement of Activities reports the "whole cost" of operating the entire government during the fiscal year. The reported change in net assets reveals whether the overall financial position improved or deteriorated during the fiscal year, the key word being *overall.* Government-wide statements do not report fund-specific information; rather, they include aggregated information that has been adjusted for specific eliminations and reclassifications. The Statement of Activities is the "whole government," segregated between governmental activities and business-type activities.

Condensed financial statement information – government-wide financial statements

The following condensed financial statement information is derived from the Commonwealth's government-wide June 30, 2002 financial statements and includes amounts for the "primary government" only. The government-wide statements include information for "component units," which are organizations that are legally separate from the Commonwealth's primary government. Information related to component units is not included in Management's Discussion and Analysis. Each component unit is identified and described in Note A to the financial statements. Audited financial statements for component units are available through the Deputy Secretary for Comptroller Operations. The following presents condensed financial statement information from the Statement of Net Assets at June 30, 2002 (amounts in billions):

	Governmental Activities	Business-Type Activities	Total
Assets:			
Cash and investments	$ 8.1	$ 5.1	$ 13.2
Capital assets (net)	18.1	-	18.1
All other assets	4.3	.9	5.2
Total assets	**30.5**	**6.0**	**36.5**
Liabilities:			
Accounts payable	3.0	.4	3.4
All other current liabilities	2.6	.6	3.2
Total current liabilities	**5.6**	**1.0**	**6.6**
Bonds payable	5.6	-	5.6
All other long-term liabilities	2.4	1.5	3.9
Total long-term liabilities	**8.0**	**1.5**	**9.5**
Total liabilities	**13.6**	**2.5**	**16.1**
Net assets:			
Invested in capital assets, net of related debt	14.4	-	14.4
Restricted	1.6	3.5	5.1
Unrestricted	.9	-	.9
Total net assets	**$ 16.9**	**$ 3.5**	**$ 20.4**

The following presents condensed financial statement information from the Statement of Activities for the fiscal year ended June 30, 2002 (amounts in billions):

	Governmental Activities	Business-Type Activities	Total
Revenues:			
Program revenues:			
Charges for sales and services	$ 4.2	$ 5.1	$ 9.3
Operating grants and contributions	13.1	.5	13.6
Capital grants and contributions	.1	-	.1
Total program revenues	**17.4**	**5.6**	**23.0**
General revenues:			
Taxes....	20.7	-	20.7
Total general revenues	**20.7**	**-**	**20.7**
Total revenues	**38.1**	**5.6**	**43.7**
Expenses:			
Governmental activities:			
Direction and supportive services	1.3	-	1.3
Protection of persons and property	3.8	-	3.8
Public education	9.7	-	9.7
Health and human services	18.9	-	18.9
Economic development	1.4	-	1.4
Transportation	2.5	-	2.5
Recreation and cultural enrichment	.5	-	.5
Interest	.3	-	.3
Business-type activities:			
State lottery	-	1.7	1.7
Unemployment	-	2.8	2.8
Liquor control	-	.9	.9
Workmen's compensation	-	.2	.2
Tuition payment	-	.2	.2
Total expenses	**38.4**	**5.8**	**44.2**
Deficiency before special item and transfers	**(.3)**	**(.2)**	**(.5)**
Special item - component unit revenues	.3	-	.3
Transfers	.5	(.5)	-
Increase (decrease) in net assets	.5	(.7)	(.2)
Net assets, July 1, 2001	16.4	4.2	20.6
Net assets, June 30, 2002	**$ 16.9**	**$ 3.5**	**$ 20.4**

Overall analysis and discussion of condensed financial statements

During the fiscal year ended June 30, 2002, the overall financial position (net assets) of the Commonwealth, including both governmental and business-type activities, deteriorated by $.2 billion from $20.6 billion at June 30, 2001 to $20.4 billion at June 30, 2002. This represents less than 1 percent of total beginning net assets. For all governmental activities, the net increase in net assets was $.5 billion or 2.5 percent of beginning net assets of $16.4 billion. Total governmental assets and liabilities were $30.5 billion and $13.6 billion, respectively, at June 30, 2002, leaving total governmental net assets of $16.9 billion. Current accounts payable were $3.0 billion for governmental activities; tax refunds payable were $.6 billion; general obligation bonds outstanding were $6.1 billion. Total investments, not counting the State Employees Retirement Fund or other fiduciary funds, were over $10.6 billion and total cash balances were over $2.6 billion. These amounts represent considerable liquidity for the current and future fiscal years. The $.2 billion decrease in total net assets during the fiscal year demonstrates that the Commonwealth operated on essentially a break-even basis during the fiscal year. Remarkably, the slowing national economy, while causing lower tax revenues than expected, did not lead to a significant deterioration in the overall financial position of the Commonwealth. Total net assets for **governmental activities** actually increased by $.5 billion and total net assets for **business-type activities** decreased by $.7 billion during the fiscal year. Total **governmental activities** revenues were $38.1 billion, more than 99.2 percent of total governmental activities expenses of $38.4 billion. Total governmental activities revenues, special item and transfers exceeded total governmental activities expenses by $.5 billion, the same amount by which governmental activities net assets increased during the fiscal year ended June 30, 2002. On a fund-specific basis, the fund balance for the General Fund decreased by $1.583 billion, fund balance for the Motor License Fund decreased almost $40 million, fund balance for the Tobacco Settlement Fund increased by $935 million and fund balance for aggregated nonmajor funds increased by almost $65 million; on a net basis, total governmental fund balance decreased by almost $622 million during the fiscal year. The Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds and the accompanying reconciliation to the Statement of Activities provide more details about the changes in fund-specific fund balances and details on over $1 billion (net) in reporting differences between governmental fund statements changes in fund balances and governmental activities change in net assets during the fiscal year ended June 30, 2002. The following section also describes some of the differences between fund financial statements and government-wide financial statements. Business-type activities operating revenues were over $239 million less than operating expenses; including net non-operating revenues and transfers, business-type activities net assets decreased by almost $692 million. The primary reason for this decrease was that Unemployment Compensation Fund expenses exceeded revenues by almost $560 million. A $600 million increase in revenues was far less than a $1.1 billion increase in expenses during the fiscal year ended June 30, 2002. We will provide a more in-depth discussion of activities when we begin to issue comparative government-wide statement information for the fiscal year ending June 30, 2003.

Fund financial statements – governmental funds

Governmental fund financial statements provide fund-specific information about the General Fund, the Motor License Fund, and the Tobacco Settlement Fund, which are treated as major funds. Fund statements for governmental funds include an aggregated nonmajor column and continue to report what was formerly reported in governmental funds in the General Purpose Financial Statements, which the Commonwealth had been presenting since the fiscal year ended June 30, 1986. Fund statements differ from government-wide statements in a few fundamental ways. 1) While the government-wide statements focus on the government taken as a whole (including governmental and business type **activities**), the fund statements reveal fund-specific information for **major** governmental and proprietary **funds** and aggregated nonmajor **funds.** 2) Unlike the aggregated columns for governmental and business-type activities (in government-wide statements), individual funds are established by state law and are used to account for specific, mandated activities. Two examples of specific funds are the Motor License Fund, a special revenue fund where gasoline taxes and motor vehicle registration fees are collected and used to repair and build highways, and the Unemployment Compensation Fund, an enterprise fund, used to collect amounts from employers to pay for unemployment compensation to workers. 3) For governmental fund statements, the current financial resources measurement focus is used, along with the modified accrual basis of accounting. This means that balances and transactions are reported as cash is received and paid, plus certain accrued revenues received within 60 days of fiscal year end, minus amounts representing accrued expenditures, which are paid for with currently available revenues. Long-term receivables, for amounts earned or billed but not available at fiscal year end, and capital assets are not reported in the governmental fund financial statements. Nor are long-term liabilities reported. The governmental fund balance sheets report far fewer assets and liabilities than the government-wide Statement of Net Assets. The Statement of Revenues and Expenditures for governmental funds reports only those cash transactions that occurred during the fiscal year or specific cash transactions that occurred within 60 days of fiscal year end. 4) Both governmental and proprietary fund financial statements provide information about cash flows and liquidity. Government-wide financial statements do not provide such information.

Budgetary Comparison Schedules are included as required supplementary information immediately following the Notes to the Financial Statements; they provide a measurement of compliance with legally adopted budgets.

General Fund – economic factors during the fiscal year ended June 30, 2002

The General Fund results reflect the effects of a slowing national economy. The 2001-02 fiscal year General Fund budget was adopted with a revenue estimate that assumed the economic recession that began in March 2001 would end and economic growth would resume for the fiscal year. Real gross domestic product during fiscal year 2001-02 was expected to increase by 2.8 percent on a quarter-to-quarter basis. In line with that expectation for economic growth, the unemployment rate was expected to be around 5 percent and gains in personal income were expected. Although statistics show the national recession ended by the first quarter of the 2001-02 fiscal year, the recovery has been modest compared to past recovery periods. Actual growth of gross domestic product during the 2001-02 fiscal year was 2.1 percent and was concentrated in the first quarter of 2002. That rate of growth was not sufficient to support expected employment and income gains. As a consequence of these trends, receipts for state tax revenues, especially those based on income, fell short of budget estimates. Aggravated further by a declining stock market, personal income tax receipts for the fiscal year actually declined from their previous fiscal year level. Total receipts for personal income tax fell by 4.7 percent from the fiscal year 2000-01 total. Income taxes paid by corporations declined by an even larger percentage, 11.5 percent. The Budgetary Comparison Schedule reveals that actual tax revenue receipts amounted to over $1 billion less than the June 2001 Official Estimate.

General Fund – budgetary basis - comparison between original budget and final budget

The Budgetary Comparison Schedule for the General Fund for the fiscal year ended June 30, 2002 is presented immediately following the Notes to the Financial Statements. Final budgeted revenues for departmental services exceed the original budget by $697 million. This difference resulted primarily from transfers of $340 million in augmenting revenues from the Motor License Fund for State Police protection of Commonwealth highways that were not reflected in the original budget for departmental services revenues and net intergovernmental transfers of $335 million that were not reflected in the original budget for departmental services revenues. The General Fund Schedule also discloses that the final budget included $1.1 billion more expenditures than the original budget. The $1.1 billion increase includes $789 million in state program expenditure increases and $326 million in increased Federal participation related to the specific state program expenditure increases. Of the $789 million state program difference, $337 million (43%) relates to increased spending authority for State Police protection of Commonwealth highways and nearly $400 million (51%) relates to increased spending authority for medical assistance and other human services benefits.

General Fund – budgetary basis - comparison between final budget and actual budgetary results

Actual budgetary results included tax collection revenues, which were lower than the final budgeted revenue estimate (from June 2001) by $1.1 billion. Also, during the fiscal year, budgetary lapses, for a variety of specific appropriations and amounting to $353 million, were posted to reduce state program spending authority. Actual Federal revenues were $933 million lower than budget because of lower Federal participation than original estimates. Actual Federal revenues were lower than budgeted for the following departments: Public Welfare, $292 million; Education, $203 million; Labor and Industry, $95 million; Health, $76 million; Transportation and Executive Offices, $58 million each; Community and Economic Development, $49 million; Environmental Protection, $39 million; and all other affected departments, $63 million.

Measurement focus and basis of accounting – governmental funds

The General Fund, special revenue, debt service and capital projects funds are reported using the current financial resources measurement focus and 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, governmental funds recognize revenue in the year that it becomes susceptible to accrual (both measurable and available) to pay current fiscal year liabilities. Grant revenues, including Federal government grant revenues, are recognized when earned. Revenue recognition from most other sources occurs at receipt. Recognition of expenditures generally occurs 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. Prepaid items and inventory purchases are reported as current fiscal year expenditures, rather than allocating a portion of related cost to the fiscal year when the items are actually 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.

Discussion of individual funds, balances, and transactions

General Fund

At June 30, 2002, the Commonwealth's General Fund reported a fund balance of $2,902.3 million, a decrease of $1,582.7 million from the reported $4,485.0 million fund balance at June 30, 2001. On a net basis, total assets decreased by $490.3 million to $7,692.9 million. Cash and investments decreased due to a decline in tax revenues and receivables increased because of a mandatory change in how taxes receivable are financially reported. Liabilities increased by $1,092.4 million to $4,790.6 million largely because of a mandatory offsetting change in deferred revenues related to how taxes receivable are reported. These changes and others are provided in the General Fund summary comparative balance sheet that follows:

General Fund
Summary Comparative Balance Sheet (Modified Accrual Basis)
(amounts in millions)

	June 30, 2002	June 30, 2001	Increase (Decrease)
Assets:			
Cash and investments	$ 4,088.0	$ 5,761.1	$ (1,673.1)
Receivables, net	2,231.7	1,121.6	1,110.1
Due from other funds/component units/governments	1,373.2	1,300.5	72.7
Total assets	$ 7,692.9	$ 8,183.2	$ (490.3)
Liabilities:			
Accounts payable and tax refunds payable	$ 2,935.0	$ 2,810.3	$ 124.7
Due to other funds/component units/governments	764.3	800.5	(36.2)
Deferred revenue	1,091.3	87.4	1,003.9
Total liabilities	4,790.6	3,698.2	1,092.4
Fund Balance:			
Reserved	795.1	1,881.1	(1,086.0)
Unreserved:			
Designated	623.9	1,079.1	(455.2)
Undesignated	1,483.3	1,524.8	(41.5)
Total fund balance	2,902.3	4,485.0	(1,582.7)
Total liabilities and fund balance	$ 7,692.9	$ 8,183.2	$ (490.3)

As previously mentioned, the slowing national economy led to lower tax revenue collections during the fiscal year ended June 30, 2002. Total tax revenue collections actually declined during the fiscal year, compared to the prior year, and actual tax collections were $1 billion below the final budgeted revenue estimate. Executive controls over budgetary spending helped overcome the tax revenue shortfall during the fiscal year ended June 30, 2002.

The General Fund, the Commonwealth's main operating fund, reported a $1.6 billion decrease in total fund balance during the fiscal year. While a very large number in absolute terms, the General Fund total fund balance decrease includes the transfer of $853.9 million to the new Tobacco Settlement Fund. In addition, on a net basis, the General Fund transferred $461 million to other Funds and provided almost $787 million to component units. Before transfers, the General Fund reported revenues over expenditures of almost $515 million. General Fund unreserved, undesignated fund balance decreased during the fiscal year by $41.5 million. During the fiscal year, total fund balance reservations decreased principally because of legislation closing the former Tax Stabilization Reserve Fund, the fund balance of which was financially reported as a General Fund fund balance reservation at June 30, 2001. On a net basis, fund balance designations declined by $455.2 million because prior year receipts from the Tobacco Master Settlement Agreement and related investment income totaling $851.4 million through June 30, 2001 were previously reported as a General Fund fund balance designation at June 30, 2001; those amounts were transferred to the newly-established Tobacco Settlement Fund during the fiscal year ended June 30, 2002. General Fund fund balance designations increased because of a new $300 million designation for the newly established Budget Stabilization Reserve Fund. Other fund balance designations increased by $96.2 million on a net basis during the fiscal year, principally a $78.7 million increase for group medical and life insurance, an $8.2 million increase for a judicial computer system and a $9.2 million increase for agency construction projects.

Motor License Fund

At June 30, 2002, the Motor License Fund reported total cash and investments of $898.7, a decrease from the prior year balances of $949.2. Total reported assets at June 30, 2002 amounted to $1,271 compared to $1,308 in the prior year. Both decreases, respectively $50.5 and $37, result from expenditures exceeding revenues by $40 during the fiscal year ended June 30, 2002. During the fiscal year the Fund reported total tax revenues of $1,694 and license and fee revenues of $839. Reported Federal revenues, received principally from the Federal Highway Administration, amounted to $1,402 during the fiscal year. The Commonwealth uses tax, license and Federal revenues to maintain and construct highways and bridges in the Commonwealth. At fiscal year-end, total fund balance of the Fund amounted to $712, compared to the prior year's balance of $752 (amounts in millions).

Tobacco Settlement Fund

At June 30, 2002, the Tobacco Settlement Fund reported total investments of $1,053 and total assets of $1,127. The Fund was established during the fiscal year ended June 30, 2002 and reported a transfer from the General Fund of $854. This transfer consisted of previous year receipts from the Tobacco Master Settlement Agreement (MSA) and related investment income, which had been deposited in a separate account in the General Fund. During the fiscal year, the Fund received MSA payments of $434 and reported investment income of $8. During the fiscal year, the Fund reported expenditures of $331. At June 30, 2002, the Fund reported total fund balance of $935, reflecting revenues over expenditures of $185.6, plus the General Fund transfer of $854, less other transfers out of $104.1 (amounts in millions).

Measurement focus and basis of accounting – proprietary funds

The enterprise funds and internal service funds (proprietary funds) are reported using the 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 statement of net assets. Under the accrual basis of accounting, revenues are recognized in the fiscal year earned and expenses are recognized in the fiscal year incurred. Enterprise funds that report loan, insurance and tuition payment programs report all revenues as operating revenues; non-operating revenues are reported for other programs and include investment income and grant revenues. Under the 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. Four enterprise funds are reported as major funds and are discussed below.

Unemployment Compensation Fund

The Unemployment Compensation Fund cash and investments, when compared to the June 30, 2001 balance, decreased by $548 to $2,351 and total assets decreased by $454 to $2,753 as of June 30, 2002. Total revenues for the fiscal year ended June 30, 2002 increased by $617 to $2,260 while total expenses increased by $1,098 to $2,820. Fund net assets at year-end totaled $2,591 – a decrease of almost $560 from June 30, 2001 restated balance of $3,151. Because the Fund, under the new reporting standards, was reclassified from an expendable trust fund to an enterprise fund, related accruals, reclassifications and eliminations produced a change in June 30, 2001 net asset balance of $52.2 (amounts in millions).

During the fiscal year, federal legislation increased the number of weeks Unemployment Compensation claimants could collect benefits. This increase in benefits – Temporary Extended Unemployment Compensation (TEUC) – began in March 2002. This Federal program extended UC benefits to claimants for an additional 13 weeks. If a claimant exhausted the additional benefits during a period of high unemployment, the program made available another 13 weeks of benefits. Additional expenses for the fiscal year related to the TEUC program amounted to $313.2 million.

State Workmen's Insurance Fund

The State Workmen's Insurance Fund cash and investments as of December 31, 2001 amounted to $1,771, an increase of $80 during the year then ended. Total assets of $1,805 represent an increase of $91 during the year. Total revenue of nearly $150 decreased by $50 during the fiscal year ended December 31, 2001. The net revenue decrease was caused by a $90 decrease in investment income and an increase of $40 in premiums collected from subscribing employers. Fund expenses increased by $53 to $175. At December 31, 2001, Fund net assets totaled $246 – a decrease of $25 from the previous year-end (amounts in millions).

State Lottery Fund

At June 30, 2002, the State Lottery Fund reported cash and investments of $354 and total assets of $376 compared to $387 and $408, respectively, at June 30, 2001. During the fiscal year, the Fund reported total revenues of $1,998 and total expenses of $1,683, an increase of $113 and $46, respectively, over the prior fiscal year. The transfer for the payment of benefits to the elderly that the Fund subsidizes amounted to $359, an increase of $69 over the prior fiscal year. Net assets of the Fund at June 30, 2002 amounted to $181, a decrease of $20 from the prior year-end. Because the Fund, under the new reporting standards, was reclassified from a special revenue fund to an enterprise fund, related accruals, reclassifications and eliminations produced a change in June 30, 2001 net asset balance of $.2 (amounts in millions).

Tuition Payment Fund

At June 30, 2002, the Tuition Payment Fund cash and investments, when compared to June 30, 2001 balances, increased by $161 to $411. Total assets increased $160 to $412. During the fiscal year ended June 30, 2002, total revenues increased by $100 to $151 and expenses increased $129 to $191. Fund net assets decreased by $40 during the fiscal year, resulting in total net assets of $(26) at June 30, 2002. Tuition cost inflation and a $6 negative return on investments caused the decline in net assets (amounts in millions).

Capital asset activity during the fiscal year ended June 30, 2002

Throughout the fiscal year, Commonwealth agencies acquire or construct capital assets. In governmental fund statements, expenditures for capital assets are typically reported as capital outlay. Funding for a significant portion of capital asset acquisition is provided by proceeds of general obligation bonds issued; such proceeds are generally accounted for in the capital projects funds in the funds financial statements as an other financing source. In the government-wide statements, bond proceeds are reported as additions to long-term bond liabilities and completed project expenditures and construction in progress at fiscal year end are reported as part of general capital assets. Construction in progress for Department of General Services and Transportation projects at June 30, 2002 amounted to $1.1 and $1.5 billion, respectively. Authorized but unissued general obligation bonds at June 30, 2002 totaled $28.3 billion.

General capital assets of the Commonwealth are those used in the performance of specific governmental functions during more than one fiscal year. Capital assets of the proprietary funds are reported in both fund statements and in government-wide statements. Fiduciary fund capital assets are reported in fund statements; fiduciary funds are not included in government-wide statements. General capital assets as of June 30, 2002 amounted to $18.1 billion at actual or estimated historical cost, net of accumulated depreciation of $7.9 billion. In the government-wide statements, depreciation expense for all capital assets is reported to recognize the cost of " using up" capital assets over their estimated useful lives. This treatment differs from reporting capital outlay as a current year expenditure in governmental funds. Highway and bridge infrastructure assets are typically funded by Motor License Fund taxes, license and registration fees and Federal revenues. The Motor License Fund reports transportation and capital outlay expenditures in fund statements; a portion of such expenditures is reported as additions to capital assets in government-wide statements. Depreciation of highway and bridge infrastructure assets is not related to the quality or relative value of these assets; rather, it is a specific accounting treatment to recognize the cost of "using up" the assets over long periods of time (25 years for highways and 50 years for bridges.) Depreciation is an allocation of an asset's cost over its estimated useful life and is reported in government-wide statements. Note E to the financial statements provides more information on capital asset activities during the fiscal year ended June 30, 2002.

Long-term debt activity during the fiscal year ended June 30, 2002

The constitution of the Commonwealth of Pennsylvania permits the incurrence of debt, without approval of the electorate, for capital projects specifically authorized in a capital budget. Capital project debt outstanding cannot exceed one and three quarters (1.75) times the average of the annual tax revenues deposited in all funds during the previous five fiscal years. The certified constitutional debt limit at August 31, 2002 was $41.4 billion. Outstanding capital project debt at August 31, 2002 amounted to $5.3 billion. In addition to constitutionally authorized capital project debt, the Commonwealth may incur debt for electorate-approved programs, such as economic revitalization, land and water development, and water facilities restoration; and for special purposes approved by the General Assembly, such as disaster relief.

The total general obligation bond indebtedness outstanding at June 30, 2002 was $6,072 million. Total debt service transfers paid from General Fund and Motor License Fund appropriations to make principal and interest payments to bondholders during the fiscal year ended June 30, 2002 amounted to $635 million. The table that follows shows total outstanding long-term indebtedness for general obligation bonds (expressed in millions) at the end of the seven most recent fiscal years.

At June 30	Outstanding Bond Indebtedness
1996	$ 5,062
1997	4,842
1998	4,841
1999	5,254
2000	5,367
2001	5,545
2002	6,072

Note K to the financial statements provides more specific details on long-term debt balances and activity during the fiscal year ended June 30, 2002.

Debt administration – fiscal year ending June 30, 2003

During the fiscal year ending June 30, 2003 the Office of the Budget currently plans general obligation bond issuances amounting to $709 million, a decrease of $646 million as compared to actual bond issuances of $1,355 million during the fiscal year ended June 30, 2002. This plan reflects the need to make investments in the Commonwealth's capital infrastructure, particularly prisons, highways, bridges, mass transportation and water supply systems. Debt principal retirements of $486 million are currently planned for the fiscal year ending June 30, 2003.

In addition to general obligation bonds, the Commonwealth may issue tax anticipation notes to meet operating cash needs during certain months of the fiscal year. Tax anticipation notes may be issued only for the General Fund and the Motor License Fund. They may not exceed 20 percent of the funds' estimated revenues for the year, and must mature during the fiscal year in which they are issued. Cash shortages may occur during the fiscal year because tax receipts, unlike cash disbursements, are concentrated in the last four months of the fiscal year. The Commonwealth has not issued tax anticipation notes during the past four fiscal years and has no plans to issue any during the 2003 fiscal year. There were no changes in credit ratings and there were no debt limitations during the fiscal year ended June 30, 2002 that may affect the Commonwealth's plans during the fiscal year ending June 30, 2003.

Legislative changes during fiscal year 2002-2003

During the fiscal year that began July 1, 2002, the legislature passed several laws that are expected to have an effect on financial position or changes in financial position: Act 130 of 2002 (October 28, 2002) increases the outstanding debt authorization for redevelopment assistance capital projects by $250 million. If all potential new bonds were issued before July 1, 2003, fiscal year 2003-2004 debt service costs could be increased over current estimates by $28 million; Act 217 of 2002 (December 9, 2002) permits additional Keystone Opportunity Zones to receive tax-exemption that could result in $20 million (estimated) of tax relief to businesses in these zones in fiscal year 2003-2004; and Act 212 of 2002 (December 9, 2002) permits a trial opening of certain State Stores on Sundays. Incremental administration costs for those open stores may exceed sales revenue increases. If no sales revenue increase occurs, increased costs could approximate $17 million and reduce amounts available to transfer from the State Stores Fund to the General Fund.

Fiscal year 2002-2003 tax collections

Through December 2002, economic growth in the nation and the Commonwealth has not achieved the projections used to estimate fiscal year 2003 revenues. Consequently, actual General Fund revenues (budgetary basis) for the fiscal year through December 2002 are $184 million below estimate for that period, a shortfall of 2 percent. Most major revenue sources show receipts below estimate for the fiscal year-to-date period. Recent assessments of the national economy now expect slower economic growth rates for the balance of fiscal year 2003 than was used for the fiscal year 2003 revenue estimates. The Commonwealth now anticipates, based on these revised assessments, that General Fund revenues may be $433 million below budget estimates, a 1.2 percent reduction from the official budget estimate for the fiscal year ending June 30, 2003.

Responding to slower than anticipated growth in the national economy and Commonwealth revenues, the Governor has directed that $270 million of fiscal year 2003 General Fund appropriations from Commonwealth revenues be placed in budgetary reserve and be unavailable for encumbrance or expenditure. In addition to placing a portion of appropriated funds into budgetary reserve, the Commonwealth currently estimates that $95 million in various appropriation lapses will also be available to offset revenue shortfalls. Finally, the Governor has proposed that the General Assembly approve the transfer of $50 million from the Budget Stabilization Reserve Fund to the General Fund as a partial offset of revenue shortfalls. The actions proposed by the Governor are intended to permit the Commonwealth to avoid an unappropriated General Fund fund balance deficit for the fiscal year ending June 30, 2003 based on current revised revenue and expenditure projections.

Management's discussion and analysis is intended to enhance the reader's understanding of the basic financial statements, which immediately follow. This supplementary information should be read in conjunction with the government-wide financial statements, the fund financial statements and the notes to financial statements.

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Basic Financial Statements – Government-Wide

Commonwealth of Pennsylvania

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Primary Government			
	Governmental Activities	Business-type Activities	Total	Component Units
ASSETS				
Cash—Note D	$ 224,609	$ 18,879	$ 243,488	$ 263,295
Cash with fiscal agents—Note D	-	2,351,285	2,351,285	-
Temporary investments—Note D	6,418,047	1,234,789	7,652,836	2,152,100
Receivables (net):				
Taxes—Note G	2,304,660	-	2,304,660	-
Unemployment assessments	-	319,254	319,254	-
Accounts	156,464	51,534	207,998	31,827
Accrued interest	22,527	17,286	39,813	102,101
Loans—Note G	50,060	238,253	288,313	7,915,943
Lease rentals—Note G	1,487	-	1,487	17,966
Other	11,385	25	11,410	51,381
Internal balances—Note H	21,057	5,155	26,212	-
Due from fiduciary funds—Note H	845	28	873	-
Due from primary government—Note H	-	-	-	6,738
Due from component units—Note H	33,405	459	33,864	146
Due from Federal government	1,564,319	42,219	1,606,538	8,823
Due from political subdivisions	543	7,000	7,543	5,284
Due from other governments	3,806	16,687	20,493	7,315
Long-term investments—Note D	1,454,519	1,515,948	2,970,467	1,952,426
Advances to other funds—Note H	5,300	-	5,300	-
Inventory	82,151	139,639	221,790	25,019
Prepaid and deferred expenses	-	-	-	49,085
Non-depreciable capital assets—Note E:				
Land	1,210,059	-	1,210,059	152,745
Construction in progress	2,583,411	-	2,583,411	469,308
Depreciable capital assets—Note E:				
Internal service/proprietary capital assets	98,821	88,048	186,869	-
Land improvements	296,019	-	296,019	198,906
Buildings and building improvements	2,946,691	-	2,946,691	2,219,224
Machinery and equipment	538,067	-	538,067	470,002
Library books and other	-	-	-	138,131
Turnpike infrastructure	-	-	-	3,649,109
Highway infrastructure	13,025,900	-	13,025,900	-
Bridge infrastructure	5,369,900	-	5,369,900	-
Waterway infrastructure	9,412	-	9,412	-
Less: accumulated depreciation	(7,948,874)	(57,622)	(8,006,496)	(3,280,492)
Net depreciable capital assets	14,335,936	30,426	14,366,362	3,394,880
Other assets	19,482	4,846	24,328	173,558
TOTAL ASSETS	$ 30,504,072	$ 5,993,712	$ 36,497,784	$ 16,779,940

- The notes to the financial statements are an integral part of this statement. -

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Primary Government			
	Governmental Activities	Business-type Activities	Total	Component Units
LIABILITIES				
Current liabilities:				
Accounts payable and accrued liabilities	$ 2,981,531	$ 446,691	$ 3,428,222	$ 243,528
Tax refunds payable	638,458	-	638,458	-
Securities lending obligations	395,466	505,317	900,783	-
Internal balances—Note H	5,213	23,490	28,703	-
Due to fiduciary funds—Note H	10,015	85	10,100	-
Due to primary government—Note H	-	-	-	31,341
Due to component units—Note H	8,250	-	8,250	146
Due to political subdivisions	674,485	4,954	679,439	-
Due to other governments	77,271	6,543	83,814	6
Interest payable	71,569	-	71,569	119,717
Deferred revenue	70,283	38,569	108,852	43,649
Notes payable—Note J	-	-	-	234,053
Bonds payable—Note K	483,871	-	483,871	18,315
Revenue bonds payable—Note K	-	-	-	164,157
Compensated absence liability—Note K	109,332	11,737	121,069	14,490
Other liabilities	22,225	10,853	33,078	89,283
Total current liabilities	5,547,969	1,048,239	6,596,208	958,685
Noncurrent liabilities:				
Tuition benefits payable—Note F	-	399,091	399,091	-
Deferred revenue	-	-	-	242
Advances from other funds—Note H	-	4,853	4,853	-
Demand revenue bonds payable—Note J	-	-	-	2,061,000
Insurance loss liability—Note F	-	1,032,506	1,032,506	-
Notes payable—Note J	-	-	-	735,978
General obligation bonds payable—Note K	5,650,890	-	5,650,890	-
Bonds payable—Note K	-	-	-	421,345
Revenue bonds payable—Note K	-	-	-	6,242,300
Capital lease/installment purchase obligations—Note K	629,437	-	629,437	106,211
Compensated absence liability—Note K	626,165	23,835	650,000	64,568
Self insurance liabilities—Note M	696,700	10,577	707,277	-
Other liabilities—Note K	480,715	-	480,715	980,699
Total non-current liabilities	8,083,907	1,470,862	9,554,769	10,612,343
TOTAL LIABILITIES	13,631,876	2,519,101	16,150,977	11,571,028
NET ASSETS—Note C				
Invested in capital assets, net of related debt	14,386,992	30,426	14,417,418	1,352,424
Restricted for:				
Transportation	605,606	30,336	635,942	-
Capital projects	3,937	-	3,937	761,457
Debt service	-	-	-	288,141
Unemployment/worker's compensation	141,678	2,836,069	2,977,747	-
Elderly programs	1,434	180,814	182,248	-
Environmental and conservation programs	480,182	-	480,182	-
Other purposes	384,027	422,971	806,998	2,523,272
Unrestricted (deficit)	868,340	(26,005)	842,335	283,618
TOTAL NET ASSETS	$ 16,872,196	$ 3,474,611	$ 20,346,807	$ 5,208,912

- The notes to the financial statements are an integral part of this statement. -

COMMONWEALTH OF PENNSYLVANIA

(Expressed in Thousands)

Functions/Programs	Expenses	Program Revenues: Charges for Sales and Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions	Net (Expense) Revenue and Changes in Net Assets — Primary Government: Governmental Activities	Primary Government: Business-Type Activities	Primary Government: Total	Component Units
Primary government:								
Governmental activities:								
Direction and supportive services	$ 1,262,359	$ 393,856	$ 64,622	$ -	$ (803,881)	$ -	$ (803,881)	$ -
Protection of persons and property	3,758,867	373,329	294,509	25,349	(3,065,680)	-	(3,065,680)	-
Public education	9,679,552	6,043	1,103,848	-	(8,569,661)	-	(8,569,661)	-
Health and human services	18,893,434	2,095,669	9,865,193	-	(6,932,572)	-	(6,932,572)	-
Economic development	1,416,557	145,119	354,817	95,749	(820,872)	-	(820,872)	-
Transportation	2,581,898	956,406	1,417,109	4,404	(203,979)	-	(203,979)	-
Recreation and cultural enrichment	481,948	188,829	22,510	-	(270,609)	-	(270,609)	-
Interest	344,482	-	-	-	(344,482)	-	(344,482)	-
Total governmental activities	38,419,097	4,159,251	13,122,608	125,502	(21,011,736)	-	(21,011,736)	-
Business-type activities:								
State lottery	1,682,675	1,955,820	65,388	-	-	338,533	338,533	-
State workmen's insurance	174,929	149,688	-	-	-	(25,241)	(25,241)	-
Tuition payment	191,188	151,149	-	-	-	(40,039)	(40,039)	-
Unemployment compensation	2,819,878	1,862,530	397,524	-	-	(559,824)	(559,824)	-
Liquor control	907,261	975,300	-	-	-	68,039	68,039	-
Economic development and other	16,820	24,031	642	-	-	7,853	7,853	-
Total business-type activities	5,792,751	5,118,518	463,554	-	-	(210,679)	(210,679)	-
Total primary government	$ 44,211,848	$ 9,277,769	$ 13,586,162	$ 125,502	(21,011,736)	(210,679)	(21,222,415)	-
Component units:								
Total component units	$ 3,290,968	$ 1,818,548	$ 567,295	$ 187,570	-	-	-	(717,555)
General revenues:								
Taxes:								
Personal income					6,713,861	-	6,713,861	-
Sales and use					7,419,373	-	7,419,373	-
Corporation					3,160,714	-	3,160,714	-
Liquid fuels					1,696,418	-	1,696,418	45,512
Other					1,705,258	-	1,705,258	-
Total taxes					20,695,624	-	20,695,624	45,512
Investment income					15,394	-	15,394	-
Other					-	-	-	9,371
Component unit subsidies—Note H					-	-	-	983,448
Total general revenues					20,711,018	-	20,711,018	1,038,331
Special item-revenues from component unit—Note H					256,206	-	256,206	(256,206)
Transfers—Note H					481,022	(481,022)	-	-
Net general revenues, special items and tranfers					21,448,246	(481,022)	20,967,224	782,125
Change in net assets					436,510	(691,701)	(255,191)	64,570
Net assets, July 1, 2001 (restated)—Note B					16,435,686	4,166,312	20,601,998	5,144,342
Net assets, June 30, 2002—Note C					$ 16,872,196	$ 3,474,611	$ 20,346,807	$ 5,208,912

- The notes to the financial statements are an integral part of this statement. -

Basic Financial Statements – Fund Statements

Commonwealth of Pennsylvania

BALANCE SHEET
Governmental Funds *June 30, 2002*

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	General Fund	Motor License Fund	Tobacco Settlement Fund	0 Nonmajor Funds	Total
ASSETS					
Assets:					
Cash—Note D	$ 185,455	$ 37,876	$ -	$ 950	$ 224,281
Temporary investments—Note D	3,308,927	559,559	941,192	1,576,075	6,385,753
Long-term investments—Note D	593,602	301,308	111,891	447,718	1,454,519
Receivables, net:					
Taxes—Note G	2,127,157	149,425	-	28,078	2,304,660
Accounts	79,820	-	32	20,559	100,411
Accrued interest	14,653	1,892	-	5,982	22,527
Loans—Note G	10,097	-	-	39,963	50,060
Lease rentals—Note G	-	-	-	1,487	1,487
Other	-	9,960	-	4	9,964
Due from other funds—Note H	49,109	4,985	-	48,238	102,332
Due from component units—Note H	7,043	2,054	-	21,849	30,946
Due from Federal government	1,281,134	203,222	73,948	3,051	1,561,355
Due from political subdivisions	18	335	-	-	353
Due from other governments	3,806	-	-	-	3,806
Advances to other funds—Note H	29,108	-	-	3,000	32,108
Other assets	3,000	-	-	-	3,000
TOTAL ASSETS	$ 7,692,929	$ 1,270,616	$ 1,127,063	$ 2,196,954	$ 12,287,562
LIABILITIES AND FUND BALANCES					
Liabilities:					
Accounts payable and accrued liabilities	$ 2,038,073	$ 422,763	$ 191,640	$ 304,382	$ 2,956,858
Tax refunds payable	637,524	934	-	-	638,458
Securities lending obligations	255,228	57,916	-	82,322	395,466
Due to other funds—Note H	72,999	40,215	4	20,362	133,580
Due to component units—Note H	134	8,116	-	-	8,250
Due to political subdivisions	655,429	11,435	-	7,621	674,485
Due to other governments	35,726	12,328	-	29,175	77,229
Deferred revenue	1,091,307	2,307	-	31,345	1,124,959
Advances from other funds—Note H	-	2,175	-	10,333	12,508
Other liabilities	4,141	-	-	3,784	7,925
TOTAL LIABILITIES	4,790,561	558,189	191,644	489,324	6,029,718
Fund balances:					
Reserved for:					
Encumbrances	479,314	389,942	25,011	921,274	1,815,541
Advances—Note C	29,111	-	-	3,000	32,111
Loans receivable	-	-	-	39,963	39,963
Other—Note C	286,711	-	355,505	51,524	693,740
Unreserved:					
Designated for:					
Budget Stabilization Reserve Fund	300,000	-	-	-	300,000
Capital projects	-	-	-	79,286	79,286
Debt service:					
Retirement of general obligation bonds	-	-	-	21,887	21,887
Highways	-	175,249	-	-	175,249
Other—Note C	323,884	-	-	12	323,896
Undesignated (deficit)-reported in:					
General Fund	1,483,348	-	-	-	1,483,348
Special Revenue Funds	-	147,236	554,903	1,089,261	1,791,400
Debt Service Funds	-	-	-	(3,782)	(3,782)
Capital Projects Funds	-	-	-	(494,795)	(494,795)
TOTAL FUND BALANCES	2,902,368	712,427	935,419	1,707,630	6,257,844
TOTAL LIABILITIES AND FUND BALANCES	$ 7,692,929	$ 1,270,616	$ 1,127,063	$ 2,196,954	$ 12,287,562

- The notes to the financial statements are an integral part of this statement. -

RECONCILIATION OF THE BALANCE SHEET
GOVERNMENTAL FUNDS TO THE STATEMENT OF NET ASSETS *June 30, 2002*

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

The governmental funds balance sheet reports total fund balance for all governmental funds. In the governmental activities column in the Statement of Net Assets, amounts are reported for all governmental funds and are adjusted to account for specific items that are treated differently on the Statement of Net Assets than on the governmental funds Balance Sheet. Under the modified accrual basis of accounting, numerous governmental assets are not reported because they may not be "available," (that is, they are not current financial resources) and, similarly, numerous governmental liabilities are not reported because they are not due and payable until after fiscal year end. The following reconciliation begins with total governmental funds fund balance and ends with total net assets for governmental activities. It includes all of the adjustments made to "convert" governmental fund information in the fund financial statements to governmental activities information in the Statement of Net Assets.

Total Fund Balances--Governmental Funds		$ 6,257,844
General capital assets used in governmental activities are not financial resources and are therefore not reported in the governmental funds balance sheet. (Refer to Note E.) These assets consist of:		
Land	$ 1,210,059	
Land improvements	296,019	
Buildings and building improvements	2,946,691	
Machinery and equipment	538,067	
Infrastructure	18,405,212	
Construction in progress	2,583,411	
Accumulated depreciation	(7,898,720)	
Net general capital assets		18,080,739
Certain revenues are earned but not available at fiscal year-end and therefore are reported as deferred revenues in the governmental funds balance sheet		1,054,684
Certain receivables are not reported as governmental fund assets because they are not collected during the availability period under the modified accrual basis of accounting		101,597
Internal service funds are proprietary in nature and charge the costs of certain goods and services to governmental funds. Therefore, the assets and liabilities of the internal service funds are included in the Statement of Net Assets as governmental activities		55,706
The Statement of Net Assets includes inventories that are not reported in the governmental funds balance sheet because they are not current financial resources		70,504
Certain general long-term liabilities are not due and payable at fiscal year-end and therefore are not reported in the governmental funds balance sheet. (Refer to Note K.) These liabilities are:		
Bonds payable	$ (6,134,761)	
Accrued bond interest payable	(71,569)	
Capital lease and installment purchase obligations	(629,437)	
Compensated absence liability	(735,497)	
Self-insurance liabilities	(696,700)	
Other liabilities	(480,715)	
Accounts payable	(199)	
		(8,748,878)
Total Net Assets---Governmental Activities		$ 16,872,196

- The notes to the financial statements are an integral part of this statement. -

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	General Fund	Motor License Fund	Tobacco Settlement Fund	Nonmajor Funds	Total
REVENUES:					
Taxes, net of refunds	$ 18,689,373	$ 1,694,421	$ -	$ 292,413	$ 20,676,207
Licenses and fees	201,388	838,525	-	206,319	1,246,232
Intergovernmental	11,652,199	1,402,468	75,829	128,967	13,259,463
Charges for sales and services	2,272,105	62,237	-	201,433	2,535,775
Investment income	14,157	(2,081)	7,565	9,974	29,615
Lease rental principal and interest	-	-	-	334	334
Other	253,009	34,117	433,529	34,237	754,892
TOTAL REVENUES	33,082,231	4,029,687	516,923	873,677	38,502,518
EXPENDITURES:					
Current:					
Direction and supportive services	910,399	48,579	-	9,585	968,563
Protection of persons and property	3,104,079	492,504	90	279,776	3,876,449
Health and human services	18,221,987	-	331,243	437,572	18,990,802
Public education	8,813,198	1,075	-	-	8,814,273
Recreation and cultural enrichment	326,361	1,927	-	151,957	480,245
Economic development	824,830	-	-	420,462	1,245,292
Transportation	315,591	3,369,240	-	318,460	4,003,291
Capital outlay	50,818	46,416	-	596,985	694,219
Debt service:					
Principal retirement	-	-	-	479,395	479,395
Interest and fiscal charges	-	-	-	278,428	278,428
TOTAL EXPENDITURES	32,567,263	3,959,741	331,333	2,972,620	39,830,957
REVENUES OVER (UNDER) EXPENDITURES	514,968	69,946	185,590	(2,098,943)	(1,328,439)
OTHER FINANCING SOURCES (USES):					
Bonds issued	-	-	-	1,042,813	1,042,813
Refunding bonds issued	-	-	-	376,854	376,854
Transfers in—Note H	213,419	3,937	853,938	1,201,120	2,272,414
Transfers out—Note H	(1,528,451)	(86,756)	(96,109)	(80,076)	(1,791,392)
Transfers from component unit—Note H	256,206	-	-	-	256,206
Tranfers to component units—Note H	(1,043,197)	(28,000)	(8,000)	-	(1,079,197)
Payment to refunded bond escrow agent	-	-	-	(376,854)	(376,854)
Capital lease and installment purchase obligations	4,428	1,339	-	-	5,767
NET OTHER FINANCING SOURCES (USES)	(2,097,595)	(109,480)	749,829	2,163,857	706,611
NET CHANGE IN FUND BALANCES	(1,582,627)	(39,534)	935,419	64,914	(621,828)
FUND BALANCES, JULY 1, 2001 (restated)—Note B	4,484,995	751,961	-	1,642,716	6,879,672
FUND BALANCES, JUNE 30, 2002	$ 2,902,368	$ 712,427	$ 935,419	$ 1,707,630	$ 6,257,844

- The notes to the financial statements are an integral part of this statement. -

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES-GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES

For the Fiscal Year Ended June 30, 2002

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

The governmental funds Statement of Revenues, Expenditures and Changes in Fund Balances reports events and activities that affect, on a current financial resources basis, fund balance changes during the fiscal year. The governmental activities column on the government-wide Statement of Activities conveys information on an economic basis. In effect, the government-wide statement demonstrates all expenses and revenues related to the operation of the government for the fiscal year ended June 30, 2002. Expenses such as depreciation and certain claims and judgments and revenues that may not be collected for several months after fiscal-year end are included in the government-wide statement but are not included in the governmental funds statement. This reconciliation reports all economic events during the fiscal year that appear on the government-wide Statement of Activities but are not included in the governmental funds statement.

Net change in total fund balances of governmental funds...		$ (621,828)
Amounts reported for governmental activities in the statement of activities are different because:		
Capital outlays are reported as expenditures in governmental funds; however, in the government-wide statements capital outlays are reported as increases in capital assets (not expenses) and the cost of general capital assets is allocated over their estimated useful lives and reported as depreciation expense. All depreciation is reported as part of functional program expenses. (Refer to Note E) The current amounts were:		
Capital asset acquisitions (net)..	$ 2,415,347	
Depreciation expense...	(727,470)	
Capital lease, installment purchase and related payments.........	42,208	
Net excess of capital asset additions/installment purchase payments over depreciation expense......................................		1,730,085
Bond proceeds provide current financial resources to governmental funds; however, issuing bonds increases general long-term liabilities in the statement of net assets. During the current fiscal year, proceeds were received from:		
General obligation bonds, including a premium of $41,813.....	$ (1,042,813)	
Refunding bonds, including a premium of $22,542................	(376,854)	
Total bond proceeds...		(1,419,667)
Repayment of general long-term liabilities is reported as an expenditure in governmental funds, but the repayment reduces general long-term liabilities in the statement of net assets. During the current fiscal year, these amounts consisted of:		
Bond principal retirement..	$ 479,395	
Payments to the refunded bond escrow agent..........................	376,854	
Total long-term debt repayment...		856,249
Internal service funds charge the costs of certain goods and services to individual funds. The net loss of the internal service funds is reported as part of governmental activities expenses..		(26,007)
Certain tax and other revenues due by fiscal year end will not be collected for several months or years after fiscal year end; they are not considered available revenues in the governmental funds, but they are reported as revenues in the statement of activities.		60,425
Certain governmental fund revenues, expenditures and balances receivable/owed between funds, but within the same expenditure function, are eliminated from the statement of activities		
Revenue due from/transfer from eliminations..........................		2,247,980
Expenditure due to/transfer to eliminations............................		(2,247,980)
Certain additional expenses are reported in the statement of activities because they are due and payable and are funded with future economic resources rather than current available financial resources..		(142,747)
Net change in governmental net assets in the statement of activities........................		$ 436,510

- The notes to the financial statements are an integral part of this statement. -

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Enterprise Funds						
	Unemployment Compensation Fund	State Workmen's Insurance Fund (Dec. 31, 2001)	State Lottery Fund	Tuition Payment Fund	Nonmajor Funds	Total	Internal Service Funds
ASSETS							
Current assets:							
Cash	$ -	$ 3,946	$ 32	$ 1,021	$ 13,880	$ 18,879	$ 328
Cash with fiscal agents—Note D	2,351,285	-	-	-	-	2,351,285	-
Temporary investments—Note D	206	531,850	340,157	142,340	220,236	1,234,789	32,294
Receivables (Net):							
Unemployment assessments	319,254	-	-	-	-	319,254	-
Accounts	17,081	14,333	17,630	12	2,478	51,534	-
Accrued interest	-	14,560	-	1,895	831	17,286	-
Loans—Note G	-	-	-	-	41,450	41,450	-
Other	-	-	13	-	12	25	221
Due from other funds—Note H	2,662	130	-	-	2,363	5,155	821
Due from fiduciary funds	6	-	-	-	22	28	20
Due from component units—Note H	399	-	-	-	60	459	338
Due from Federal government	38,281	-	3,938	-	-	42,219	-
Due from political subdivisions	7,000	-	-	-	-	7,000	190
Due from other governments	16,687	-	-	-	-	16,687	-
Inventory	-	-	-	-	139,639	139,639	11,647
Total current assets	2,752,861	564,819	361,770	145,268	420,971	4,245,689	45,859
Noncurrent assets:							
Long-term investments	-	1,234,730	14,021	267,197	-	1,515,948	-
Receivables (net):							
Loans—Note G	-	-	-	-	196,803	196,803	-
Depreciable capital assets—Note E	-	2,226	423	-	85,399	88,048	98,821
Less: accumulated depreciation	-	(897)	(316)	-	(56,409)	(57,622)	(50,154)
Net depreciable capital assets	-	1,329	107	-	28,990	30,426	48,667
Other assets	-	3,899	-	-	947	4,846	7
Total noncurrent assets	-	1,239,958	14,128	267,197	226,740	1,748,023	48,674
TOTAL ASSETS	2,752,861	1,804,777	375,898	412,465	647,711	5,993,712	94,533
LIABILITIES							
Current liabilities:							
Accounts payable and accrued liabilities	155,604	5,092	186,706	4,971	94,318	446,691	24,474
Securities lending obligations	-	469,054	1,924	34,339	-	505,317	-
Due to other funds—Note H	-	2,637	40	15	20,798	23,490	-
Due to fiduciary funds	-	-	2	1	82	85	3
Due to political subdivisions	-	-	4,954	-	-	4,954	-
Due to other governments	6,029	-	-	3	511	6,543	42
Deferred revenue	-	35,014	1,351	-	2,204	38,569	8
Compensated absences	-	571	-	-	11,166	11,737	-
Other liabilities	-	10,768	-	-	85	10,853	14,300
Total current liabilities	161,633	523,136	194,977	39,329	129,164	1,048,239	38,827
Noncurrent liabilities:							
Advances from other funds—Note H	-	1,803	-	50	3,000	4,853	-
Self insurance	-	-	-	-	10,577	10,577	-
Tuition benefits payable—Note F	-	-	-	399,091	-	399,091	-
Insurance loss liability—Note F	-	1,032,506	-	-	-	1,032,506	-
Compensated absences	-	1,162	-	-	22,673	23,835	-
Total noncurrent liabilities	-	1,035,471	-	399,141	36,250	1,470,862	-
TOTAL LIABILITIES	161,633	1,558,607	194,977	438,470	165,414	2,519,101	38,827
NET ASSETS							
Invested in capital assets, net of related debt	-	1,329	107	-	28,990	30,426	48,510
Restricted for:							
Transportation	-	-	-	-	30,336	30,336	-
Unemployment/worker's compensation	2,591,228	244,841	-	-	-	2,836,069	-
Elderly programs	-	-	180,814	-	-	180,814	-
Other purposes—Note C	-	-	-	-	422,971	422,971	30,437
Unrestricted	-	-	-	(26,005)	-	(26,005)	(23,241)
TOTAL NET ASSETS	$ 2,591,228	$ 246,170	$ 180,921	$ (26,005)	$ 482,297	$ 3,474,611	$ 55,706

- The notes to the financial statements are an integral part of this statement. -

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
Proprietary Funds

For the Fiscal Year Ended June 30, 2002

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Enterprise Funds						
	Unemployment Compensation Fund	State Workmen's Insurance Fund (Dec. 31, 2001)	State Lottery Fund	Tuition Payment Fund	Nonmajor Funds	Total	Internal Service Funds
OPERATING REVENUES:							
Sales and services	$ 1,760,461	$ 99,687	$ 1,932,692	$ 157,360	$ 997,835	$ 4,948,035	$ 333,878
Investment income	156,231	49,959	-	(6,211)	5,280	205,259	-
Interest on loans	-	-	-	-	7,821	7,821	-
Other	343,362	42	65,474	-	107	408,985	-
TOTAL OPERATING REVENUES	2,260,054	149,688	1,998,166	151,149	1,011,043	5,570,100	333,878
OPERATING EXPENSES:							
Cost of sales and services	2,819,878	167,789	1,614,322	191,188	928,737	5,721,914	349,327
Interest expense	-	4,608	-	-	-	4,608	-
Depreciation	-	173	27	-	5,196	5,396	11,353
Provision for uncollectible accounts	-	2,359	-	-	6,426	8,785	-
Other	-	-	68,326	-	320	68,646	-
TOTAL OPERATING EXPENSES	2,819,878	174,929	1,682,675	191,188	940,679	5,809,349	360,680
OPERATING INCOME (LOSS)	(559,824)	(25,241)	315,491	(40,039)	70,364	(239,249)	(26,802)
NONOPERATING REVENUES (EXPENSES):							
Investment income	-	-	23,042	-	4,968	28,010	1,237
Other revenues	-	-	-	-	642	642	-
Other expenses	-	-	-	-	(82)	(82)	(442)
NONOPERATING REVENUES, NET	-	-	23,042	-	5,528	28,570	795
INCOME (LOSS) BEFORE TRANSFERS	(559,824)	(25,241)	338,533	(40,039)	75,892	(210,679)	(26,007)
TRANSFERS:							
Transfers out—Note H	-	-	(359,000)	-	(122,022)	(481,022)	-
TOTAL TRANSFERS	-	-	(359,000)	-	(122,022)	(481,022)	-
DECREASE IN NET ASSETS	(559,824)	(25,241)	(20,467)	(40,039)	(46,130)	(691,701)	(26,007)
TOTAL NET ASSETS, JULY 1, 2001 (restated)—Note B	3,151,052	271,411	201,388	14,034	528,427	4,166,312	81,713
TOTAL NET ASSETS, JUNE 30, 2002	$ 2,591,228	$ 246,170	$ 180,921	$ (26,005)	$ 482,297	$ 3,474,611	$ 55,706

- The notes to the financial statements are an integral part of this statement. -

STATEMENT OF CASH FLOWS
Proprietary Funds

For the Fiscal Year Ended June 30, 2002

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Enterprise Funds						
	Unemployment Compensation Fund	State Workmen's Insurance (Dec. 31, 2001) Fund	State Lottery Fund	Tuition Payment Fund	Nonmajor Funds	Total	Internal Service Funds
CASH FLOWS FROM OPERATING ACTIVITIES:							
Receipts from employers	$ 2,069,841	$ 105,298	$ -	$ -	$ -	$ 2,175,139	$ -
Receipts from customers	-	-	1,946,950	156,659	998,197	3,101,806	379,161
Receipts from borrowers	-	-	-	-	40,188	40,188	-
Payments to programs for the elderly	-	-	(445,884)	-	-	(445,884)	-
Payments to prize winners	-	-	(1,002,461)	-	-	(1,002,461)	-
Payments to participants	-	-	-	9,858	-	9,858	-
Payments to claimants	(2,774,522)	(73,937)	-	-	(2,433)	(2,850,892)	-
Payments to borrowers	-	-	-	-	(45,340)	(45,340)	-
Payments to suppliers	-	-	(195,312)	-	(896,735)	(1,092,047)	(345,111)
Other receipts (payments)	-	(128)	86	10	(90)	(122)	503
NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES	(704,681)	31,233	303,379	166,527	93,787	(109,755)	34,553
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES							
Net borrowings (repayments) under advances from other funds	-	(184)	-	(100)	-	(284)	(23,700)
Transfers out	-	-	(359,000)	-	(122,022)	(481,022)	-
NET CASH USED FOR NON-CAPITAL FINANCING ACTIVITIES	-	(184)	(359,000)	(100)	(122,022)	(481,306)	(23,700)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:							
Acquisition and construction of capital assets	-	(1,007)	-	-	(6,492)	(7,499)	(15,383)
NET CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES	-	(1,007)	-	-	(6,492)	(7,499)	(15,383)
CASH FLOWS FROM INVESTING ACTIVITIES:							
Purchase of Investments	(5,715)	(904,848)	(939,872)	(10,361,343)	(770,733)	(12,982,511)	(250,275)
Sales and maturities of investments	5,710	849,571	972,618	10,185,962	795,372	12,809,233	253,765
Investment income	156,231	27,016	22,768	9,394	9,500	224,909	1,089
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES	156,226	(28,261)	55,514	(165,987)	34,139	51,631	4,579
NET INCREASE (DECREASE) IN CASH	(548,455)	1,781	(107)	440	(588)	(546,929)	49
CASH AT JULY 1, 2001	2,899,740	2,165	139	581	14,468	2,917,093	279
CASH AT JUNE 30, 2002	$ 2,351,285	$ 3,946	$ 32	$ 1,021	$ 13,880	$ 2,370,164	$ 328
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES							
Operating income (loss)	$ (559,824)	$ (25,241)	$ 315,491	$ (40,039)	$ 70,364	$ (239,249)	$ (26,802)
Depreciation and amortization	-	173	27	-	5,196	5,396	11,353
Provision for uncollectible accounts	-	2,359	-	-	6,426	8,785	-
Non-operating revenues	-	-	38	-	671	709	2,311
Reclassification of investment income	(156,231)	(49,959)	-	6,211	(5,280)	(205,259)	-
Change in assets and liabilities:							
Accounts receivable	6,363	(8,383)	(2,454)	(701)	(11,553)	(16,728)	134
Inventory	-	-	-	-	8,974	8,974	1,902
Due from other funds	(501)	94	1,500	8	(312)	789	44,208
Due from component units	(109)	-	-	-	(7)	(116)	179
Due from other governments	(39,735)	-	426	-	12	(39,297)	144
Other current assets	-	(3,876)	-	-	(66)	(3,942)	8
Accounts payable and accrued liabilities	43,530	(321)	(10,009)	4,826	18,152	56,178	1,487
Tuition benefits payable	-	-	-	177,965	-	177,965	(375)
Securities lending obligations	-	113,458	(105)	18,257	-	131,610	-
Due to other funds	-	1,131	(38)	-	1,044	2,137	-
Due to other governments	1,826	-	39	-	21	1,886	-
Deferred revenue	-	15,417	(1,536)	-	85	13,966	4
Insurance loss liability	-	(21,746)	-	-	-	(21,746)	-
Other liabilities	-	8,127	-	-	60	8,187	-
Total Adjustments	(144,857)	56,474	(12,112)	206,566	23,423	129,494	61,355
NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES	$ (704,681)	$ 31,233	$ 303,379	$ 166,527	$ 93,787	$ (109,755)	$ 34,553

- The notes to the financial statements are an integral part of this statement. -

STATEMENT OF FIDUCIARY NET ASSETS
Fiduciary Funds and Similar Component Units

June 30, 2002

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Pension and Other Employee Benefits Trust				Investment Trust Fund	Agency		
							Discretely Presented Component Units	
	State Employees' Retirement System (Blended Component Unit) (December 31, 2001)	Deferred Compensation Fund (December 31, 2001)	Public School Employees' Retirement System (Discretely Presented Component Unit)	Total	INVEST Program for Local Governments (December 31, 2001)	Primary Government Agency Funds	PA Life and Health Insurance Guaranty Assoc. (December 31, 2001)	PA Property and Casualty Insurance Guaranty Assoc. (December 31, 2001)
ASSETS								
Cash—Note D	$ -	$ 6,511	$ -	$ 6,511	$ -	$ 23,526	$ 4,836	$ 3,919
Cash with fiscal agents—Note D	-	-	-	-	-	562,668	-	-
Temporary investments—Note D	810,937	86,212	3,990,427	4,887,576	1,328,897	735,482	241,152	77,599
Long-term investments—Note D	25,559,386	949,146	42,748,589	69,257,121	-	941,266	-	19,421
Receivables, net:				-				
Taxes—Note G	-	-	-	-	-	22,679	-	-
Accounts	-	-	-	-	-	177,209	-	771
Accrued interest	89,571	227	-	89,798	1,768	2,370	-	-
Loans—Note G	-	-	-	-	-	6,015	-	-
Pension contributions	-	4,524	203,468	207,992	-	-	-	-
Investment proceeds	186,976	-	1,000,379	1,187,355	-	-	-	-
Other	-	-	181,699	181,699	-	-	-	150,695
Due from other funds—Note H	1,515	-	-	1,515	-	-	-	-
Due from primary government—Note H	-	-	562	562	-	-	-	-
Due from political subdivisions	749	-	-	749	-	-	-	-
Due from other governments	5,362	-	19	5,381	-	-	-	-
Capital assets—Note E	-	-	11,277	11,277	-	-	-	-
Less: accumulated depreciation	-	-	(8,127)	(8,127)	-	-	-	-
Net depreciable capital assets	-	-	3,150	3,150	-	-	-	-
Other assets	-	-	-	-	-	475,622	-	265
TOTAL ASSETS	26,654,496	1,046,620	48,128,293	75,829,409	1,330,665	2,946,837	245,988	252,670
LIABILITIES								
Accounts payable and accrued liabilities	43,606	1,284	48,076	92,966	3,414	21,683	-	-
Investment purchases payable	692,319	-	1,992,272	2,684,591	-	-	-	-
Securities lending obligations	1,212,508	52,684	2,282,799	3,547,991	-	40,272	-	-
Due to primary government—Note H	-	-	409	409	-	-	-	-
Due to political subdivisions	-	-	-	-	-	274,994	-	-
Due to other governments	-	-	-	-	-	12	-	-
Deferred revenue	-	-	-	-	-	-	-	941
Other liabilities	-	121	208,087	208,208	-	2,609,876	245,988	251,729
TOTAL LIABILITIES	1,948,433	54,089	4,531,643	6,534,165	3,414	2,946,837	245,988	252,670
NET ASSETS:								
Held in trust for:								
Pension and other employee benefits	24,706,063	-	43,473,249	68,179,312	-	-	-	-
Healthcare benefits	-	-	123,401	123,401	-	-	-	-
Employee salary deferrals	-	992,531	-	992,531	-	-	-	-
INVEST Program participants	-	-	-	-	1,327,251	-	-	-
TOTAL NET ASSETS	$ 24,706,063	$ 992,531	$ 43,596,650	$ 69,295,244	$ 1,327,251	$ -	$ -	$ -

- The notes to the financial statements are an integral part of this statement. -

STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
Fiduciary Funds and Similar Component Units

For the Fiscal Year Ended June 30, 2002

COMMONWEALTH OF PENNSYLVANIA

(Expressed in Thousands)

	Pension and Other Employee Benefits Trust				Investment Trust Fund
	State Employees' Retirement System (Blended Component Unit) (December 31, 2001)	Deferred Compensation Fund (December 31, 2001)	Public School Employees' Retirement System (Discretely Presented Component Unit)	Total	INVEST Program for Local Governments (December 31, 2001)
ADDITIONS:					
Pension contributions:					
Employer	$ 76,710	$ -	$ 109,450	$ 186,160	$ -
Employee	240,528	111,823	805,567	1,157,918	-
Total contributions	317,238	111,823	915,017	1,344,078	-
Investment income:					
Net depreciation in					
fair value of investments	(2,805,153)	(67,927)	(3,777,153)	(6,650,233)	-
Interest income	388,626	16,458	820,891	1,225,975	49,148
Dividend income	106,253	-	447,870	554,123	-
Rental and other income	223,534	-	131,890	355,424	-
Total investment activity income	(2,086,740)	(51,469)	(2,376,502)	(4,514,711)	49,148
Less: investment expenses					
Investment activity expense	(148,778)	(972)	(162,777)	(312,527)	-
Net investment earnings	(2,235,518)	(52,441)	(2,539,279)	(4,827,238)	49,148
Securities lending activities:					
Income	54,813	-	57,391	112,204	-
Expenses	(44,922)	-	(41,137)	(86,059)	-
Total securities lending income	9,891	-	16,254	26,145	-
Total net investment income	(2,225,627)	(52,441)	(2,523,025)	(4,801,093)	49,148
Share transactions (at net asset value of $1.00 per share):					
Shares purchased	-	-	-	-	3,303,295
Shares issued in lieu of cash distributions	-	-	-	-	46,909
Shares redeemed	-	-	-	-	(3,111,721)
Net increase in net assets from share transactions	-	-	-	-	238,483
TOTAL ADDITIONS	(1,908,389)	59,382	(1,608,008)	(3,457,015)	287,631
DEDUCTIONS:					
Benefit payments	1,237,953	27,922	2,888,871	4,154,746	-
Refunds of contributions	7,176	-	14,858	22,034	-
Administrative expenses	20,887	231	35,373	56,491	712
Other expenses	-	2,039	9,434	11,473	-
Distributions to participants	-		-	-	47,493
TOTAL DEDUCTIONS:	1,266,016	30,192	2,948,536	4,244,744	48,205
CHANGE IN PLAN NET ASSETS HELD IN TRUST FOR:					
Pension and other employee benefits	(3,174,405)	-	(4,623,706)	(7,798,111)	-
Healthcare benefits	-	-	67,162	67,162	-
Employee salary deferrals	-	29,190	-	29,190	-
INVEST program participants	-	-	-	-	239,426
Net assets, July 1, 2001 (restated)—Note B	27,880,468	963,341	48,153,194	76,997,003	1,087,825
Net assets, June 30, 2002	$ 24,706,063	$ 992,531	$ 43,596,650	$ 69,295,244	$ 1,327,251

- The notes to the financial statements are an integral part of this statement. -

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STATEMENT OF NET ASSETS
Discretely Presented Nonfiduciary Component Units

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	State Public School Building Authority	Philadelphia Shipyard Development Corporation (December 31, 2001)	Ben Franklin/ IRC Partnership	Ben Franklin/ Technology Development Fund	Insurance Fraud Prevention Authority	Pennsylvania Higher Educational Facilities Authority	Port of Pittsburgh Commission
ASSETS							
Cash—Note D	$ 12,578	$ 47,660	$ -	$ -	$ 4,361	$ -	$ 2
Temporary investments—Note D	-	-	242	27,704	-	-	1,664
Receivables:							
Accounts	27	-	-	-	-	22	95
Accrued interest	314	20	-	-	-	-	-
Loans—Note G	1,593	30,000	-	9,800	-	-	124
Lease rentals—Note G	-	-	-	-	-	-	-
Other	4,780	817	-	-	-	-	-
Due from primary government—Note H	-	-	-	-	-	-	-
Due from component units—Note H	-	-	-	-	-	-	-
Due from Federal government	-	-	-	-	-	-	-
Due from political subdivisions	-	-	-	-	-	-	-
Due from other governments	-	7,196	-	-	119	-	-
Long-term investments—Note D	14,879	-	-	-	-	-	-
Inventory	-	-	-	-	-	-	-
Prepaid and deferred expenses	-	30	-	-	6	-	-
Capital assets—Note E:							
Land	-	161	-	-	-	-	-
Land improvements	-	-	-	-	-	-	-
Buildings and building improvements	-	-	-	-	-	-	-
Equipment	503	-	-	-	32	-	2,096
Infrastructure	-	-	-	-	-	-	-
Library books	-	-	-	-	-	-	-
Construction in progress	-	-	-	-	-	-	-
Other capital assets	-	-	-	-	26	-	-
Less: accumulated depreciation	(324)	-	-	-	(25)	-	(236)
Other assets	-	-	-	-	2	-	-
TOTAL ASSETS	34,350	85,884	242	37,504	4,521	22	3,745
LIABILITIES							
Current liabilities:							
Accounts payable and accrued liabilities	632	7,807	226	3,950	114	22	156
Due to primary government—Note H	-	-	-	-	-	-	-
Due to component units—Note H	-	-	-	-	-	-	-
Due to other governments	-	-	-	-	-	-	-
Interest payable	-	-	-	-	-	-	-
Deferred revenue	-	-	-	-	-	-	-
Notes payable—Note J	-	-	-	-	-	-	-
Bonds payable—Note K	-	-	-	-	-	-	-
Revenue bonds payable—Note K	-	-	-	-	-	-	-
Compensated absences	44	-	-	-	-	-	3
Other liabilities	48	-	-	-	-	-	-
Total current liabilities	724	7,807	226	3,950	114	22	159
Non-current liabilities:							
Deferred revenue	-	-	-	-	-	-	-
Demand revenue bonds payable—Note J	-	-	-	-	-	-	-
Other liabilities	742	-	-	-	-	-	-
Notes payable—Note J	-	-	-	-	-	-	-
Bonds payable—Note K	-	-	-	-	-	-	-
Revenue bond payable—Note K	-	-	-	-	-	-	-
Compensated absences	253	-	-	-	-	-	35
Capital lease obligation	-	30,000	-	-	-	-	2,000
Total Non-Current Liabilities	995	30,000	-	-	-	-	2,035
TOTAL LIABILITIES	1,719	37,807	226	3,950	114	22	2,194
NET ASSETS—Note C:							
Invested in capital assets, net of related debt	179	161	-	-	33	-	(140)
Restricted for:							
Capital projects	-	1,061	-	-	-	-	-
Debt service	-	-	-	-	-	-	-
Other purposes	32,452	46,855	16	33,554	4,374	-	1,691
Unrestricted	-	-	-	-	-	-	-
TOTAL NET ASSETS	$ 32,631	$ 48,077	$ 16	$ 33,554	$ 4,407	$ -	$ 1,551

- The notes to the financial statements are an integral part of this statement. -

Pennsylvania Turnpike Commission (May 31, 2002)	Pennsylvania Industrial Development Authority	Pennsylvania Housing Finance Agency	Pennsylvania Higher Education Assistance Agency	Pennsylvania Infrastructure Investment Authority	State System of Higher Education	Philadelphia Regional Port Authority	Total
$ 72,689	$ 589	$ 63,917	$ 28,829	$ 509	$ 27,988	$ 4,173	$ 263,295
202,901	230,464	861,023	149,095	418,039	260,968	-	2,152,100
13,537	-	-	12,975	-	3,798	1,373	31,827
13,421	4,781	-	81,514	2,051	-	-	102,101
-	554,629	2,814,373	3,222,787	1,249,300	33,337	-	7,915,943
-	17,966	-	-	-	-	-	17,966
-	18	3,016	-	-	42,750	-	51,381
6,643	-	-	95	-	-	-	6,738
-	-	16	-	130	-	-	146
-	-	-	6,117	2,706	-	-	8,823
-	-	-	-	-	5,284	-	5,284
-	-	-	-	-	-	-	7,315
764,971	49,562	85,552	561,596	-	475,866	-	1,952,426
13,836	-	-	-	-	11,183	-	25,019
-	-	27,179	-	16,791	5,079	-	49,085
121,380	-	-	-	-	31,204	-	152,745
-	-	-	2,946	-	195,960	-	198,906
621,958	-	-	62,720	-	1,431,064	103,482	2,219,224
250,938	-	-	17,787	-	179,461	19,185	470,002
3,649,109	-	-	-	-	-	-	3,649,109
-	-	-	-	-	73,707	-	73,707
334,128	-	-	-	-	134,906	274	469,308
-	-	-	59,788	603	-	4,007	64,424
(2,284,059)	-	-	(67,165)	(410)	(868,462)	(59,811)	(3,280,492)
59,489	14,550	-	69,797	1,843	20,994	6,883	173,558
3,840,941	872,559	3,855,076	4,208,881	1,691,562	2,065,087	79,566	16,779,940
36,338	1,232	2,874	60,594	2,454	125,489	1,640	243,528
5,773	-	5	97	24,767	699	-	31,341
-	-	130	-	16	-	-	146
-	-	-	-	6	-	-	6
49,392	-	48,939	18,712	2,674	-	-	119,717
16,428	469	-	-	-	26,561	191	43,649
-	-	-	234,053	-	-	-	234,053
-	-	-	-	-	18,315	-	18,315
48,595	24,815	74,092	-	14,685	-	1,970	164,157
11,653	-	-	2,790	-	-	-	14,490
-	10,312	2,035	-	-	76,586	302	89,283
168,179	36,828	128,075	316,246	44,602	247,650	4,103	958,685
-	-	-	-	-	-	242	242
-	-	-	2,061,000	-	-	-	2,061,000
25,342	-	281,926	246,819	1,843	424,027	-	980,699
-	-	-	735,978	-		-	735,978
-	-	-	-	-	421,345	-	421,345
2,095,966	552,113	2,866,247	529,856	131,543	15,970	50,605	6,242,300
-	-	-	2,315	-	61,454	511	64,568
-	-	-	49,630	-	24,581		106,211
2,121,308	552,113	3,148,173	3,625,598	133,386	947,377	51,358	10,612,343
2,289,487	588,941	3,276,248	3,941,844	177,988	1,195,027	55,461	11,571,028
597,488	-	-	17,163	193	721,689	15,658	1,352,424
739,873	-	-	-	-	20,523	-	761,457
-	-	85,552	197,140	-	-	5,449	288,141
214,093	-	493,276	52,734	1,513,381	127,848	2,998	2,523,272
-	283,618	-	-	-	-	-	283,618
$ 1,551,454	$ 283,618	$ 578,828	$ 267,037	$ 1,513,574	$ 870,060	$ 24,105	$ 5,208,912

- The notes to the financial statements are an integral part of this statement. -

STATEMENT OF ACTIVITIES

Discretely Presented Nonfiduciary Component Units

COMMONWEALTH OF PENNSYLVANIA

(Expressed in Thousands)

	State Public School Building Authority	Philadelphia Shipyard Development Corporation (December 31, 2001	Ben Franklin/ IRC Partnership	Ben Franklin/ Technology Development Fund	Insurance Fraud Prevention Authority	Pennsylvania Higher Educational Facilities Authority
Expenses	$ 2,457	$ 46,178	$ 3,339	$ 40,844	$ 9,889	$ 1,267
Program revenues:						
Charges for goods and services	1,267	-	92	989	9,990	1,267
Operating grants and contributions	-	61,205	-	-	-	-
Capital grants and contributions	-	9,735	-	-	-	-
Investment/interest earnings	1,715	589	-	-	-	-
Total program revenues	2,982	71,529	92	989	9,990	1,267
Net (expense) revenue	525	25,351	(3,247)	(39,855)	101	-
General revenues:						
Taxes and other general revenues	8	-	-	2,400	-	-
Primary government subsidies—Note H	-	-	-	71,009	-	-
Total general revenues	8	-	-	73,409	-	-
Special item-primary government payment—Note H.	-	-	-	-	-	-
Net general revenues and special item	8	-	-	73,409	-	-
Change in net assets	533	25,351	(3,247)	33,554	101	-
Net assets, July 1, 2001 (restated)—Note B	32,098	22,726	3,263	-	4,306	-
Net assets, June 30, 2002	$ 32,631	$ 48,077	$ 16	$ 33,554	$ 4,407	$ -

- The notes to the financial statements are an integral part of this statement. -

Port of Pittsburgh Commission	**Pennsylvania Turnpike Commission (May 31, 2002)**	**Pennsylvania Industrial Development Authority**	**Pennsylvania Housing Finance Agency**	**Pennsylvania Higher Education Assistance Agency**	**Pennsylvania Infrastructure Investment Authority**	**State System of Higher Education**	**Philadelphia Regional Port Authority**	**Total**
$ 990	$ 515,063	$ 25,692	$ 461,214	$ 746,319	$ 48,158	$ 1,369,872	$ 19,686	$ 3,290,968
39	420,854	20,794	24,691	154,326	29,913	662,078	4,168	1,330,468
754	36,197	-	242,744	6,365	-	211,262	8,768	567,295
-	-	-	-	-	112,489	63,288	2,058	187,570
62	-	9,960	207,571	214,182	18,532	35,011	458	488,080
855	457,051	30,754	475,006	374,873	160,934	971,639	15,452	2,573,413
(135)	(58,012)	5,062	13,792	(371,446)	112,776	(398,233)	(4,234)	(717,555)
-	45,512	606	1,926	-	-	4,263	168	54,883
-	28,000	-	-	412,618	-	471,821	-	983,448
-	73,512	606	1,926	412,618	-	476,084	168	1,038,331
-	-	(256,206)	-	-	-	-	-	(256,206)
-	73,512	(255,600)	1,926	412,618	-	476,084	168	782,125
(135)	15,500	(250,538)	15,718	41,172	112,776	77,851	(4,066)	64,570
1,686	1,535,954	534,156	563,110	225,865	1,400,798	792,209	28,171	5,144,342
$ 1,551	$ 1,551,454	$ 283,618	$ 578,828	$ 267,037	$ 1,513,574	$ 870,060	$ 24,105	$ 5,208,912

- The notes to the financial statements are an integral part of this statement. -

INDEX TO NOTES

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation: The basic financial statements of the Commonwealth of Pennsylvania have been prepared in accordance with accounting principles generally accepted in the United States applicable to governments. The Governmental Accounting Standards Board (GASB) establishes accounting and financial reporting requirements for governments. For the fiscal year ended June 30, 2002, the Commonwealth has newly adopted several new accounting and reporting standards (collectively, the New Standards): GASB Statement No. 33, Accounting and Financial Reporting for Nonexchange Transactions, GASB Statement No.34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments, GASB Statement No. 36, Recipient Reporting for Certain Shared Nonexchange Revenues, GASB Statement No.37, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus and GASB Statement No. 38, Certain Financial Statement Note Disclosures. For the fiscal year ended June 30, 2002 the State System of Higher Education, a discretely presented component unit, has adopted GASB Statement No. 35, Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities.

Among other things, the New Standards require presentation of government-wide and fund financial statements and numerous changes to how fund financial statements are presented. Effective July 1, 2001, as part of implementing GASB Statement No. 34, the Commonwealth has reclassified and/or restated numerous fund balance amounts previously reported at June 30, 2001. Note B to the Financial Statements provides a more detailed explanation of the restatement.

Government-Wide Financial Statements: Government-wide financial statements report financial position and results of activities for the Commonwealth of Pennsylvania as a whole. Amounts are separated between governmental and business-type activities within the primary government (defined below) and nonfiduciary component units. The Statement of Net Assets reports all economic resources (assets) and all liabilities for the primary government of the Commonwealth. The Statement of Activities reports the total cost of providing governmental services, by function, net of related program revenues, and, after including general revenues, reports whether the total net assets of the government increased or decreased during the fiscal year ended June 30, 2002. The government-wide financial statements do not include any fiduciary fund assets, liabilities or activities for the primary government or component units (defined below) that are fiduciary in nature. Governmental activities within government-wide financial statements include specific balances and transactions related to Internal Service Funds that are reported as proprietary funds in fund financial statements. Business-type activities include information for all Enterprise Funds.

Financial Reporting Entity: Government-wide financial statements include separate columns and/or rows for the primary government and discretely presented nonfiduciary component units. Fiduciary component unit balances are reported in the Statement of Fiduciary Net Assets and combining statements for all nonfiduciary component units are presented following fund financial statements as a Statement of Net Assets and a Statement of Activities.

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 Funds) — 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.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Discretely Presented Component Units:

State Public School Building Authority (SPSBA) and Pennsylvania Higher Educational Facilities Authority (HEFA) **-** 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) — 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 15 voting members of the governing board. All Partnership expenditures must be appropriated annually by the General Assembly.

Ben Franklin Technology Development Authority (PTDA) **-** The PTDA is very similar to the Ben Franklin/IRC Partnership and will supersede and replace it as of June 30, 2003. The PTDA will also include a PTDA Revolving Loan Program. The PG appoints all 21 voting members of the governing board. The PG may appropriate funding for the PTDA from the General Fund.

Port of Pittsburgh Commission (PPC) – The PPC promotes economic development throughout waterways in southwestern Pennsylvania by constructing and/or financing transportation and recreation facilities. The PG appoints all 15 voting members of the governing board and can remove board members at will. The PG provides funding for the PPC but is not required to do so.

Insurance Fraud Prevention Authority (IFPA) **-** 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.

Philadelphia Shipyard Development Corporation (PSDC) **-** 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. For the purposes of this report, the PSDC has a December 31, 2001 fiscal year end.

Philadelphia Regional Port Authority (PRPA) – The PRPA operates a port facility and manages port-related activities to promote commerce and economic development in southeastern Pennsylvania. The PRPA charges rental and other fees to port users and obtains other funding from the PG. The PRPA also issues revenue bonds to finance its activities. The PG appoints all eleven voting board members and can remove board members at will. The PG provides operating and capital subsidies and pays rent in amounts equal to PRPA debt service requirements. The PRPA is fiscally dependent on the PG, as the Governor must approve the issuance of its debt.

Pennsylvania Higher Education Assistance Agency (PHEAA) **-** 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

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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) **-** 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) - The PIDA collaborates with local industrial development corporations to make loans that 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) - 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) - 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.

State System of Higher Education (SSHE) **-** 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 Life and Health Insurance Guaranty Association (PLHIGA) (Fiduciary Funds) **-** 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 Funds) **-** 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.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

***Public School Employees' Retirement System (PSERS) (Fiduciary Funds)* -** 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 covered employers and the PG share state-owned schools equally; all covered public school employees also contribute. 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.

***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. 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.

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.

The **Philadelphia Parking Authority** (Authority) is financially reported as a discretely presented component unit in the City of Philadelphia's (City) financial reporting entity. During 2001, the General Assembly passed Senate Bill 780 that provided, in part, for the Commonwealth to appoint a voting majority of the Authority's governing board. The 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 passage of the law, the Authority and the City have pursued several legal actions contesting, among other things, the constitutionality of the new law.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The **Philadelphia School District** (School District) is financially reported as a discretely presented component unit in the City of Philadelphia's (City) financial reporting entity. During 2001, the General Assembly passed Senate Bill 640 that provided, in part, for several changes to the Public School Code. Among other things, the changes provide for the Commonwealth to appoint a voting majority of the School Reform Commission that now governs the School District. Despite these changes, the School District remains fiscally dependent on the City.

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 the board is appointed by the Commonwealth and one-half is appointed by 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 because 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.

Measurement Focus and Basis of Accounting- Government-Wide Financial Statements

The government-wide financial statements are reported using the economic resources measurement focus and accrual basis of accounting. This means that the Statement of Net Assets reports all assets (including receivables regardless of when collected and capital assets, such as heavy trucks, highways and bridges) and liabilities regardless of when payment is due. The Statement of Activities reports program revenues, which are revenues derived directly from a specific governmental function and are reported by the function which generates the revenue. Charges for goods or services, most investment income, grant revenues and fines are reported as program revenues. Neither program revenues nor expenses are reported for donated works of art, historical treasures or similar assets received during the fiscal year because such donations are not material. Except for unemployment compensation tax revenues, which are reported as charges for sales and services program revenues, all tax revenues are classified as general revenues in the Statement of Activities. The Statement of Activities also reports governmental activities expenses that include governmental fund expenditures (which are not eliminated or reclassified) and current year depreciation on capital assets, which recognizes the cost of ordinary use of the assets over their estimated useful lives. The costs of most employee benefits earned during the fiscal year (such as vacation time earned) and increases in self-insurance liabilities are also reported as expenses in the statement, regardless of when the benefits are used or the liabilities are paid.

Measurement Focus and Basis of Accounting – Fund Financial Statements

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 rare cases, by administrative action.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The fund financial statements include: three major governmental funds and total nonmajor governmental funds; and four major enterprise funds and total nonmajor enterprise funds and all fiduciary funds. The Commonwealth uses the following fund categories to account for each fund included in 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 main operating fund and is reported as a Major Fund.

Special Revenue Funds—Account for the proceeds of specific revenue sources (other than debt service or capital projects funds) that are legally restricted to expenditure for specified purposes. The **Motor License Fund** and the **Tobacco Settlement Fund** are reported as Major Funds. The **Motor License Fund** receives revenues from liquid fuels taxes, licenses and fees on motor vehicle registrations and operating privileges, aviation fuel taxes, federal aid for highway and aviation purposes, contributions from local subdivisions for highway projects and other miscellaneous revenues. The Fund makes expenditures for highway and bridge improvement, design, maintenance, and purchases of rights-of-way, as well as aviation activities and Transportation licensing and safety activities. It also finances State Police highway patrol operations and pays subsidies to local subdivisions for construction and maintenance of roads. The **Tobacco Settlement Fund** was established to deposit all payments received by the Commonwealth pursuant to the Master Settlement Agreement with tobacco product manufacturers. Deposits into this fund include: jurisdictional payments received by the Commonwealth from the master agreement; strategic contribution payments from the master agreement and earnings from investments. Expenditures from this fund are determined by the annual budget appropriated to each program distributed as follows: 8 percent to the Health Account; 13 percent for Home and Community Based Services; 12 percent for Tobacco Use Prevention and Cessation; 19 percent for Health Related Research; 10 percent for Uncompensated Care; 30 percent for Health Investment Insurance; and 8 percent for the expansion of the PACENET Program.

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. There are no major debt service funds.

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). There are no major capital projects 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 Lottery Fund, State Workmen's Insurance Fund, Unemployment Compensation Fund** and **Tuition Payment Fund** are all reported as Major Funds. The **State Lottery Fund** provides for the operation of the Pennsylvania State Lottery and for programs to support older Pennsylvanians. Revenues are derived from the sale of lottery tickets, interest earned on securities and deposits, unclaimed prize monies and Federal grants. Fund expenses pay for prizes to holders of winning lottery tickets and commissions to local lottery agents. Amounts remaining after payment of lottery prizes and commissions are used to fund programs benefiting older Pennsylvanians including PENNCARE, PACE, free mass transit and reduced fare shared-ride programs, and property tax and rent rebates.

The **State Workmen's Insurance Fund** (SWIF) was created by legislation on June 2, 1915 and operates within the Department of Labor and Industry. It is a self-sustaining fund providing workers' compensation insurance to employers, including those who are refused policies by private insurance firms. SWIF is subject to underwriting rules, classifications and rates promulgated by rating bureaus authorized by the Commonwealth Insurance Commissioner. Premium rates are established by the bureaus based on the history of accidents by industry classification. Revenues are generated by premiums charged to policyholders plus investment income. Workers' compensation payments and administration costs are paid from the Fund. The **State Workmen's Insurance Fund** is included for its fiscal year ended December 31, 2001.

The **Unemployment Compensation Fund** is comprised of four basic components: the 63 Employer Contribution Fund, 64 UC Benefit Payment Fund, 21 Special Administration Fund, and the UC Trust Fund in Washington, D.C. The purpose of these funds is to collect employer assessments for UC (63 Fund) and transfer the assessments to the Federal government for deposit in the UC Trust Fund. As needed, these funds are drawn back to pay unemployment compensation payments to claimants (64 Fund). The 21 Special Administration Fund is used to

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

isolate penalty and interest charges from employers and claimants. It is used to supplement grant-funding shortfalls and pay audit disallowances with any remaining amounts over $200 thousand being transferred to the UC Trust Fund in Washington, D.C. each June 30. The 64 UC Benefit Payment Fund also receives amounts from the Federal government to reimburse Pennsylvania for those Federal workers who collected UC benefits from Pennsylvania.

The **Tuition Payment Fund** offers a college savings program with a guaranteed rate of return based on increases in the cost of tuition. The program is administered by the Tuition Account Program Bureau within the Treasury Department with oversight by the Tuition Account Program Advisory Board. Revenue is derived primarily from application fees, participant contributions and investment income. Fund expenses consist mainly of payments to educational institutions and administrative costs. The State Stores Fund is reported for its fiscal year ended June 25, 2002.

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. The Purchasing Fund is used to purchase materials, supplies, services, and equipment for use by departments, agencies, boards, and commissions of state government, and to pay costs associated with administering the fund. The fund receives reimbursements from the various Commonwealth departments, boards, and commissions for the materials, services, and supplies they obtain, from appropriations and periodic loans from the General Fund, from the sale of vehicles and unserviceable property and from interest earned on securities. The Manufacturing Fund is a fund that uses inmate labor to produce items for the Department of Corrections and other state agencies. The revenue source is the sale of items produced or services provided. Expenditures are for raw materials, inmate labor, and general and administrative costs.

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 Pension Trust Funds, an Investment Trust Fund and Agency Funds.

The State Employees' Retirement System, a pension trust fund, is a component unit and accounts for the payment of retirement, disability and death benefits to members of the State Employees' Retirement System and their beneficiaries. The *Deferred Compensation Fund* is a pension trust fund that collects and administers amounts contributed by Commonwealth employees who are deferring a portion of their income until future years, in accordance with Internal Revenue Code Section 457. The INVEST Program for Local Governments is an Investment Trust Fund that investments amounts owned by local governments and school districts.

The State Employees’ Retirement System and the Deferred Compensation Fund, Pension Trust Funds, and the INVEST Program for Local Governments, an Investment Trust Fund, are included for their fiscal years ended December 31, 2001.

The Pennsylvania Life and Health Insurance Guaranty Association and the Pennsylvania Property and Casualty Insurance Guaranty Association, discretely presented component units, are included for their fiscal years ended December 31, 2001.

The **General Fund**, special revenue, debt service and capital projects funds are reported using the current financial resources measurement focus and 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 funds are recognized in the year that they become susceptible to accrual (both measurable and available) to pay current fiscal year liabilities. The Commonwealth accrues the following major revenue sources that are both measurable and available (available is treated as being received within 60 days of fiscal year end for these revenues):

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

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Grant revenues, including Federal government grant revenues, are recognized when earned. Revenues from most 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. Prepaid items and inventory purchases are reported as current fiscal year expenditures, rather than allocating a portion of related cost to the fiscal year when the items are actually 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.

The enterprise, internal service (proprietary funds), pension trust funds and the investment trust fund are reported using the 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 statement of net assets. Under the accrual basis of accounting, revenues are recognized in the fiscal year earned and expenses are recognized in the fiscal year incurred. Enterprise funds that report loan, insurance and tuition payment programs report all revenues as operating revenues; non-operating revenues are reported for other programs and include investment income and grant revenues. Under the 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. Assets and liabilities of agency funds are reported using the accrual basis of accounting.

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 that 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 preservation of principal, liquidity, diversification and income 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 Treasury Investment Program (TIP); practically all individual funds that are part of primary government are participants in the TIP. The Treasury Department accounts for each participating fund's equity (considered "shares") in the TIP 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 TIP is considered an internal investment pool. Periodic TIP earnings are allocated to specific participating funds based on either the weighted daily average share balance or the net asset value on redemption date combined with share balances on declaration date.

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 amortized cost.

Long-Term Investments: Investments expected to be realized in cash after more than twelve months from fiscal year end 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 amortized 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 that are not actively traded. Certain pension trust fund investments, including real estate, venture capital, private equity, private placements and alternative investments, are valued based on appraisals, independent advisors or the present value of projected future income.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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. Certain investment income from specific funds' investments is assigned to another fund and is reported by the receiving fund if the income is transferred for legal or contractual reasons; otherwise, the investment income is reported as a transfer by the receiving fund. Specific fund disclosures for assigned investment income are provided in Note H.

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

Inventories: Inventories of operating materials and supplies are reported by certain governmental activities and operating and merchandise inventories are reported by Proprietary Funds and the State System of Higher Education, a discretely presented component unit. These inventories are valued at the lower of cost or market (first-in, first-out) by governmental activities and Proprietary Funds, and lower of cost or market by the State System of Higher Education, with cost determined principally using weighted average. In the governmental fund financial statements, inventories are accounted for using the purchases method.

Capital Assets and Depreciation: General capital assets (including infrastructure) and other capital assets are reported at cost or estimated historical cost in the Statement of Net Assets. Donated capital assets are reported at fair market value at the time of donation. The cost of all land is reported; for other types of capital assets the following minimum dollar reporting thresholds are used:

Land improvements, buildings and building improvements….	$25,000
Machinery and equipment	$25,000
Highway and bridge infrastructure..	$100,000
All other infrastructure...	$25,000

Commonwealth agencies maintain inventories of all their respective capital assets, including assets acquired for less than the above minimum amounts, which are not reported in the BFS. Certain waterway and other non-highway institutional infrastructure acquired prior to July 1, 2001 is not reported in the Statement of Net Assets. The Pennsylvania Historical and Museum Commission (PHMC) owns diverse collections of historical, architectural, prehistoric and artistic artifacts; archives and manuscripts; and scientific specimens. The Commonwealth does not capitalize these collections as they meet the following criteria: PHMC's mission in acquiring these collections is for the purpose of preservation, education, research and exhibition; PHMC secures and preserves all collections in order to adequately preserve Commonwealth history; and all acquisitions and deaccessions must be approved by the PHMC Collections Committee and the PHMC Executive Director. All amounts received from the deacessioning of artifacts/collections are placed in a restricted account that can only be used for the purchase of new artifacts/collections. The Commonwealth does not capitalize expenditures for software or expenditures to protect farmland under the Agricultural Area Security Law. Capital assets (excluding land and construction in progress) are depreciated over the estimated useful lives of major capital asset classes using the straight-line method. Depreciation expense is reported in the Statement of Activities as part of direct functional expenses; all depreciation is allocated to a specific function. Capital assets reported by proprietary funds are reported in those funds at cost or estimated historical cost. Depreciation is reported on the straight-line basis over the capital assets' estimated useful lives. The following useful lives are used for primary government governmental activities:

Buildings and building improvements...	40 years
Improvements other than buildings...	30 years
Machinery and equipment	10 years
Highway heavy equipment	15 years
Highway infrastructure..	25 years
Bridge infrastructure..	50 years
Dams, dikes and pier infrastructure...	50 years
Other infrastructure...	20 years

Primary government business-type activities report depreciation expense using useful lives that are very similar to the above and do not report any infrastructure. Certain land, buildings and improvements owned by the Commonwealth and used by the State System of Higher Education (SSHE), a discretely presented component unit, which were acquired or constructed before July 1, 1983 (the inception date for the SSHE), are financially reported by the SSHE. All capital assets acquired or constructed

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

for the SSHE by the Commonwealth subsequent to June 30, 1983 without the use of university funds or incurrence of the SSHE debt are also financially reported by the SSHE.

Self-Insurance: The Commonwealth is uninsured for property losses and self-insured for annuitant medical/hospital benefits, employee disability and tort claims. Note M 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 liabilities payable with expendable available financial resources are reported by Governmental Funds; all compensated absences payable are reported by governmental activities and Proprietary Funds and Pension Trust Funds.

Liabilities: In the Statement of Net Assets, governmental activities liabilities are presented as either "current" or "noncurrent." Liabilities are segregated into these categories by establishing an average maturity for the liability class and classifying the portion due within one year of the statement date as current and the portion due beyond one year of the statement date as noncurrent. For liabilities without specific maturity or due dates, estimates are made of maturities. Liabilities without specific due dates include those related to self-insurance and compensated absences.

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.

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

Restricted Net Assets: These amounts were determined based on enabling legislation that provides for restrictions on how the resources of special (non-**General Fund**) funds may be used. Practically all reported restricted net assets could become unrestricted based on possible future legislative changes.

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 was not to exceed 6 percent of the estimated revenues of the **General Fund**. Revenue was provided through an executive authorization appropriated by the General Assembly for transfer to this Fund. Act 74 of 2001 provided 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 was to be deposited into this Fund. In addition, the proceeds received from the disposition of certain assets of the Commonwealth were also to be deposited into this Fund. During the fiscal year ended June 30, 2001 there was no surplus transfer to this Fund. For GAAP reporting purposes, at June 30, 2001 the fund balance in this Fund was reported as a fund balance reservation in the **General Fund**. During the fiscal year ended June 30, 2002, Act 91 of 2002 abolished this Fund and net investment assets (valued at $1.038 billion at June 30, 2002) were transferred, resulting in a decrease in fund balance reservations and an increase to unreserved/undesignated fund balance in the **General Fund**.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Budget Stabilization Reserve Fund: Act 91 of 2002 provides for this new Fund effective July 1, 2002 to eventually establish a budgetary reserve amounting to 6 percent of the revenues of the **General Fund**. For the fiscal year beginning July 1, 2002 and in any fiscal year thereafter in which the Secretary of the Budget certifies that there is a surplus in the **General Fund**, 25 percent of the surplus shall be deposited by the end of the next succeeding quarter into this Fund.

Tobacco Master Settlement Agreement Proceeds: 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 that provided, among other things, that the Commonwealth cease 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, 2002 the Commonwealth received $433.5 million from the settlement; this amount is reported as revenue in the **Tobacco Settlement Fund**. Also, during the fiscal year ended June 30, 2002, $853.9 million was transferred from the **General Fund** to the **Tobacco Settlement Fund**. This amount represents prior year settlement proceeds and related investment income through June 30, 2001that were deposited in the **General Fund**.

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

Interfund Transactions: The Commonwealth has the following types of transactions between funds, between primary government governmental activities and business-type activities and between primary government and discretely presented non-fiduciary component units:

Statutory Transfers —Legally required transfers that subsidize recipient fund programs and are reported when incurred as “Transfers in” by the recipient fund and as “Transfers out” by the disbursing fund. Legally required payments from the primary government to component unit organizations are reported when incurred as governmental activities program expenses and component unit subsidies by the recipient organization. Interfund balances (amounts due from/to other funds) are reported for unremitted transfers at fiscal year end. In the Statement of Activities, only transfers between governmental activities and business-type activities are reported as transfers.

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.

Interfund Payments (Quasi-external Transactions)—Charges or collections for services provided by one fund to another that are recorded as revenues of the recipient fund and expenditures or expenses of the disbursing fund. Interfund balances (amounts due from/to other funds), are reported for unremitted charges or collections at fiscal year end that arise in connection with routine, ordinary governmental fund and proprietary fund operations. Intra-function revenues/expenditures reported by governmental funds are eliminated in the Statement of Activities.

The composition of the Commonwealth’s interfund receivables/payables at June 30, 2002 and transfers in/out during the fiscal year ended June 30, 2002 is presented in Note H. Interfund balances between two governmental funds or two proprietary funds are not reported in the Statement of Net Assets.

New Accounting Pronouncement: In May 2002 the Governmental Accounting Standards Board (GASB) issued Statement No. 39, “Determining Whether Certain Organizations Are Component Units.” The Commonwealth must adopt the new standard effective July 1, 2003, for financial statements for the fiscal year ending June 30, 2004. GASB No. 39 amends GASB No. 14 and potentially affects the composition of the financial reporting entity; both the primary government and discretely presented component units may be affected.

NOTE B – RESTATEMENT OF PREVIOUSLY REPORTED FUND BALANCE/FUND EQUITY/NET ASSETS AT JUNE 30, 2001

Implementation of the New Standards has resulted in the reclassification of several of the Commonwealth's individual Funds and a restatement of Fund-specific fund balance/fund equity for specific funds. Fund balances have also been restated for several discretely presented component units.

Primary Government

Fund Reclassifications: Several Funds have been reclassified to different fund categories to meet the requirements of GASB Statement No. 34. The **State Lottery Fund** and the Historical Preservation Fund have been reclassified from Special Revenue funds to Enterprise funds; the **Unemployment Compensation Fund** has been reclassified from an Expendable Trust fund to an Enterprise fund; the Workmen's Compensation Security Trust Fund and the Catastrophic Loss Trust Fund have been reclassified from Expendable Trust funds to Special Revenue funds; and, the Deferred Compensation Fund has been reclassified from an Expendable Trust fund to a Pension Trust fund.

Fund-Specific Restatements: Two Fiduciary funds reported restatements of June 30, 2001 net assets. The Deferred Compensation Fund restated December 31, 2000 net assets by $4,245 to include member contributions earned but not received as of December 30, 1999. The INVEST Program for Local Governments restated net assets at June 30, 2001 by $405 to correct a prior year error. The Self-Insurance Guaranty Fund, a Special Revenue Fund, was previously not reported and June 30, 2001 fund balance was $3,929 (amounts in thousands).

Major Funds: Funds that meet certain criteria established by GASB Statement No. 34 are considered **Major** funds. These Funds' beginning balances are presented on the Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds and the Statement of Revenues, Expenses and Changes in Fund Net Assets – Proprietary Funds. Two of these Funds, **State Lottery** and **Unemployment Compensation**, were changed, in accordance with the New Standards, from the governmental fund category to the proprietary fund category. The change in fund category also produced a change in basis of accounting for these two funds. The change in basis of accounting required a restatement of beginning net assets that is included in the amounts presented below. The major funds and their associated beginning fund balances/net assets at June 30, 2001 are as follows (amounts in thousands):

General Fund	$ 4,484,995
Motor License	751,961
Unemployment Compensation (restated)	3,151,052
State Workmen's Insurance	271,411
State Lottery (restated)	201,388
Tuition Payment	14,034

Nonmajor Funds: Fund Balance at June 30, 2001 for nonmajor governmental funds is $1,642,716. This amount appears on the Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds in the Nonmajor column, and is comprised of the following (amounts in thousands):

Special Revenue Funds	$ 1,296,625
Debt Service Funds	152,077
Capital Projects Funds	194,014
Total	$ 1,642,716

Net assets, as reported at June 30, 2001 for nonmajor Enterprise funds, total $525,343. After including certain fund-specific accruals, reclassifications, and eliminations and amounts related to funds newly reclassified to the Enterprise fund category (amounting to a net increase of $3,084), the restated net assets at June 30, 2001 is $528,427. This beginning balance amount appears on the Statement of Revenues, Expenses and Changes in Net Assets – Proprietary Funds in the Nonmajor column (amounts in thousands).

NOTE B – RESTATEMENT OF PREVIOUSLY REPORTED FUND BALANCE/FUND EQUITY/NET ASSETS AT JUNE 30, 2001 (continued)

Net Assets at June 30, 2001 - Net Assets at June 30, 2001, (restated), as presented on the Statement of Activities for both governmental and business-type activities, includes numerous accruals, reclassifications and eliminations to major and aggregated nonmajor fund balance/net assets at June 30, 2001. These changes are necessary for full accrual presentation of governmental activities and conforming presentation for business-type activities at June 30, 2001. Some of the more significant changes involve discontinuing reporting general capital assets and bonds and other general long-term liabilities in the former General Fixed Assets Account Group (GFAAG) and the General Long-Term Obligations Account Group (GLTDAG); these items are now reported as governmental activities assets and liabilities, respectively, at June 30, 2001. The addition of infrastructure capital assets, accumulated depreciation and the accrual of all taxes receivable also affects the government-wide statements. Internal Service funds are considered a part of governmental activities as of June 30, 2001; these funds are included in the calculation of beginning governmental net assets. That calculation is as follows (amounts in thousands):

Total fund balances/equity after reclassifications and Restatements (includes General Fund, Special Revenue Funds, Debt Service funds, Capital Projects funds and Internal Service funds	$	6,961,385
Net accruals, reclassifications and eliminations		9,474,301
Net assets – governmental activities at June 30, 2001, as restated	$	16,435,686

Net assets (restated) at June 30, 2001 for business-type activities in the Statement of Activities is calculated as follows (amounts in thousands):

Total fund equity after fund reclassifications	$	4,113,488
Net accruals, reclassifications and eliminations		52,824
Net assets – business type activities at June 30, 2001, as restated	$	4,166,312

NOTES TO FINANCIAL STATEMENTS

NOTE B – RESTATEMENT OF PREVIOUSLY REPORTED FUND BALANCE/FUND EQUITY/NET ASSETS AT JUNE 30, 2001 (continued)

Government-wide statements do not include amounts segregated by fund classification. The shaded area in the exhibit below includes accruals, reclassifications and eliminations needed to convert June 30, 2001 governmental fund balances to governmental net assets at June 30, 2001. Boxed areas include amounts for **major** and aggregated nonmajor funds in the fund statements at June 30, 2001.

	General	Special Revenue	Debt Service	Capital Projects	Internal Service	Total Governmental Activities	Enterprise	Expendable Trust	Pension Trust	Investment Trust
Fund balance/fund equity/net assets, as previously reported at June 30, 2001	$ 4,484,995	$ 1,689,147	$ 152,077	$ 194,014	$ 81,713	$ 6,601,946	$ 810,788	$ 4,617,306	$ 27,880,468	$ 1,087,420
Fund classification changes:	-	-	-	-	-	-	-	-	-	-
State Lottery	-	(201,215)	-	-	-	(201,215)	201,215	-	-	-
Historical Preservation	-	(2,678)	-	-	-	(2,678)	2,678	-	-	-
Unemployment Compensation	-	-	-	-	-	-	3,098,807	(3,098,807)	-	-
Workmen's Compensation Security Trust	-	523,855	-	-	-	523,855	-	(523,855)	-	-
Catastrophic Loss Trust	-	35,548	-	-	-	35,548	-	(35,548)	-	-
Deferred Compensation	-	-	-	-	-	-	-	(959,096)	959,096	-
Totals after Fund reclassifications	4,484,995	2,044,657	152,077	194,014	81,713	6,957,456	4,113,488	-	28,839,564	1,087,420
Fund specific restatements:										
Self-Insurance Guaranty		3,929				3,929				
INVEST Program for Local Government	-	-	-	-	-		-	-	-	405
Deferred Compensation	-	-	-	-	-		-	-	4,245	-
Totals after Fund reclassifications and restatements	4,484,995	2,048,586	152,077	194,014	81,713	6,961,385	4,113,488	-	28,843,809	1,087,825
Major Governmental Funds - Fund Balance										
General Fund	4,484,995	-	-	-	-	4,484,995	-			
Motor License	-	751,961	-	-	-	751,961	-			
Total Nonmajor Funds - Governmental Fund Balance		1,296,625	152,077	194,014		1,642,716				
Government-wide reporting accruals, reclassifications and eliminations:						-				
Accrued taxes receivable	1,048,300	-	-	-	-	1,048,300	47,985			
Accrued accounts receivable	36,008	-	-	4,298	-	40,306	12,820			
Other receivables	-	1,637	-	-	-	1,637	-			
Eliminated due from other funds	(20,454)	(59,288)	(27)	(16,413)	(44,522)	(140,704)	(89)			
Eliminated inter fund advances	(50,508)	-	-	-	38,000	(12,508)	-			
Reclassification of due from fiduciary funds	396	432	17	-	34	879	25			
Inventory	10,717	40,226	-	-	-	50,943	-			
Accounts payable	-	-	-	-	-	-	(8,500)			
Eliminated due to other funds	111,043	55,998	(1)	131	344	167,515	77			
Reclassification of due to fiduciary funds	(23,286)	(4,402)	-	-	-	(27,688)	(13)			
Deferred revenue	(29,263)	21,495	7,768	-	-	-	-			
Eliminated inter fund advances	-	12,508	-	-	-	12,508	-			
Accrued interest payable	(69,138)	-	-	-	-	(69,138)	-			
Infrastructure capital assets	19,109,600	-	-	-	-	19,109,600	-			
General capital assets	4,505,090	-	-	-	-	4,505,090	-			
Proprietary capital assets	-	-	-	-	-	-	1,766			
Accumulated depreciation on infrastructure	(5,694,600)					(5,694,600)				
Accumulated depreciation on general capital assets	(1,511,570)	-	-	-	-	(1,511,570)	(1,247)			
Bonds payable and other general long-term liabilities	(8,006,269)	0	0	0	0	(8,006,269)	-			
Net adjustments	9,416,066	68,606	7,757	(11,984)	(6,144)	9,474,301	52,824			
Major Enterprise Funds - Net Assets:										
Unemployment Compensation							3,151,052			
State Workmen's Insurance							271,411			
State Lottery							201,388			
Tuition Payment							14,034			
Total Nonmajor Funds - Enterprise - Net Assets							528,427			
Restated June 30, 2001 Net Assets	$ 13,901,061	$ 2,117,192	$ 159,834	$ 182,030	$ 75,569	$ 16,435,686	$ 4,166,312			

NOTE B – RESTATEMENT OF PREVIOUSLY REPORTED FUND BALANCE/FUND EQUITY/NET ASSETS AT JUNE 30, 2001 (continued)

Compliance with the New Standards caused the Commonwealth to initiate changes in accounting for General Fixed Assets. At June 30, 2001, the minimum reporting threshold amount for machinery and equipment assets was increased from $20 thousand to $25 thousand. As a result, $56.360 million was removed from depreciable General Capital Assets. At June 30, 2001, classification of two former Special Revenue funds changed to the Enterprise fund category. Consequently, $1.766 million of machinery and equipment is accounted for in Enterprise funds. The Commonwealth owns various real estate assets that are used by the State System of Higher Education (SSHE), a discretely presented component unit. For financial reporting purposes, these assets, with a cost of $836.077 million, were reclassified from the Commonwealth's financial statements as of June 30, 2001. Previously unreported accumulated depreciation of $7.3 billion and infrastructure assets of $19 billion is being reported as of June 30, 2001. Restatement changes did not affect infrastructure asset balances and those amounts are included for informational purposes.

Asset Class	General Fixed Assets Reported Ending Balance June 30, 2001	Less: Increase in Minimum Reporting Threshold for Equipment Assets	Less: Change in Classification of **State Lottery** and Historical Preservation Funds to Proprietary Funds	Less: Change in Reporting Treatment for Commonwealth Owned Assets Used by SSHE	General Fixed Assets Restated Ending Balance June 30, 2001	Add: Infrastructure Assets at June 30, 2001	Less: Accumulated Depreciation at June 30, 2001	Net General Capital Assets at June 30, 2001
Non-depreciable capital assets:								
Land	$ 264,568	$ -	$ -	$ 17,251	$ 247,317	$ -	$ -	$ 247,317
Highway right-of-way	-	-	-	-	-	840,100	-	840,100
Construction in progress	651,361	-	-	36,039	615,322	-	-	615,322
Transportation construction	-				-	-		-
in progress	-	-	-	-	-	1,183,100	-	1,183,100
Subtotal	$ 915,929	$ -	$ -	$ 53,290	$ 862,639	$ 2,023,200	$ -	$ 2,885,839
Depreciable capital assets:								
Buildings	3,541,868	-	-	699,350	2,842,518	-	1,122,393	1,720,125
Improvements other than buildings	360,425	-	-	83,437	276,988	-	103,871	173,117
Machinery and equipment	581,071	56,360	1,766	-	522,945	-	285,306	237,639
Highway infrastructure	-	-	-	-	-	12,145,400	4,744,100	7,401,300
Bridge infrastructure	-	-	-	-	-	4,941,000	950,500	3,990,500
Subtotal	$ 4,483,364	$ 56,360	$ 1,766	$ 782,787	$ 3,642,451	$ 17,086,400	$ 7,206,170	$ 13,522,681
Totals	$ 5,399,293	$ 56,360	$ 1,766	$ 836,077	$ 4,505,090	$ 19,109,600	$ 7,206,170	$ 16,408,520

NOTE B – RESTATEMENT OF PREVIOUSLY REPORTED FUND BALANCE/FUND EQUITY/NET ASSETS AT JUNE 30, 2001 (continued)

Discretely Presented Non-Fiduciary Component Units

Restatements of June 30, 2001 Fund Balance/Fund Equity to June 30, 2001 Net Assets – Two former governmental component units, the State Public School Building Authority and the Pennsylvania Higher Educational Facilities Authority reported restatements, respectively, of $86,532 and $449,315 of June 30, 2001 fund balance to June 30, 2001 net assets. These restatements are the result of the discontinuation of the reporting of conduit debt obligations on the financial statements. The Insurance Fraud Prevention Authority, at June 30, 2001 and the Philadelphia Shipyard Development Corporation, at December 31, 2000, reported fund balance restatements of $22 and $22,422, respectively, due to implementation of the New Standards. At June 30, 2001, beginning net assets for the Pennsylvania Industrial Development Authority differ by $10 from total equity reported at June 30, 2001 because of a correction of a prior year error (amounts in thousands).

State System of Higher Education (SSHE) Fund Balance restatement – The SSHE, formerly reported under the AICPA's College and University financial reporting model, has adopted, effective June 30, 2001, the GASB's Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities.* Adjustments, additions and reclassifications related to this adoption produced a restatement of $218,372 from June 30, 2001 fund balance to June 30, 2001 net assets. This net amount includes a net increase of $382,162 in capital asset balances due to a change in the financial reporting of real estate assets owned by the primary government but used by the SSHE (amounts in thousands).

The following table depicts restatements of June 30, 2001 fund balance/fund equity for discretely presented component units (amounts in thousands):

Component Unit	Previously Reported June 30, 2001 Balance	Net Change	Restated Balance At June 30, 2001
State Public School Building Authority	$ 118,630	$ (86,532)	$ 32,098
Pennsylvania Higher Educational Facilities Authority	449,315	(449,315)	-
Insurance Fraud Prevention Authority	4,284	22	4,306
Philadelphia Shipyard Development Corporation	304	22,422	22,726
Pennsylvania Industrial Development Authority	534,146	10	534,156
State System of Higher Education	573,837	218,372	792,209
		$ (295,021)	

The Philadelphia Regional Port Authority, with beginning net assets of $28,171, and the Port of Pittsburgh Commission, with beginning net assets of $1,686, were not reported prior to June 30, 2001 (amounts in thousands)	$	29,857
Previously reported fund balance/fund equity for discretely presented non-fiduciary component units at June 30, 2001		5,409,506
Net New Standard and other reporting changes		(295,021)
Net assets, discretely presented non-fiduciary component units, June 30, 2001, as restated	$	5,144,342

NOTE C – NET ASSETS/FUND EQUITY

Governmental Activities and Business-Type Activities Net Assets: Total Net Assets are the difference between Total Assets and Total Liabilities reported on the Statement of Net Assets. Total Net Assets are reported in three distinct components: Invested in capital assets, net of related debt; Restricted net assets; and Unrestricted net assets. Invested in capital assets, net of related debt represents total capital assets less accumulated depreciation and the outstanding liability for debt specifically related to the acquisition of the capital assets. At June 30, 2002 governmental and business-type activities, respectively, reported $14,386,992 and $30,426 in net assets invested in capital assets net of related debt. Restricted net assets for special funds are those that are statutorily established and for which net assets may only be used for specific legislated purposes. Governmental fund balance "designations" are not treated as restricted net assets because they represent plans and can easily be changed. Restraints established by enabling legislation, on the other hand, are not easily changed. At June 30, 2002 governmental and business-type activities, respectively reported $1,616,864 and $3,470,190 in restricted net assets. Unrestricted net assets represent total net assets minus the totals of invested in capital assets, net of related debt and restricted net assets. At June 30, 2002 governmental activities reported unrestricted net assets of $868,340. Business-type activities reported an unrestricted net assets deficit of $26,005 at June 30, 2002 (amounts in thousands).

Governmental Fund Balance Reservations: Fund balance reservations reported in governmental fund balance sheets represent portions of governmental fund balances that are legally segregated for a specific future use or are not available for expenditure.

The amount reserved for advances in the **General Fund**, $29.1 million, is applicable to advances as follows: $14.3 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.

Governmental funds reported total fund balance "other" reservations of $693,740 at June 30, 2002. The $286,711 reported as "Reserved for other" in the **General Fund** at June 30, 2002 pertains to the following (amounts in thousands):

Continuing programs	$ 102,435
Restricted revenue	156,396
Judicial carryover appropriations	17,786
Receivables	10,094
Total **General Fund**	$ 286,711

"Reserved for other" at June 30, 2002 includes $355,505 reserved in the **Tobacco Settlement Fund** for various health-related programs. The remaining amount of $51,524 for nonmajor funds pertains to the following (amounts in thousands):

Land reclamation	$ 31,389
Pharmaceutical assistance programs	8,227
Recreation programs	1,596
Conservation, recycling and economic development programs	1,586
Worker's compensation	6,954
Total nonmajor Special Revenue programs	49,752
General State Authority maintenance in the Capital Facilities Fund	1,772
Total nonmajor funds other reservations	$ 51,524

NOTE C – NET ASSETS/FUND EQUITY (continued)

Governmental Fund Balance Designations - Designations of unreserved fund balances reported in governmental funds balance sheets reflect managerial plans for the future use of financial resources. At June 30, 2002 the Commonwealth has included the following amounts as "Designated—Other" for the **General Fund** and Special Revenue Funds (amounts in thousands):

General Fund:	
Group medical and life insurance	$ 151,464
Job creation tax credits	53,952
Judicial computer system	51,929
Agency construction projects	50,467
Other	16,072
Total **General Fund**	$ 323,884
Special Revenue Fund:	
Surface Mining Fund - Transfer	$ 12

Governmental Fund Balance Deficits: Individual funds have reported fund balance deficits in governmental funds balance sheets. The Workmen's Compensation Supersedeas Fund, a Special Revenue Fund, reported a fund balance deficit of $6,190 at June 30, 2002. The Capital Debt Fund, a Debt Service fund, reported a fund balance deficit of $3,782 at June 30, 2002 (amounts in thousands).

The Capital Facilities Fund, a Capital Projects Fund, reported a deficit unreserved/undesignated fund balance of $494,795 at June 30, 2002. In total, the Capital Facilities Fund reported a fund balance of $257,722 at June 30, 2002. Total Capital Projects Funds reported reservations for encumbrances of $795,392; other reservations of $1,772; designations for Capital Projects of $79,286; and an unreserved/undesignated fund balance deficit of $494,795; for total combined fund balances of $381,655 at June 30, 2002 (amounts in thousands).

Proprietary Fund Net Assets: Nonmajor funds reported total restricted net assets for "other purposes" of $422,971 at June 30, 2002 for the following programs: economic development loans, $192,912; emergency services loans, $116,458; liquor control, $68,571; mine subsidence insurance, $33,743; vocational rehabilitation, $3,843; and $7,444 for other programs (amounts in thousands).

The **Tuition Payment Fund**, an Enterprise Fund, reported deficit unrestricted net assets of $26,005 at June 30, 2002. The Purchasing Fund, an Internal Service Fund, reported deficit unrestricted net assets of $23,241 at June 30, 2002 (amounts in thousands).

Component Unit Net Assets: Except for the Pennsylvania Industrial Development Authority, net assets of all component units are restricted, consistent with enabling legislation for component units. Net assets are restricted to purposes specifically identified by the legislation that created the component unit entity.

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 Treasury Department is granted the power to invest in any deposits and investments 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. Such deposits and investments may include equity securities and mutual funds.

The Treasury Department manages the Treasury Investment Program (TIP), which is comprised of the Common Investment Pool, Treasury Liquid Asset Pool, **General Fund** Program and **Motor License Fund** Program. As of June 30, 2002, approximately 88 percent of the amounts from practically all Commonwealth Funds are invested on a temporary basis in the TIP. The objectives of the TIP are preservation of principal, liquidity, diversification, and income and all investments are made in accordance with the preceding statutory authority. Throughout the fiscal year, the TIP 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 and **Motor License Fund** Program represent funds accumulated beyond the ordinary cash needs of these Funds. These two Programs invest in equity and intermediate-term securities.

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, a Pension Trust fund, Workmen's Compensation Security Trust, a Special Revenue fund, and Underground Storage Tank Indemnification and Statutory Liquidator, both 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, often 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, 2002 (amounts in thousands).

Primary Government

	Category 1	Category 2	Category 3	Total Bank Balance	Carrying Amount
Cash	$ 608,209	-	$ 6,906	$ 615,115	$ 273,525
Cash with fiscal agents	2,913,953	-	-	2,913,953	2,913,953
Certificates of deposit and related items	162,080	-	14,613	176,693	176,693

Fiduciary funds reported $30,037 and $562,668, respectively, of cash and cash with fiscal agents at June 30, 2002. These amounts are not included in the Statement of Net Assets. The above-listed $176,693 in certificates of deposit and related items are reported as part of primary government temporary investments at June 30, 2002 (amounts in thousands).

Discretely Presented Component Units

	Category 1	Category 2	Category 3	Total Bank Balance	Carrying Amount
Cash	$ 92,993	-	$201,323	$ 294,316	$ 272,050

Fiduciary component units reported $8,755 (in thousands) of cash at their fiscal years ended December 31, 2001. These amounts are not included in the Statement of Net Assets.

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, 2002 (amounts in thousands).

Primary Government

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

Commercial paper	$ 214,128
Common and preferred stocks	8,921,736
Corporate bonds and notes	3,798,821
Certificates of deposit-negotiable	87
International fixed income	54,000
International equities	32,481
Mortgage loans	32,832
Real estate	349,223
Repurchase agreements	2,945,216
State and municipal obligations	863,292
U.S. Treasury obligations	3,735,874
U.S. Government agency obligations	2,609,940
Total categorized investments	23,557,630
Add investments not susceptible to credit risk categorization:	
Investments held by the **Tuition Payment Fund** at June 30, 2002:	
Securities lending collateral	34,339
Treasury Department global pool	29,067
Investments owned by the Deferred Compensation Fund at December 31, 2001:	
Money market funds	33,528
Mutual funds	949,146
Securities lending collateral	52,684
Investments owned by the State Employes' Retirement System (SERS) at December 31, 2001:	
Investments with Treasury Department	554,138
Money market funds	256,799
Mortgage loans	97,876
Mutual funds	7,396,900
Real estate	2,183,528
Securities lending collateral	1,212,508
Venture capital	2,496,474
Securities lent by SERS at December 31, 2001:	
U.S. Treasury obligations	425,683
Corporate bonds and notes	434,837
Common and preferred stocks	355,546
Investments owned by the Statutory Liquidator Fund at June 30, 2002:	
Treasury Department global pool	73,774
Annuities	1,976
Subsidiaries	79
Mortgage loans	219
Partnership interests	18
Subtotal forwarded to next page	$ 40,146,749

NOTE D - DEPOSITS AND INVESTMENTS (continued)

Subtotal forwarded from previous page	$ 40,146,749
Investments owned by the Underground Storage Tank Indemnification Fund at June 30, 2002:	
Private placements	2,673
Securities lending collateral	40,272
Treasury Department global pool	7,263
Securities lending collateral held by the **State Lottery Fund** at June 30, 2002	1,924
Investments held by the Workmen's Compensation Security Trust Fund at June 30, 2002:	
Mortgage loans	3,270
Securities lending collateral	82,322
Treasury Department global pool	61,569
Private placements, fixed income and equities	5,159
Securities lending collateral held by the **State Workmen's Insurance Fund** at December 31, 2001	469,054
Investments owned by the **General Fund** at June 30, 2002:	
Mortgage loans	815
Securities lending collateral	255,228
Investments owned by the **Tobacco Settlement Fund** at June 30, 2002	690
Investments owned by the Common Investment Pool at June 30, 2002:	
Money market funds	326,413
Mutual funds	25,347
Investments owned by the **Motor License Fund** at June 30, 2002:	
Securities lending collateral	57,916
Mortgage loans	533
Private placements	3,427
Subtotal	$41,490,624
Certificates of deposit and related items	176,693
Amount financially reported by discretely presented component units in Pennsylvania Treasury Common Investment Pool at June 30, 2002	(632,688)
Total primary government temporary and long-term investments	$ 41,034,629

The above-listed $176,693 in certificates of deposit and related items are financially reported as part of temporary investments at June 30, 2002, but are treated as deposits for a determination of the level of credit risk associated with them. Fiduciary funds reported $30,411,326 and non-fiduciary funds reported $10,623,303 of the above $41,034,629 total primary government investments at June 30, 2002. Non-fiduciary funds reported temporary and long-term investments, respectively, of $7,652,836 and $2,970,467 at June 30, 2002 (amounts in thousands). Primary government fiduciary funds investments are not reported in government-wide financial statements.

The State Employees' Retirement System, a Pension Trust Fund, owns 100 percent of the venture capital, 100 percent of the real estate, 100 percent of the investments with treasury department, approximately 54 percent of the securities lending collateral, 88 percent of mutual funds, 77 percent of the common and preferred stocks, 73 percent of the mortgage loans, 62 percent of the corporate bonds and notes and 48 percent of the U.S. Treasury obligations, reported in the above summary. The Treasury Common Investment Pool owns 100 percent commercial paper, approximately 97 percent of the state and municipal obligations, 66 percent of the international fixed income, 64 percent of the repurchase agreements, 63 percent of the U.S. Government agency obligations and 53 percent of the money market funds 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, 2000. The INVEST financial statements disclosed an auditor conclusion that investments in repurchase agreements involving $145.5 million in U.S. Government Agency securities that were not backed by the full faith and credit of the United States Government were not authorized investments for some INVEST program participants under state laws governing those INVEST participants at December 31, 2000. The terms of the repurchase agreements were four days and matured on January 2, 2001 with both principal and interest earned returned to 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.

NOTE D - DEPOSITS AND INVESTMENTS (continued)

Government and were not considered short term. Treasury Department management contends that since the repurchase agreements had a four-day maturity, the repurchase agreement were permissible *short-term* investments.

During the year ended December 31, 2001 INVEST owned additional similar repurchase agreements; at December 31, 2001 the independent auditor noted INVEST owned a similar repurchase agreement with $12.4 million in long-term U.S. Government Agency securities that were not backed by the full faith and credit of the United States Government. The Treasury Department is seeking statutory amendments to applicable laws to clarify this matter. Further, the Treasurer decided January 2002 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. Government or U.S. Government Agency securities unless they are backed by the full faith and credit of the U.S. Government.

Financial Instruments With Off-Balance Sheet Risk

The State Employees' Retirement System (SERS) enters into derivative and structured financial instruments primarily to enhance the performance and reduce the volatility of its investment portfolio. It enters into foreign exchange contracts to hedge foreign currency exposure, futures contracts to gain or hedge exposure to certain equity markets and manage interest rate risk, swaps to hedge against the effects of inflation, and collateralized mortgage obligation investments as part of its overall fixed income portfolio.

Foreign exchange contracts are agreements to exchange the currency of one country for the currency of another country at an agreed upon price and settlement date. The SERS uses these contracts primarily to hedge the currency exposure of its investments. To reduce the risk of counterparty nonperformance, the SERS generally enters into these contracts with institutions regarded as meeting high standards of creditworthiness. The unrealized gain/loss on contracts is included in the SERS's net assets and represents the fair value of the contract on December 31. At December 31, 2001, the SERS had contracts to purchase foreign currencies for a total notional amount of $3,999,140 and contracts to sell foreign currencies for a total notional amount of $3,113,334, for a total notional amount of $7,112,474. (amounts in thousands). Net unrealized gains on foreign currency contracts were approximately $23.5 million at December 31, 2001.

Discretely Presented Component Units
(amounts in thousands)

	Category 1	Category 2	Category 3	Total
Asset backed securities	$ -	$ 83,559	$ -	$ 83,559
Commercial paper	-	115,834	174,621	290,455
Common and preferred stocks	16,852,046	592	11	16,852,649
Corporate bonds and notes	4,300,793	88,914	114,941	4,504,648
International equities	6,777,450	-	-	6,777,450
International fixed income	1,055,057	-	-	1,055,057
Mortgage-backed securities	5,171,543	56,324	-	5,227,867
Repurchase agreements	120,377	99,822	81,236	301,435
State and municipal obligations	-	43,200	6,000	49,200
U.S. Treasury obligations	-	480,361	67,477	547,838
U.S. Government agency obligations	843,071	340,893	184,948	1,368,912
Various short-term investments	861,050	4,049	1,022	866,121
Total categorized investments	$ 35,981,387	$1,313,548	$ 630,256	$ 37,925,191

Investments not susceptible to credit risk categorization:

Investments owned by the Ben Franklin/IRC Partnership in Pennsylvania Treasury Common Investment Pool at June 30, 2002	242
Investments owned by the Ben Franklin Technology Development Authority in Pennsylvania Treasury Common Investment Pool at June 30, 2002	27,704
Investments owned by the Pennsylvania Housing Finance Agency at June 30, 2002:	
Investment agreements	28,357
Money market funds	146,583
Investments owned by the Pennsylvania Higher Education Assistance Agency at June 30, 2002:	
Guaranteed investment contracts	102,119
Investment agreements	6,000
Subtotal forwarded to next page ...	$ 38,236,196

NOTE D - DEPOSITS AND INVESTMENTS (continued)

Subtotal forwarded from previous page	$ 38,236,196
Money market funds	124,584
Pennsylvania Treasury Common Investment Pool	225,587
Investments owned by the Pennsylvania Infrastructure Investment Authority in Pennsylvania Treasury Common Investment Pool at June 30, 2002	377,491
Guaranteed investment contracts owned by the Pennsylvania Turnpike Commission at May 31, 2002	375,441
Investments owned by the Public School Employees' Retirement System at June 30, 2002:	
Invested with Pennsylvania Treasury Department	1,330,999
Mutual funds	1,269,174
Private equity	2,712,854
Real estate	1,754,636
Securities lending collateral	2,282,799
Securities lending investments	2,224,751
Venture capital	231,194
Investments owned by the Port of Pittsburgh Commission in the Pennsylvania Treasury Common Investment Pool at June 30, 2002	1,664
Mutual funds and other investments owned by the State System of Higher Education at June 30, 2002	34,344
Total temporary and long-term investments	$51,181,714

The total amount reported by discretely presented component units in the Pennsylvania Treasury Common Investment Pool is $632,688 at June 30, 2002; Common Investment Pool disclosures are included as part of Primary Government investment disclosures. Of the $51,181,714 in total temporary and long-term investments, non-fiduciary component units reported $2,152,100 in temporary investments and $1,952,426 in long-term investments; fiduciary component units reported $4,309,178 in temporary investments and $42,768,010 in long-term investments at June 30, 2002 (amounts in thousands). Fiduciary component unit investments are not included in government-wide financial statements.

The Public School Employees' Retirement System (PSERS), a Pension Trust fund, owns approximately 100 percent of the common and preferred stocks, 95 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 100 percent of the real estate reported in the above summary. The Pennsylvania Higher Education Assistance Agency owns 56 percent of commercial paper. The Pennsylvania Turnpike Commission owns 79 percent of the guaranteed contracts, 56 percent of state and municipal obligations and 85 percent of U.S. government obligations. The State System of Higher Education owns 100 percent of asset backed securities and 96 percent of mutual funds. The Pennsylvania Housing Finance Authority owns 56 percent of the various short-term investments, 83 percent of investment agreements and 54 percent of money markets. There were no violations of statutory authority or contractual provisions for investments during the fiscal year ended June 30, 2002.

Financial Instruments with Off-Balance Sheet Risk

The Public School Employees' Retirement System (System) enters into a variety of financial contracts, which include options and futures. The System also enters into foreign exchange positions, such as forward and spot contracts to hedge foreign exposure; collateralized mortgage obligations (CMOs); other forward contracts, and U.S. Treasury STRIPS. The System 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 System is exposed to credit risk in the event of nonperformance by counterparties to financial instruments. As the System 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 selection of executing brokers and review of all documentation. The System 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, through buying or selling instruments or entering into offsetting positions.

The notional or contractual amounts of derivatives indicate the extent of the System's involvement in the various types and uses of derivative financial instruments and do not measure the System'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.

NOTE D - DEPOSITS AND INVESTMENTS (continued)

The following table summarizes the aggregate notional or contractual amounts for the System's derivative financial instruments at June 30, 2002 (in thousands):

Futures contracts – long	$ 4,974,538
Futures contracts – short	3,286,061
Foreign exchange forward and spot contracts, gross	3,287,684
Options – calls purchased	83,000
Options – calls sold	214,148
Options – puts sold	129,602

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 future 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. In addition, the System enters into short sales, sales of securities it does not presently own, to neutralize the market risk of certain equity positions. Initial margin requirements on futures contracts and collateral for short sales are provided by investment securities pledged as collateral or by cash held in segregated accounts by the System's custodial bank or short sale broker. Although the System 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 and the amount of cash held at June 30, 2002 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 option. The System generally uses exchange listed currency, index, stock, and futures options. The System has authorized an investment manager to write covered call stock index option spreads up to a notional amount of $500,000,000.

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 $3,287,684,000 of foreign currency contracts outstanding at June 30, 2002 consist of "buy" contracts, which represents the U.S. dollar equivalents of commitments to purchase foreign currencies of $2,223,356,000 and "sell" contracts, which represent U.S. dollar equivalents of commitments to sell foreign currencies of $1,064,328,000. The unrealized gain/(loss) on contracts of $54,776,000 at June 30, 2002 is included in the System's net assets and represents the fair value of the contracts.

The System 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, 2002 is $2,229,059,000.

The System invests in U.S. Treasury STRIPS, which essentially act as zero coupon bonds and are subject to market volatility from an increase or decrease in interest rates. Through certain collective trust funds, the System also indirectly holds various derivative financial instruments. The collective trust funds invest in futures and options thereon; forward foreign currency contracts; options; interest rates, currency, equity, index, and total return swaps; interest-only STRIPS, and CMOs, to enhance the performance and reduce the volatility of their portfolios. Swap agreements are used to modify investment returns or interest rates on investments in the collective trust funds. Swap transactions involve the exchange of investment returns or interest rate payments without the exchange of the underlying principal amounts. These swaps expose the collective trust funds entering into these types of arrangements to credit risk in the event of nonperformance by counterparties.

NOTE D - DEPOSITS AND INVESTMENTS (continued)

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, 2002 (December 31, 2001 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, 2002 (December 31, 2001 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	$ 279,688
State Lottery Fund	3,298
Motor License Fund	64,713
State Workmen's Insurance Fund	536,502
Tuition Payment Fund	34,176
Workmen's Compensation Security Trust Fund	84,104
Deferred Compensation Fund	53,830
State Employees' Retirement System	1,216,066
Public School Employees' Retirement System	2,364,972
Underground Storage Tank Indemnification Fund	41,856

NOTE E – CAPITAL ASSETS

A summary of capital assets by category at June 30, 2002 is as follows (amounts in thousands):

	Primary Government			Discretely Presented Component Units	
	Governmental Activities		Business-Type Activities		
	General Capital Assets	Internal Service Funds	Enterprise Funds	Non-Fiduciary Funds	Fiduciary Funds
Land	$ 269,759	$ 6	$ 323	$ 152,745	$ -
Highway right-of-way	940,300	-	-	-	-
Buildings	2,946,691	3,981	6,711	2,219,224	-
Improvements other than buildings	296,019	3,025	16,095	198,906	-
Machinery and equipment	538,067	91,809	64,919	470,002	11,277
Library books and other	-	-	-	138,131	-
Turnpike infrastructure	-	-	-	3,649,109	-
Highway infrastructure	13,025,900	-	-	-	-
Bridge infrastructure	5,369,900	-	-	-	-
Waterway infrastructure	9,412	-	-	-	-
Construction in progress	1,061,011	-	-	469,308	-
Highway and bridge construction in progress	1,522,400	-	-		-
Total	$ 25,979,459	$ 98,821	$ 88,048	$ 7,297,425	$ 11,277

Changes in general capital assets for the fiscal year ended June 30, 2002 are as follows (amounts in thousands):

	Balance June 30, 2001 (Restated)	Additions	Retirements	Balance June 30, 2002
Non-Depreciable General Capital Assets:				
Land	$ 247,317	$ 22,456	$ 14	$ 269,759
Highway right-of-way	840,100	100,200	-	940,300
Construction in progress	615,322	559,175	113,486	1,061,011
Transportation construction in progress	1,183,100	1,648,700	1,309,400	1,522,400
Subtotal	2,885,839	2,330,531	1,422,900	3,793,470
Depreciable General Capital Assets:				
Buildings	2,842,518	105,195	1,022	2,946,691
Improvements other than buildings	276,988	19,031	-	296,019
Machinery and equipment	522,945	64,634	49,512	538,067
Highway infrastructure	12,145,400	880,500	-	13,025,900
Bridge infrastructure	4,941,000	428,900	-	5,369,900
Waterway infrastructure	-	9,412	-	9,412
Subtotal	20,728,851	1,507,672	50,534	22,185,989
Total general capital assets	$ 23,614,690	$ 3,838,203	$ 1,473,434	$ 25,979,459

NOTE E – CAPITAL ASSETS (continued)

Changes in General Capital Assets Accumulated Depreciation for the fiscal year ended June 30, 2002 are as follows (amounts in thousands):

	Balance June 30, 2001 (Restated)	Additions	Retirements	Balance June 30, 2002
Buildings	$ 1,122,393	$ 74,322	$ 321	$ 1,196,394
Improvements other than buildings	103,871	10,512	-	114,383
Machinery and equipment	285,306	35,917	34,599	286,624
Highway infrastructure	4,744,100	503,400	-	5,247,500
Bridge infrastructure	950,500	103,100	-	1,053,600
Waterway infrastructure	-	219	-	219
Total accumulated depreciation	$ 7,206,170	$ 727,470	$ 34,920	$ 7,898,720

Depreciation expense, by function, related to General Capital Assets for the fiscal year ended June 30, 2002 is as follows (amounts in thousands):

Direction and supportive services	$ 21,297
Protection of persons and property	51,844
Public education	1,259
Health and human services	14,033
Recreation and cultural enrichment	10,159
Transportation	628,878
Total depreciation expense	$ 727,470

The Pennsylvania Turnpike Commission, a discretely presented component unit, capitalized interest costs of $1.5 million during its fiscal year ended May 31, 2002.

The Commonwealth's initial valuation of general capital assets was made as of June 30, 1986 using appraisal and historical cost reconstruction techniques. Subsequent to June 30, 1986, general capital asset acquisitions are reported at cost or, for donations or confiscations, at fair market value. At June 30, 2002 the amount of general capital assets related to the initial 1986 valuation amounts to $1,241 million and does not include highway, bridge or waterway infrastructure.

Construction in progress included in general capital assets at June 30, 2002 includes project information as follows (amounts in thousands):

		Expended Through June 30, 2002		
	Project Authorization	Amounts Previously Capitalized	Amounts Not Capitalized To Date	Authorization Available
Department of Corrections Institutions	$ 934,957	$ 152,111	$ 510,641	$ 272,205
Capital Complex	782,842	191,246	341,990	249,606
State Parks and Forests	171,483	-	45,905	125,578
Agriculture Facilities	94,803	-	29,861	64,942
Veterans Homes and Military Armories	61,679	-	36,710	24,969
Transportation Facilities	61,508	-	34,994	26,514
Historical & Museum Commission Facilities	48,059	-	15,936	32,123
State Police Facilities	32,464	-	21,578	10,886
Education Department Institutions	30,858	-	10,214	20,644
Department of Public Welfare Institutions	46,406	-	10,850	35,556
Other	8,038	-	2,332	5,706
Total	$2,273,097	$ 343,357	$ 1,061,011	$ 868,729

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 4.5 percent and a 4.0 percent discount rate at December 31, 2000 and 2001, 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, 2001 and 2000, 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 December 31	Prior Year Liability	Incurred Claims Current	Incurred Claims Prior	Payments Current	Payments Prior	Current Year Liability
2001..........................	$1,054,252	$ 127,025	$ (4,267)	$ 15,322	$ 129,182	$1,032,506
2000..........................	$1,137,459	$ 103,184	$ (31,831)	$ 11,505	$ 143,055	$1,054,252

Tuition Benefits Payable

The reported liability for tuition benefits payable of $399 million of the **Tuition Payment Fund**, an Enterprise Fund, at June 30, 2002, is based on several actuarial assumptions, including those related to future sales of tuition credits, tuition cost increases, investment experience and program expenses. The June 30, 2002 actuarial analysis includes the effects of material changes, in both structural items relating to the Tuition Account Program (TAP) and in outlook regarding economic items, from the June 30, 2001 analysis. Based on implementation of a separate market based investment plan, program expenses to be paid by the fund are significantly reduced. Projected voluntary termination of TAP Credit owners has been increased to 1.0 percent from 0.5 percent. The projected tuition inflation assumptions have been revised because of higher than projected tuition inflation during the fiscal year ended June 30, 2002. The short-term investment return assumptions have been reduced from 8.5 percent to 8.0 percent for the fiscal years ending June 30, 2004 and 7.5 percent for the following three fiscal years. For fiscal years ending June 30, 2008 and later, the investment return assumption reverts to 8.5 percent. The effect of these changes increased the aggregate actuarial reserve (actuarial value of assets less liabilities) by $1.4 million.

NOTE G - TAXES, LOANS AND LEASE RENTALS RECEIVABLE

Taxes Receivable: Taxes receivable at June 30, 2002 consisted of the following (amounts in thousands):

	Statement of Net Assets Governmental Activities
Sales and use	$ 927,627
Personal income	453,765
Corporation	759,740
Liquid fuels	63,358
Other	100,170
Total	$ 2,304,660

Governmental activities taxes receivable includes $604,380 expected to be collected after June 30, 2003 (amounts in thousands).

	Fund Balance Sheets			
	General	Motor License	Nonmajor Governmental Funds	Fiduciary Funds
Sales and use	$ 899,549	$ -	$ 28, 078	$ -
Personal income	453,765	-	-	-
Corporation	759,740	-	-	-
Liquid fuels	-	63,358	-	-
Other	14,103	86,067	-	22,679
Total	$ 2,127,157	$ 149,425	$ 28,078	$ 22,679

General Fund taxes receivable includes $604,380 expected to be collected after June 30, 2003 (amounts in thousands).

Loans Receivable: Loans receivable at June 30, 2002 consisted of the following (amounts in thousands):

	Primary Government		
	Governmental Activities Special Revenue Funds	Business Type Activities Enterprise Funds	Discretely Presented Component Units
Mortgage loans	$ -	$ -	$ 3,153,369
Student loans	-	-	3,260,384
Economic development loans	44,711	147,998	580,265
Drinking water, storm water and sewer system loans	11,650	-	1,271,612
Volunteer fire company loans	-	109,794	-
Other notes and loans	15,543	13,699	74,854
	71,904	271,491	8,340,484
Less: allowance for uncollectible amounts	31,941	33,238	424,541
Loans receivable, net	$ 39,963	$ 238,253	$ 7,915,943

Special Revenue funds report $37,479 in loans due after June 30, 2003 and the Enterprise funds report $196,803 in loans due after June 30, 2003. Discretely presented component units reported $6,966,683 in loans receivable due after June 30, 2003 (amounts in thousands).

The **General Fund** and Agency Funds reported $10,097 and $6,015 in loans, respectively, for program objectives and to replace underground storage tanks at June 30, 2002 (amounts in thousands).

NOTE G - TAXES, LOANS AND LEASE RENTALS RECEIVABLE (continued)

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 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, 2002 the total minimum lease payments to be received were $1.7 million and the present value of the lease payments was $1.5 million, the difference representing interest of $.2 million. The Pennsylvania Industrial Development Authority, a discretely presented component unit, reported a lease rental receivable with total minimum payments of $28 million, present value of $18 million and interest of $10 million at June 30, 2002. Minimum lease payments receivable for the five fiscal years succeeding June 30, 2002 are as follows (amounts in thousands):

Fiscal Year Ending June 30	Primary Government	Discretely Presented Component Units
2003	$ 194	$ 634
2004	193	634
2005	194	634
2006	193	2,923
2007	194	5,212

Except for $194 due to the primary government and $634 due to discretely presented component units, all amounts receivable under lease rentals are due after June 30, 2003 (amounts in thousands).

NOTE H – INTERNAL/INTERFUND BALANCES AND TRANSFERS

In the Statement of Net Assets, reported internal balances assets/liabilities for governmental activities differ from internal balances assets/liabilities for business-type activities because the **State Workmen's Insurance Fund**, an Enterprise Fund, reports for its fiscal year ended December 31, 2001.

The composition of governmental and proprietary funds interfund balances reported at June 30, 2002 is as follows, with Major Fund titles in bold. Aggregate nonmajor governmental funds receivables from other funds and from component units, respectively, amount to $48,238 and $21,849; aggregate nonmajor enterprise funds receivables amount to $2,385; aggregate internal service funds receivables amount to $821; and aggregate fiduciary funds receivables amount to $1,515 at June 30, 2002 (amounts in thousands):

FUND TYPE/FUND PRIMARY GOVERNMENT	DUE FROM Other Funds	DUE FROM Component Units	DUE TO Other Funds	DUE TO Component Units
General Fund	$ 49,109	$ 7,043	$ 72,999	$ 134
Special Revenue:				
Motor License Fund	4,985	2,054	40,215	8,116
Tobacco Settlement Fund	-	-	4	-
Hazardous Sites Clean-up Fund	16,487	-	9	-
State Racing Fund	-	-	7,312	-
Vocational Rehabilitation Fund	50	-	1,798	-
Pharmaceutical Assistance Fund	3,500	-	-	-
Agricultural Conservation Easement Fund	10,242	-	-	-
Public Transportation Assistance Fund	3,241	-	385	-
Other Funds	1,835	-	5,157	-
	40,340	2,054	54,880	8,116
Debt Service:				
Pennsylvania Infrastructure Investment Authority Redemption Fund	-	21,849	-	-
Other Funds	13	-	-	-
	13	21,849	-	-
Capital Projects:				
Capital Facilities Fund	12,870	-	1	-
Keystone Recreation, Park and Conservation Fund	-	-	5,700	-
	12,870	-	5,701	-
Enterprise:				
Unemployment Compensation Fund	2,668	399	-	-
State Lottery Fund	-	-	42	-
State Workmen's Insurance Fund	130	-	2,637	-
Tuition Payment Fund	-	-	16	-
State Stores Fund	313	-	20,827	-
Rehabilitation Center Fund	1,606	-	44	-
Other Funds	466	60	9	-
	5,183	459	23,575	-
Internal Service:				
Purchasing Fund	836	287	-	-
Manufacturing Fund	5	51	3	-
	841	338	3	-
Pension Trust:				
State Employees' Retirement System	1,515	-	-	-
	1,515	-	-	-
Total primary government	$ 109,871	$ 31,743	$ 157,158	$ 8,250

NOTE H – INTERNAL/INTERFUND BALANCES AND TRANSFERS (continued)

DISCRETELY PRESENTED COMPONENT UNITS	DUE FROM PRIMARY GOVERNMENT	DUE FROM COMPONENT UNITS	DUE TO PRIMARY GOVERNMENT	DUE TO COMPONENT UNITS
Non-fiduciary:				
Pennsylvania Turnpike Commission	$ 6,643	$ -	$ 5,773	$ -
Pennsylvania Infrastructure Investment Authority	-	130	24,767	16
Other Component Units.................................	95	16	801	130
	6,738	146	31,341	146
Fiduciary:				
Public School Employees Retirement System..	562	-	409	-
Total discretely presented component units...	$ 7,300	$ 146	$ 31,750	$ 146

The amount of total reported interfund receivables of $149,060 thousand does not agree with total reported interfund payables of $197,304 thousand at June 30, 2002 due to different fiscal year ends and reporting differences for certain Funds included in the Fund Financial Statements at June 30, 2002. The amount reported for the Pennsylvania Turnpike Commission, a discretely presented component unit, is reported at its fiscal year ended May 31, 2002 and the amounts reported as interfund balances for the State Employees' Retirement System and the Deferred Compensation Fund, Pension Trust Funds, the INVEST Program for Local Governments, an Investment Trust Fund and the **State Workmen's Insurance Fund**, an Enterprise Fund, are reported at their fiscal years ended December 31, 2001. The following presents a reconciliation of interfund balances reported at June 30, 2002 and those amounts which would have been reported if all Funds reported at the same fiscal year end (amounts in thousands):

Due from other funds at June 30, 2002..	$ 109,823
Due from fiduciary funds at June 30, 2002...	48
Due from primary government at June 30, 2002..	7,300
Due from component units at June 30, 2002	31,889
Reported Interfund Receivables...	149,060
Pennsylvania Turnpike Commission increase in receivables from June 1, 2002 to June 30, 2002..	1,473
State Workmen's Insurance Fund decrease in receivables from January 1, 2002 through June 30, 2002	61
State Employees' Retirement System increase in receivables from January 1, 2002 through June 30, 2002	702
Interfund receivables eliminated from Internal Service Funds.........................	37,443
Interfund receivables eliminated from certain Enterprise Funds.....................	64
Interfund receivables reported as Accounts Receivable in Fiduciary Funds......	7,965
Reconciled Interfund Receivables	$ 196,768
Due to other funds at June 30, 2002	$ 157,070
Due to fiduciary funds at June 30, 2002..	88
Due to primary government at June 30, 2002..	31,750
Due to component units at June 30, 2002	8,396
Reported Interfund Payables..	197,304

NOTE H – INTERNAL/INTERFUND BALANCES AND TRANSFERS (continued)

State Employees' Retirement System increase in payables from January 1, 2002 through June 30, 2002	714
State Workmen's Insurance Fund decrease in payables from January 1, 2002 through June 30, 2002	(2,440)
Deferred Compensation Fund increase in payables from January 1, 2002 through June 30, 2002	85
Interfund payables eliminated from Internal Service Funds	373
Interfund payables eliminated from certain Enterprise Funds	67
Interfund payables reported as Accounts Payable in Fiduciary Funds	665
Reconciled Interfund Payables	$ 196,768

At June 30, 2002 the **General Fund** reported Advances to Other Funds of $29,108. 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, Special Revenue Funds, and $14,300 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 $1,803 at its fiscal year ended December 31, 2001 and the Purchasing Fund, which reports a $14,300 "other" liability (amounts in thousands). At June 30, 2002 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, 2002 the **Tuition Payment Fund**, an Enterprise Fund, has reported an Advance from Other Funds of $50 thousand.

In the Statement of Net Assets, only advances between governmental activities and business-type activities are reported.

A summary of transfers reported for the fiscal year ended June 30, 2002 is as follows, with Major Fund titles in bold. Aggregate nonmajor governmental fund transfers from other funds amount to $1,201,120 during June 30, 2002 and include a $359,000 transfer from the **State Lottery Fund** to the Pharmaceutical Assistance Fund (amounts in thousands):

	TRANSFERS			
PRIMARY GOVERNMENT	**In**	**From Component Units**	**Out**	**To Component units**
General Fund	$ 213,419	$ 256,206	$1,528,451	$1,043,197
Special Revenue:				
Tobacco Settlement Fund	853,938	-	96,109	8,000
Motor License Fund	3,937	-	86,756	28,000
Hazardous Sites Clean-up Fund	-	-	7,000	-
State Racing Fund	-	-	7,293	-
Vocational Rehabilitation Fund	37,357	-	-	-
Pharmaceutical Assistance Fund	418,560	-	-	-
Water Facilities Loan Fund	-	-	2,491	-
Environmental Stewardship Fund	80,000	-	19,130	-
Other Funds	30,212	-	40,225	-
	1,424,004	-	259,004	36,000
Debt Service:				
Land and Water Development Sinking Fund	7,751	-	-	-
Water Facilities Loan Redemption Fund	11,823	-	-	-
Capital Debt Fund	546,781	-	-	-
Pennsylvania Infrastructure Investment Authority Redemption Fund	23,587	-	-	-
Local Criminal Justice Sinking Fund	14,926	-	-	-
Agricultural Conservation Easement Sinking Fund	7,239	-	-	-
Keystone Recreation, Park and Conservation Fund	4,157	-	-	-

NOTE H – INTERNAL/INTERFUND BALANCES AND TRANSFERS (continued)

	TRANSFERS (continued from previous page)			
	In	From Component Units	Out	To Component units
Debt Service continued:				
Disaster Relief Redemption Fund............................	9,759	-	-	-
Pennsylvania Economic Revitalization Sinking Fund	5,055	-	-	-
Volunteer Company Loan Sinking Fund	2,882	-	-	-
Other Funds..	1,031	-	-	-
	634,991	-	-	-
Capital Projects:				
Capital Facilities Fund..	-	-	3,937	-
Enterprise:				
State Lottery Fund	-	-	359,000	-
State Stores Fund..	-	-	121,716	-
Small Business First Fund	-	-	306	-
	-	-	481,022	-
Total primary governments...................................	$2,272,414	$256,206	$2,272,414	$1,079,197

DISCRETELY PRESENTED COMPONENT UNITS	In	From Primary Government	Out	To Primary Government
Non-fiduciary:				
Pennsylvania Higher Education Assistance Agency..	$ -	$ 412,618	$ -	$ -
Ben Franklin/Technology Development Authority ...	-	71,009	-	-
Pennsylvania Industrial Development Authority.......	-	-	-	256,206
State System of Higher Education...........................	-	471,821	-	-
Pennsylvania Turnpike Commission	-	28,000	-	
Total discretely presented component units............	$ -	$ 983,448	$ -	$ 256,206

Total primary government governmental funds transfers between governmental funds of $1,791,392 have been eliminated in the Statement of Activities; total business-type activities transfers of $481,022 to governmental activities are reported. The total amount of primary government governmental funds transfers to component units of $1,079,197 is reported as part of governmental activities expenses in the Statement of Activities. Total component unit subsidies reported in the Statement of Activities does not include $95,749 in resources from the primary government to the Pennsylvania Infrastructure Investment Authority that are reported as capital grants and contributions. During the fiscal year ended June 30, 2002 the Pennsylvania Industrial Development Authority issued bonds and deposited $256,206 (amounts in thousands) in a Commonwealth account. The amount deposited will be used to fund debt service expenditures during the fiscal year ending June 30, 2003.

Assigned Investment Income: Certain funds, as follows, receive but do not financially report investment income that 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/contractual reasons (in thousands).

Assigning Fund	Receiving Fund	Reason	Amount
Liquor License	**General**	Legal/contractual	$ 76
Liquid Fuels Tax	**Motor License**	Legal/contractual	365
Land and Water Development	Land and Water Development Sinking	Legal/contractual	49
Remining Financial Assurance	Land and Water Development Sinking	Other than legal/contractual	99
PA Economic Revitalization	PA Economic Revitalization Sinking	Other than legal/contractual	26
Fire Insurance Tax	State Insurance	Legal/contractual	783
Fire Insurance Tax	Municipal Pension Aid	Legal/contractual	301

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
30 North Third Street
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, 2001 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 5 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 for Class A members 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.

Article II of the Pennsylvania Constitution provides the General Assembly the authority to establish or amend benefit provisions. Act 9, signed into law on May 17, 2001 established Class AA membership whereby, generally, annual full retirement benefits for electing active members were increased by 25 percent and, for certain members of the General Assembly, by 50 percent effective July 1, 2001. State employees hired after June 30, 2001 are Class AA members.

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. Commonwealth law determines all member contribution rates. 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. Act 9 of 2001 provides that new benefits arising from Act 9 are to be funded over a ten-year period, with level dollar funding, beginning July 1, 2002. Act 9 also provides that all the existing actuarial assets and liabilities will be combined and refinanced over a ten-year period using level dollar funding and future actuarial gains and losses are to be amortized using ten-year level dollar funding.

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 (amounts in thousands):

Year ended December 31	Annual Required Contribution	Percentage Contributed
2001	$ 52,104	147.2
2000	$ 168,002	100
1999	$ 269,869	100

At December 31, 2001, 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: 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. United States government obligations, corporate and foreign bonds and notes, and common and preferred stocks are generally valued based on published market prices and quotations from national security exchange and securities pricing services. Collective trust funds do not pay interest or dividends to shareholders, and reinvest all income earned on securities held by the fund. The fair value of these funds is based on the reported share value of the respective fund. Collective trust funds are principally managed by Barclays Global Investors, N.A. for which the United States Office of the Comptroller of the Currency has regulatory oversight. Securities that are not traded on a national security exchange are valued by the asset manager or third parties based on similar sales. 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. Alternative investments, which include venture capital, leveraged buyouts, international private equities and other investments are valued based on amounts established by valuation committees, which are subject to an annual independent audit.. 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. During 2001 the reported value of total investments declined by over $2 billion.

Investment Concentration: At December 31, 2001, approximately $452 million, or 17.8 percent, of the total SERS real estate portfolio was located in the Commonwealth of Pennsylvania. Also, investments in corporate and foreign bonds and notes include approximately $774 million and $1,049 million of high-yield bonds at December 31, 2001.

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 employee members. At June 30, 2002 there were 706 participating employers, generally school districts. The PSERS provides retirement, death, disability and health care benefits. In most cases, retirement benefits vest after 5 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.

Act 9 of 2001 provided for members to elect Membership Class T-D and convert from Membership Class T-C effective July 1, 2001. Benefits for full retirement are generally equal to 2 percent (Membership Class T-C) or 2.5 percent (Membership Class T-D) 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 rates for employees in Membership Class T-C and T-D hired before July 22, 1983 are 5.25 and 6.50 percent of covered payroll, respectively; for employees in Membership Class T-C and T-D hired after July 21, 1983, the rate are 6.25 and 7.50 percent, respectively. The increased member contribution rates for Class T-D became effective January 1, 2002. Commonwealth law determines member contribution rates.

Since 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 that are not school entities, the employer contribution is paid equally by the employer and the Commonwealth to the PSERS; no Commonwealth reimbursement occurs.

NOTE I - RETIREMENT AND OTHER POSTEMPLOYMENT BENEFITS (continued)

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
2002	$ 539	100
2001	$ 158,193	100
2000	$ 390,504	100

At June 30, 2002, the PSERS disclosed that $82,900 of $166,238 (in thousands) of member receivables for purchases of service credit are due subsequent to June 30, 2003.

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 employees' 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 that 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 is 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 and equity real estate are reported based on amounts established by valuation committees. 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 the fair value of investments. Initial margin requirements for such financial instruments are provided by investment securities pledged as collateral or by cash.

Investment Concentration: At June 30, 2002, 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 $295 million for the fiscal year ended June 30, 2002. Approximately 86,000 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, 2002.

NOTE J - NOTES AND DEMAND REVENUE BONDS PAYABLE

Primary Government

During the fiscal year ended June 30, 2002, the Commonwealth did not issue any tax or bond anticipation notes or any other short-term debt and no short-term debt was repaid. At June 30, 2002 and 2001, no short-term debt was outstanding.

Discretely Presented Component Units

The Pennsylvania Higher Education Assistance Agency (PHEAA), a discretely presented component unit, has reported $2,061 million of demand revenue bonds outstanding and $970 million of notes payable, consisting of student loan financing of $770 million, capital financing of $78.8 million, term financing of $91.2 million and other lines of credit of $30 million at June 30, 2002 as follows (amounts in thousands):

	Balance June 30, 2001	Additions	Reductions	Balance June 30, 2002
Student loan demand revenue bonds due 2018-2040, at weighted average interest rates of 1.58 and 3.23 percent at June 30, 2002 and 2001, respectively.......................................	$ 1,711,000	$ 350,000	$ -	$ 2,061,000
Notes Payable:				
Student loan financing, due in 2001-2007, at weighted average interest rates of 2.33 and 5.25 percent at June 30, 2002 and 2001, respectively.......................................	735,785	193,974	159,800	769,959
Capital financings, due 2001-2031 at weighted average interest rates of 5.36 and 6.06 percent at June 30, 2002 and 2001, respectively.......................................	82,155	681	3,553	79,283
Term financings, due 2002-2003 at weighted average interest rates of 5.26 and 5.93 percent at June30, 2001 and 2002, respectively........	19,773	76,501	4,448	91,826
Other lines of credit, due on demand at weighted average interest rates of 3.91 and 6.50 percent at June 30, 2002 2001, respectively.......................................	20,000	10,000	-	30,000
	857,713	281,156	167,801	971,068
Less: unamortized discount.........................	421	647	31	1,037
Total Notes Payable	$ 857,292	$ 280,509	$ 167,770	$ 970,031

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 2002 through 2010. The PHEAA is required to pay annual commitment fees ranging from 15 to 33 basis points on the stated amount of the letter of credit coverage. At June 30, 2002 total letter of credit coverage was $1.3 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, 2002, $3.4 billion of debt is collateralized by $3.2 billion of student loan principal and related interest receivable, and $327 million of investments and related interest receivable. Capital

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

financings are collateralized with capital assets. Amounts due under other lines of credit are generally unsecured. At June 30, 2002 the PHEAA had $50 million of available credit under student loan financing arrangements and $16 million available under other lines of credit.

Debt service requirements subsequent to June 30, 2002, based upon stated maturities of notes payable, bonds payable and other financings and obligations are as follows (amounts in thousands):

	Student Loan Bonds And Financings		Capital and Other Financings and Obligations Under Capital Lease	
Year of Maturity	**Principal**	**Interest**	**Principal**	**Interest**
2003	$ 147,049	$ 49,265	$ 87,004	$ 12,386
2004	-	48,528	9,304	8,616
2005	587,910	34,535	9,467	8,037
2006	-	34,534	5,697	7,577
2007	35,000	34,373	3,652	7,291
2008-12	-	167,842	74,970	28,599
2013-17	-	167,842	11,120	13,626
2018-22	321,000	150,523	13,970	10,669
2023-27	375,000	139,649	17,820	6,710
2028-32	425,000	101,215	17,735	1,790
2033-37	-	89,089	-	-
2038-42	940,000	65,559	-	-
Total	$ 2,830,959	$1,082,954	$ 250,739	$ 105,301

The PHEAA has $2.8 billion of student loan bonds and financings that are variable-rate debt, of which $971 million resets based upon auctions every seven days, $940.1 million resets based upon auctions every 28 days, $150 million resets based upon auctions every 35 days, $622.9 million is indexed to 91-day Treasury bills, and the remaining $147 million is indexed to the 3-month LIBOR.

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 the principal, redemption price, if any, or interest on any of the PHEAA's debt.

The Pennsylvania Housing Finance Agency (PHFA), a discretely presented component unit, maintains a $50 million note for the funding of the Hafer Homebuyer Program. This note bears interest from the date of issuance at a rate equal to the daily short-term investment pool rate. At June 30, 2002 there was no balance 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 and a Pew Foundation Bridge Loan Note bearing interest at a fixed rate of 3 percent. At June 30, 2002 the amounts owed against these notes were zero and $796 thousand, respectively.

NOTE K – LONG TERM OBLIGATIONS

Long-term obligations of the Commonwealth's primary government at June 30, 2002 and changes for the fiscal year ended June 30, 2002 are as follows (amounts in thousands):

GENERAL LONG-TERM OBLIGATIONS	**Issue Dates**	**Interest Rates**	**Maturity Dates Through**	**Bonds Authorized But Unissued**	**Balance July 1, 2001**	**Additions**	**Reductions**	**Balance June 30, 2002**
General Obligation Bonds Payable From Tax Revenues:								
Capital Facilities......................................	1972-02	4.36-6.60%	2022	$ 27,826,406	$ 3,687,885	$ 1,000,000	$ 516,905	$ 4,170,980
Disaster Relief...	1973-01	4.60- 5.56%	2021	105,908	37,550	-	7,795	29,755
Land and Water Development................	1972-94	4.89- 6.44%	2014	300	19,660	-	7,990	11,670
Nursing Home Loan Development	1983	8.26%	2002	31,000	1,075	-	525	550
Volunteer Companies Loan....................	1982-98	4.84-8.26%	2018	-	20,675	-	2,670	18,005
Vietnam Conflict Veterans Compensation...	1974	5.36%	2003	3,000	1,365	-	430	935
Water Facilities Loan..............................	1983-97	4.89- 8.26%	2017	11,500	98,880	-	19,045	79,835
Pennsylvania Economic Revitalization	1991-95	5.04- 6.44%	2015	14,000	23,465	-	13,020	10,445
Pennsylvania Infrastructure Investment Authority	1991-01	4.62- 6.44%	2021	267,000	230,935	-	45,085	185,850
Agricultural Conservation Easement Purchase..	1991-98	4.47- 6.60%	2018	-	66,070	-	21,420	44,650
Local Criminal Justice	1992-01	4.36- 6.60%	2021	8,000	146,600	1,000	45,195	102,405
Keystone Recreation, Park and Conservation...	1994-98	4.84- 6.60%	2018	-	41,640	-	6,995	34,645
Refunding Bonds.....................................	1992-02	4.36- 5.73%	2018	-	1,169,281	354,312	141,380	1,382,213
....				28,267,114	5,545,081	1,355,312	828,455	6,071,938
Other General Long-Term Obligations Payable From Tax and Other Revenues:								
Installment Purchase Obligations...........	-	-	-	-	26,165	1,733	13,554	14,344
Capital Lease Obligations.......................	-	-	-	-	52,299	4,034	4,260	52,073
Obligations Under Master Lease— Prison Facilities......................................	-	-	-	-	594,520	-	31,500	563,020
Self-Insurance—Note M.........................	-	-	-	-	633,446	172,567	98,736	707,277
Compensated Absences	-	-	-	-	699,178	360,515	324,196	735,497
Catastrophic Motor Vehicle Losses........	-	-	-	-	126,368	14,509	18,890	121,987
Other	-	-	-	-	329,212	279,528	182,469	426,271
				-	2,461,188	832,886	673,605	2,620,469
TOTAL GENERAL LONG-TERM OBLIGATIONS				$ 28,267,114	$ 8,006,269	$ 2,188,198	$ 1,502,060	$ 8,692,407

Revenue bond obligations of discretely presented component units at June 30, 2002 (May 31, 2002 for the Pennsylvania Turnpike Commission) and changes for the fiscal year then ended are as follows (amounts in thousands):

Pennsylvania Higher Education Assistance Agency.................................	1988-02	4.18%	2026	$ 537,925	$ -	$ -	$ 537,925
Philadelphia Regional Port Authority.....	1993	2.75-6.20%	2020	54,445	-	1,870	52,575
State System of Higher Education	2000	5.70-10.00%	2032	15,970	-	-	15,970
Pennsylvania Housing Finance Agency .	1982-02	1.80-9.48%	2033	2,884,769	495,660	406,310	2,974,119
Pennsylvania Industrial Development Authority...	1994-02	4.00-7.00%	2021	328,220	258,100	29,695	556,625
Pennsylvania Turnpike Commission	1992-01	2.50-6.00%	2041	1,936,365	732,545	517,675	2,151,235
Pennsylvania Infrastructure Investment Authority...	1990-98	4.00-6.45%	2013	161,400	-	14,085	147,315
				5,919,094	1,486,305	969,635	6,435,764
Less: Bond discounts..............................	-	-	-	42,082	14,323	53,298	3,107
Deferred costs of refunding……...	-	-	-	11,565	13,467	961	24,071
Deferred refunding loss.................	-	-	-	2,166	286	323	2,129
TOTAL REVENUE BONDS				$ 5,863,281	$ 1,458,229	$ 915,053	$6,406,457

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 its general obligation bonds. Typically only the **General Fund** and the **Motor License Fund** transfer amounts to Debt Service funds for general obligation bond principal and interest payments. During the fiscal year ended June 30, 2002, respectively, these Funds transferred $462,709 and $84,072 to the Capital Debt fund, which reported $667,439 (88 percent) of total Debt Service funds principal and interest expenditures of $757,823 (amounts in thousands). Except for Catastrophic Motor Vehicle Losses, which are funded by motorist violation fines, general long-term obligations other than general obligation bonds are funded by specific Funds where capital assets are procured using long-term vendor or other financing, where employees earn compensated absences or where self-insurance claims originate.

The total “Additions” of $1,355,312 for General Obligations Bonds Payable from Tax Revenues at June 30, 2002 differs from total bond and refunding bond proceeds of $1,419,667 for Governmental Funds, as reported in the Statement of Revenues, Expenditures and Changes in Fund Balances, by $64,355. This difference includes premium on bonds issued of $68,032, less principal accretion for capital appreciation bonds of $3,677. During the fiscal year ended June 30, 2002 $1,532 of bond premium was amortized and credited to bond interest expense in the Statement of Activities, unamortized premium in the Statement of Net Assets at June 30, 2002 is $62,823 (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, 2002 for general obligation refunding bonds includes $26.7 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 workmen’s compensation assessments and **General Fund** tax revenues are the following at June 30, 2002 (amounts in thousands):

Workmen’s Compensation Security Trust Claims	$ 363,911
Public Utility Realty Tax Act (PURTA)	25,614
Litigation—Note N	36,438
Arbitrage Rebate Tax	308
	$ 426,271

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 General Long-Term Obligations at June 30, 2002 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, 2002 the Commonwealth has reported $563 million as a liability under prison master lease arrangements and has reported general fixed assets for the related prison facilities.

NOTE K – LONG TERM OBLIGATIONS (continued)

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 $41.4 billion as of August 31, 2002, with net debt outstanding of $5.3 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 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, 2002 (May 31, 2002 for the PTC) include bond discounts, deferred costs of refunding, and deferred refunding losses of $3.1 million, $24.1 million, and $2.1 million, respectively.

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, 2002 (May 31, 2002 for the Pennsylvania Turnpike Commission) (amounts in thousands):

PRIMARY GOVERNMENT

	2003	2004	2005	2006	2007	2008-12	2013-17
GENERAL OBLIGATION BONDS:							
Capital Facilities	$ 478,405	$ 452,473	$ 427,486	$ 416,161	$ 407,301	$ 1,851,426	$ 1,401,753
Disaster Relief	9,717	2,735	2,656	2,577	2,494	11,215	8,976
Land and Water Development	4,492	1,092	1,036	982	977	4,884	1,265
Nursing Home Loan Development	550	-	-	-	-	-	-
Volunteer Companies Loan	2,473	2,013	1,992	1,877	1,857	9,073	5,277
Vietnam Conflict Veterans Compensation	487	491	-	-	-	-	-
Water Facilities Loan	10,652	10,026	9,216	8,773	8,749	43,157	17,310
Pennsylvania Economic Revitalization	1,830	1,820	1,060	1,059	1,046	5,161	1,722
Pennsylvania Infrastructure Investment Authority	23,605	23,324	21,187	19,990	19,815	96,154	46,517
Agricultural Conservation Easement Purchase	6,236	6,148	5,552	4,642	4,591	20,143	10,393
Local Criminal Justice	13,761	13,743	12,761	12,735	12,699	50,739	19,732
Keystone Recreation, Park and Conservation	3,960	3,915	3,881	3,842	3,802	16,174	12,911
Refunding Bonds	218,002	208,625	173,061	170,126	147,941	588,962	227,866
Total Principal and Interest	774,170	726,405	659,888	642,764	611,272	2,697,088	1,753,722
Less: Interest Payments	288,211	263,275	244,349	242,231	220,614	806,573	357,039
	485,959	463,130	415,539	400,533	390,658	1,890,515	1,396,683
Other General Long-Term Obligations	164,895	120,440	123,966	128,056	129,592	665,662	657,470
TOTAL GENERAL LONG-TERM OBLIGATIONS	$ 650,854	$ 583,570	$ 539,505	$ 528,589	$ 520,250	$ 2,556,177	$ 2,054,153

NOTE K – LONG TERM OBLIGATIONS (continued)

	2018-22	2023-27	2028-32	2033-37	2038-42	Total
GENERAL OBLIGATION BONDS:						
Capital Facilities	$ 670,886	$ -	$ -	$ -	$ -	$ 6,105,891
Disaster Relief	579	-	-	-	-	40,949
Land and Water Development	-	-	-	-	-	14,728
Nursing Home Loan Development	-	-	-	-	-	550
Volunteer Companies Loan	312	-	-	-	-	24,874
Vietnam Conflict Veterans Compensation	-	-	-	-	-	978
Water Facilities Loan	-	-	-	-	-	107,883
Pennsylvania Economic Revitalization	-	-	-	-	-	13,698
Pennsylvania Infrastructure Investment Authority	3,189	-	-	-	-	253,781
Agricultural Conservation Easement Purchase	1,995	-	-	-	-	59,700
Local Criminal Justice	1,299	-	-	-	-	137,469
Keystone Recreation, Park and Conservation	729	-	-	-	-	49,214
Refunding Bonds	23,986	-	-	-	-	1,758,569
Total Principal and Interest	702,975	-	-	-	-	8,568,284
Less: Interest Payments	74,054	-	-	-	-	2,496,346
	628,921	-	-	-	-	6,071,938
Other General Long-Term Obligations	474,494	155,894	-	-	-	2,620,469
TOTAL GENERAL LONG-TERM OBLIGATIONS	$ 1,103,415	$ 155,894	$ -	$ -	$ -	$ 8,692,407

DISCRETELY PRESENTED COMPONENT UNITS

	2003	2004	2005	2006	2007	2008-12	2013-17
Pennsylvania Higher Education Assistance Agency	$ 22,137	$ 22,137	$ 22,137	$ 22,138	$ 22,137	$ 110,686	$ 251,623
Philadelphia Regional Port Authority	5,118	5,115	5,107	5,059	4,547	22,623	22,565
State System of Higher Education	1,082	1,237	1,252	1,223	1,227	6,146	6,508
Pennsylvania Housing Finance Agency	243,317	236,051	240,434	239,505	238,637	1,218,888	1,135,879
Pennsylvania Industrial Development Authority	50,517	51,956	53,491	54,239	55,697	269,242	201,047
Pennsylvania Turnpike Commission	136,909	137,213	138,710	139,441	139,825	635,863	699,568
Pennsylvania Infrastructure Investment Authority	22,075	21,768	21,388	20,493	19,446	59,891	21,265
Total Principal and Interest	481,155	475,477	482,519	482,098	481,516	2,323,339	2,338,455
Less: Interest Payments	316.997	313,627	305,540	296,719	287,064	1,258,239	949,991
TOTAL REVENUE BONDS	$ 164,158	$ 161,850	$ 176,979	$ 185,379	$ 194,452	$ 1,065,100	$ 1,388,464

	2018-22	2023-27	2028-32	2033-37	2038-42	Total
Pennsylvania Higher Education Assistance Agency	$ 295,320	$ 181,657	$ -	$ -	$ -	$ 949,972
Philadelphia Regional Port Authority	17,838	-	-	-	-	87,972
State System of Higher Education	6,646	6,144	9,335	-	-	40,800
Pennsylvania Housing Finance Agency	960,892	711,792	322,210	16,731	-	5,564,336
Pennsylvania Industrial Development Authority	112,918	-	-	-	-	849,107
Pennsylvania Turnpike Commission	483,341	401,729	416,621	45,346	199,676	3,574,242
Pennsylvania Infrastructure Investment Authority	-	-	-	-	-	186,326
Total Principal and Interest	1,876,955	1,301,322	748,166	62,077	199,676	11,252,755
Less: Interest Payments	601,868	304,107	117,786	46,172	18,881	4,816,991
TOTAL REVENUE BONDS	$ 1,275,087	$ 997,215	$ 630,380	$ 15,905	$ 180,795	$ 6,435,764

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, 2002 (amounts in thousands):

	Primary Government			Discretely Presented Component Units	
	Capital Lease Obligations	Master Lease Obligations	Installment Purchase Obligations	Pennsylvania Higher Education Assistance Agency	State System of Higher Education
Fiscal year ending June 30					
2003	$ 8,732	$ 61,337	$ 5,466	$ 51,554	$ 41,360
2004	8,161	61,287	3,942	-	41,075
2005	6,902	61,224	2,516	-	40,545
2006	6,233	61,197	1,227	-	40,053
2007	6,179	61,071	664	-	38,962
2008-12	31,416	304,411	2,545	-	175,241
2013-17	24,713	155,473	1,067	-	168,457
2018-22	-	-	-	-	127,902
2023-27	-	-	-	-	34,142
Total minimum lease payments	92,336	766,000	17,427	51,554	707,737
Less: amount representing estimated executory cost included in minimum lease payments	11,342	-	-	-	-
Net minimum lease payments and Installment purchases	80,994	766,000	17,427	51,554	707,737
Less: amount representing interest	28,921	202,980	3,083	1,924	268,077
TOTAL CAPITAL LEASE AND INSTALLMENT PURCHASE OBLIGATIONS	$ 52,073	$ 563,020	$ 14,344	$ 49,630	$ 439,660

At June 30, 2002 general capital assets included $95.8 million of buildings and $8.3 million of equipment being procured by capital leases. A total of $29.4 million in general capital assets is being procured by vendor-financed installment purchase arrangements.

Capital lease obligations outstanding as of June 30, 2002 reported by the State System of Higher Education (SSHE), a discretely presented component unit, 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. SSHE capital assets include $116.7 million of construction in progress related to capital leases at June 30, 2002.

Conduit Debt

The State Public School Building Authority (SPSBA) finances construction and improvement projects for public schools through the issuance of tax-exempt instruments (bonds, notes or other obligations), for the purpose of making lower cost tax-exempt financing available to school districts and community colleges. The debt instruments issued by the SPSBA represent limited obligations payable solely from lease/loan payments made by the borrowing institutions and related assets held by trustees. At June 30, 2002 the SPSBA has $521 million of debt outstanding. Neither the SPSBA 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 Higher Educational Facilities Authority (PHEFA), a discretely presented component unit, finances projects through the issuance of tax-exempt instruments (bonds, notes and other obligations) to provide a source of tax-exempt financing for colleges and universities. The debt instruments issued by the PHEFA represent limited obligations payable solely from payments made by the related borrowing institutions and related assets held by the trustees. At June 30, 2002 the PHEFA has $4.02 billion of debt outstanding. Neither the PHEFA 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 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, 2002 the PEDFA

NOTE K – LONG TERM OBLIGATIONS (continued)

has $1,624.5 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 $92.9 million in revenue bonds outstanding at June 30, 2002. 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

During the fiscal year ended June 30, 2002 the Commonwealth issued $350.6 million in general obligation bonds, First Refunding Series of 2002, with an average interest rate of 5.31 percent to advance refund $349.1 million of previously issued general obligation bonds with an average interest rate of 6.48 percent. The net refunding bond proceeds of $376.9 million (including bond premium of $27.9 million), after payment of underwriting fees, insurance, and other issuance costs, were deposited in irrevocable trusts to provide for all future debt service payments on the refunded bonds. As a result, the bonds refunded are considered to be defeased and have been removed from the Commonwealth's financial statements. The Commonwealth advance refunded its previously issued bonds to reduce debt service payable on its general obligation bonds by $36 million and to obtain an economic gain of $33.2 million.

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, 2002, $202 million of general obligation bonds outstanding that were previously accounted for in the Commonwealth's financial statements have been defeased through advance refundings.

Discretely Presented Component Units

During the fiscal year ended June 30, 2002, the Pennsylvania Higher Education Assistance Agency (PHEAA) issued $312.9 million of student loan revenue bonds at a weighted average interest rate of 2.64 percent to current refund $312.9 million of outstanding student loan revenue bonds with a weighted-average interest rate of 7.10 percent. The current refunding bonds are fixed rate bonds with a mandatory tender on July 1, 2003. At that date, the bonds will be remarketed. The PHEAA expects to reduce interest payments over the next year by $13.9 million as a result of the refunding. The current refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $8.2 million. This difference, reported in the accompanying statement of net assets as a deduction from student loan revenue bonds payable, is being charged to student loan financings and bonds payable interest expense ratably over the life of the student loan revenue bonds.

During the fiscal year ended June 30, 2002 the Pennsylvania Housing Finance Agency (PHFA) redeemed prior to maturity $331.7 million of Single Family Mortgage Revenue Bonds, Series 1990-29, 1991-30, 1991-31, 1991-32, 1992-33, 1992-34, 1994-38, 1994-39, 1994-40, 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, 1998-62, 1998-64, 1999-65, 1999-66, 1999-67, 1999-68, 2000-69 and 2000-70 using mortgage prepayments. Extraordinary losses of $734 thousand that resulted from the redemptions as unamortized bond discount and related costs of issuance for the bonds redeemed were expensed. Additionally, during the year ended June 30, 2002 the PHFA redeemed prior to maturity $257.7 million of Single Family Mortgage Revenue Bonds, Series U, 1990-29, 1991-31, 1992-34, 1991-32, 1991-30, 1991-31, 1992-33, 1994-39, 1994-40, 1994-41, 1994-42, 1994-44, 1996-49, 1996-50 and 1996-51 using bond proceeds.

Although a deferred loss of $5.3 million resulted from the refundings, the PHFA in effect obtained an economic gain of $67.2 million and was able to reduce its aggregate debt service payments as a result of these transactions by a total of $190.6 million over the next 30 years.

At June 30, 2002, $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, 2002 the Pennsylvania Turnpike Commission (PTC) issued $86.6 million in Series T Revenue Refunding Bonds and $169.8 million in Series U Revenue Refunding Bonds. The proceeds of the bonds were used to advance refund the PTC's Series M and N Revenue Bonds. As a result of the Series T and U advance refundings, the PTC incurred economic losses of $6.4 million and $12.1 million, respectively, which will be amortized over the life of the new bonds.

At May 31, 2002, the PTC has no bonds outstanding that were previously accounted for in their financial statements that have been defeased through refundings.

At June 30, 2002, $24.3 million of bonds outstanding that were previously accounted for in the financial statements of the Pennsylvania Infrastructure Investment Authority have been defeased through refundings.

NOTE L - REFUNDED DEBT (continued)

At June 30, 2002, $6 million of bonds outstanding that were previously accounted for in the financial statements of the Pennsylvania Industrial Development Authority have been defeased through refundings.

At June 30, 2002, $63.9 million of bonds outstanding that were previously accounted for in the financial statements of the State System of Higher Education have been defeased through refundings.

NOTE M - 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, 2002. 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, 2002. No accrued liability has been reported for property losses.

At June 30, 2002, the accrued liabilities that will be paid with current expendable available financial resources are reported in the **General Fund** ($108,577), the **Motor License Fund** ($17,605), a Special Revenue Fund, and the State Stores Fund ($2,277), an Enterprise Fund. Those liabilities that will not be paid with current expendable available financial resources at June 30, 2002 are reported as governmental long-term obligations and will be funded by the **General Fund** ($382,947), the **Motor License Fund** ($313,753), a Special Revenue Fund, and as a non-current liability of the State Stores Fund ($10,577), an Enterprise Fund. All accrued self-insurance liabilities at June 30, 2002 are summarized as follows (amounts in thousands):

	General Fund	Motor License Fund	State Stores Fund	GLTO	Total
Employee disability	$ 64,908	$ -	$ 2,277	$ 312,063	$ 379,248
Annuitant medical/hospital	36,499	-	-	-	36,499
Automobile tort	2,850	-	-	16,826	19,676
Employee tort	2,500	-	-	25,131	27,631
General tort	1,820	-	-	39,504	41,324
Transportation	-	17,605	-	313,753	331,358
Totals	$ 108,577	$ 17,605	$ 2,277	$ 707,277	$ 835,736

The following summary provides aggregated information on June 30, 2001 reported self-insurance liabilities; incurred claims and payments during the fiscal year ended June 30, 2002 and reported self-insurance liabilities at June 30, 2002 (amounts in thousands):

-	June 30, 2001 Liability	Incurred Claims		Payments		June 30, 2002 Liability
		Current	Prior	Current	Prior	
Employee disability	$ 378,934	$ 44,363	$ 9,966	$ 5,965	$ 48,050	$ 379,248
Annuitant medical/hospital	36,181	314,832	-	278,333	36,181	36,499
Automobile tort	17,786	6,850	(2,054)	1,046	1,860	19,676
Employee tort	26,086	1,269	1,384	82	1,026	27,631
General tort	32,729	7,125	2,557	20	1,067	41,324
Transportation	272,815	67,050	3,642	463	11,686	331,358
Totals	$ 764,531	$ 441,489	$ 15,495	$ 285,909	$ 99,870	$ 835,736

NOTE M - SELF-INSURANCE (continued)

The following summary provides aggregated information on June 30, 2000 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 N – COMMITMENTS AND CONTINGENCIES

Construction and Other Commitments: At June 30, 2002, the Department of Transportation and at May 31, 2002, the Pennsylvania Turnpike Commission, a discretely presented component unit, have contractual commitments of approximately $1,978.8 million and $450 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 $5.6 billion at June 30, 2002. Actual expenditures are contingent upon approved spending authority and/or availability of financial resources.

Loan Commitments: At June 30, 2002, the following discretely presented component units had approved loans that had not been disbursed (amounts in millions):

Pennsylvania Housing Finance Agency	$ 133
Pennsylvania Industrial Development Authority	154
Pennsylvania Infrastructure Investment Authority	458

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, 2002 were as follows (amounts in thousands):

Fiscal year ending June 30:	Primary Government	Discretely Presented Component Units
2003	$ 263,372	$8,245
2004	142,247	6,594
2005	103,599	3,071
2006	77,783	1,446
2007	58,281	341
2008-2012	157,512	586
Total Minimum Lease Payments	$ 802,794	$20,283

Rental expenditures/expenses for all operating leases for the fiscal year ended June 30, 2002 amounted to $296.1 million ($287.1 million for primary government, $9 million for discretely presented component units).

Child Support Payments: At June 30, 2002, the Commonwealth is contingently liable for approximately $48 million in payments received by a contractor to be used for child support payments.

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, 2002 with respect to torts as described in Note M, and other General Long-Term Obligations with respect to other matters of litigation in the amount of $36,438 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 $80 million to $463 million, .4 to $228 million, .2 to $38.2 million, zero to $1 million, zero to $37 million, and zero to $1.1 billion of additional liabilities for the **General Fund**, Special Revenue Funds, Capital Projects Funds, Enterprise Funds, Agency Funds and the Pension Trust Funds, 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.

The range of potential liability for governmental and business-type activities, respectively, is between $280 million and $1.7 billion and zero to $1 million at June 30, 2002. The range for the **Motor License Fund** and the **Unemployment Compensation Fund**, respectively, is between $400 thousand and $225 million and zero and $1 million at June 30, 2002.

NOTE N – COMMITMENTS AND CONTINGENCIES (continued)

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 $37 to $275 million at June 30, 2002. The Commonwealth's management believes ultimate disallowances and sanctions, if any, will not have a material effect on the basic financial statements.

Student Loan Guarantees: The Pennsylvania Higher Education Assistance Agency (PHEAA), a discretely presented component unit, guarantees loans made by private lenders to certain resident students. Total original principal of outstanding guarantees issued by PHEAA approximated $18.2 billion at June 30, 2002. Under the Federal Family Education Loan Program, as amended, the PHEAA has entered into agreements 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 these agreements, PHEAA receives reimbursement of claims paid to lenders, provided that PHEAA is in compliance with numerous Federal requirements. Reinsurance rates vary from 75 percent to 100 percent depending upon default rates in the portfolio guaranteed by PHEAA and upon the time period when specific loans were guaranteed by PHEAA. During the fiscal year ended June 30, 2002, 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**, an Enterprise 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, 2002, the amount of future payments owed to prizewinners is $1.65 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, 2002, the future payments of $381 million have been voluntarily assigned by prizewinners.

NOTE O - 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, 2002 totals $2.2 billion. The amount of expendable financial resources available to pay claims at June 30, 2002 is $157.7 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 $471.1 million at December 31, 2001; on a pro-rata basis, $431.8 million at June 30, 2002. 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, 2002. Owners and operators will be assessed for any claims exceeding Fund assets and no financial liability is reported for those claims.

NOTE P - 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 $1,047 million in assets reported in the Deferred Compensation Fund, a Pension Trust Fund, at December 31, 2001, $1,026 million relates to primary government employees and $18 million relates to employees of discretely presented component units. The remaining balance of $3 million relates to organizations not included in the Commonwealth's financial reporting entity.

NOTE Q - 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 almost 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, 2002, the Commonwealth contributed over $715 million to fund benefits. Neither the Commonwealth nor the unions have an equity interest in the PEBTF.

At June 30, 2002, the PEBTF reported total assets of $247 million, total liabilities and benefit obligations of $110 million, and net assets available for benefits of $137 million. The financial status of the PEBTF is monitored on an ongoing basis; financial stress is evident as a result of increasing benefit and other expenses. During the fiscal year ended June 30, 2002 the PEBTF reported a decrease in net assets available for benefits of $120 million for the Active Plan program. This was caused by a continuing increase in the cost of medical benefits incurred without an increase in contributions made by the Commonwealth. Also, investment income decreased during the fiscal year due to a decrease in the average investment balance as the PEBTF liquidated certain investments to pay claims. The PEBTF prepared an analysis that showed that the decrease in net assets available for benefits would likely continue through the fiscal year ending June 30, 2003 to the point where total benefit obligations would exceed total net assets.

The PEBTF is in the process of changing certain benefit provisions under its current agreement with labor unions. However, the changes in benefit provisions may not be sufficient to ensure that total net assets continue to equal or exceed total benefit obligations. In addition, neither the Commonwealth nor the various labor unions can presently guarantee that either joint venture participant would subsidize the Active Plan program in the event that the PEBTF does not generate adequate cash flows to pay for claims and other operating expenses through June 30, 2003 and subsequent periods.

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 R – SUBSEQUENT EVENTS

Primary Government

On October 1, 2002, the Commonwealth issued $641.2 million of General Obligation Bonds, Second Refunding Series of 2002 with an interest rate of 4.99 percent. The Commonwealth issued the bonds to refund a portion of seven separate issues of previously issued Commonwealth of Pennsylvania General Obligation Bonds in order to reduce debt service on its general obligation bonds.

Discretely Presented Component Units

On July 12, 2002, the Pennsylvania Housing Finance Agency (PHFA) issued $124.1 million of Series 2002 Rental Housing Refunding Bonds. The proceeds of the bonds will be used to refund the PHFA's outstanding Series 1992 Rental Housing Refunding Bonds.

On July 25, 2002, the PHFA issued $100 million of Series 2002-74 Single Family Mortgage Revenue Bonds. The proceeds of the bonds will be used to refund certain of PHFA's outstanding Single Family Mortgage Revenue Bonds and to fund new single family mortgage loans.

On September 2, 2002, the PHFA signed a five year lease for office space in the Pittsburgh area. The lease, which is retroactive to June 1, 2002, requires annual rental payments of $58 thousand.

In July 2002, the Pennsylvania Turnpike Commission (PTC approved the issuance of Series A and B of 2002 Revenue Refunding Bonds for the purpose of advance refunding Series O and P Revenue Bonds. These revenue refunding bonds will be issued in September 2002.

Subsequent to June 30, 2002, the Pennsylvania Higher Education Assistance Agency (PHEAA), issued $1.11 billion of student loan demand revenue bonds. Of that amount, $150 million was issued to refund existing student loan revenue bonds.

In August 2002, the State System of Higher Education (SSHE) entered into a loan agreement with the Pennsylvania Higher Educational Facilities Authority (PHEFA) in connection with the issuance by the PHEFA of $14.4 million of Series U tax-exempt bonds and $25.2 million of Series V tax-exempt bonds. In October 2002, the SSHE entered into another loan agreement with the PHEFA in connection with the issuance by the PHEFA of $69.1 million of Series W tax-exempt bonds to refund the debt of Series H, J, and M. Under the agreements, the SSHE pledged its full faith and credit for the repayment of the bonds.

Required Supplementary Information

Commonwealth of Pennsylvania

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Original Budget	Difference	Final Budget	Difference	Actual (Budgetary Basis)
REVENUES:					
State Programs:					
Taxes, net of refunds	$ 19,754,750	$ (35,200)	$ 19,719,550	$ (1,112,822)	$ 18,606,728
Liquor store profits transfer	120,000	-	120,000	-	120,000
Licenses and fees	85,800	-	85,800	4,599	90,399
Fines, penalties and interest	27,600	-	27,600	4,986	32,586
Investment income	205,120	-	205,120	(110,283)	94,837
Unclaimed property	33,050	-	33,050	12,239	45,289
Departmental services	1,629,268	696,755	2,326,023	-	2,326,023
Miscellaneous	169,930	(900)	169,030	(66,126)	102,904
TOTAL STATE PROGRAMS	22,025,518	660,655	22,686,173	(1,267,407)	21,418,766
Federal Programs	12,140,700	325,701	12,466,401	(932,664)	11,533,737
TOTAL REVENUES	34,166,218	986,356	35,152,574	(2,200,071)	32,952,503
EXPENDITURES:					
State Programs:					
Direction and supportive services	1,154,874	19,711	1,174,585	(41,206)	1,133,379
Protection of persons and property	2,743,294	337,142	3,080,436	(116,294)	2,964,142
Health and human services	8,080,229	399,840	8,480,069	(54,546)	8,425,523
Public education	8,778,379	18,069	8,796,448	(87,368)	8,709,080
Recreation and cultural enrichment	153,979	1,951	155,930	(10,528)	145,402
Debt service	550,708	676	551,384	(195)	551,189
Economic development	465,311	9,962	475,273	(37,029)	438,244
Transportation	392,345	1,821	394,166	(5,703)	388,463
TOTAL STATE PROGRAMS	22,319,119	789,172	23,108,291	(352,869)	22,755,422
Federal Programs	12,140,700	325,701	12,466,401	(932,664)	11,533,737
TOTAL EXPENDITURES	34,459,819	1,114,873	35,574,692	(1,285,533)	34,289,159
REVENUES UNDER EXPENDITURES	(293,601)	(128,517)	(422,118)	(914,538)	(1,336,656)
OTHER FINANCING SOURCES (USES):					
Prior year lapses	-	104,593	104,593	-	104,593
Transfer from Tax Stabilization Reserve Fund	-	-	-	1,038,431	1,038,431
Transfer to Tax Stabilization Reserve Fund	(767)	767	-	-	-
TOTAL OTHER FINANCING SOURCES (USES)	(767)	105,360	104,593	1,038,431	1,143,024
REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURES AND OTHER USES	(294,368)	(23,157)	(317,525)	123,893	(193,632)
UNRESERVED/UNDESIGNATED FUND BALANCES (BUDGETARY BASIS), JUNE 30, 2001, RESTATED	336,467	-	336,467	-	336,467
UNRESERVED/UNDESIGNATED FUND BALANCES (BUDGETARY BASIS), JUNE 30, 2002	$ 42,099	$ (23,157)	$ 18,942	$ 123,893	$ 142,835

- The notes to required supplementary information are an integral part of this schedule. -

BUDGETARY COMPARISON SCHEDULE
Budgeted Major Funds
Special Revenue Fund-Motor License

For the Fiscal Year Ended June 30, 2002

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Original Budget	Difference	Final Budget	Difference	Actual (Budgetary Basis)
REVENUES:					
State Programs:					
Taxes, net of refunds	$ 1,064,450	$ -	$ 1,064,450	$ 26,037	$ 1,090,487
Licenses and fees	790,300	-	790,300	24,050	814,350
Fines, penalties and interest	31,800	-	31,800	(4,044)	27,756
Investment income	48,350	-	48,350	(30,335)	18,015
Departmental services	45,564	273,632	319,196	3	319,199
Miscellaneous	20,890	-	20,890	(16,473)	4,417
TOTAL STATE PROGRAMS	2,001,354	273,632	2,274,986	(762)	2,274,224
Federal Programs	1,227,130	(172,870)	1,054,260	43,205	1,097,465
TOTAL REVENUES	3,228,484	100,762	3,329,246	42,443	3,371,689
EXPENDITURES:					
State Programs:					
Direction and supportive services	61,709	55	61,764	(5,432)	56,332
Protection of persons and property	355,881	-	355,881	(12,114)	343,767
Public education	1,620	-	1,620	(550)	1,070
Recreation and cultural enrichment	1,000	-	1,000	-	1,000
Debt service	60,721	(135)	60,586	(760)	59,826
Transportation	1,625,659	273,712	1,899,371	(864)	1,898,507
TOTAL STATE PROGRAMS	2,106,590	273,632	2,380,222	(19,720)	2,360,502
Federal Programs	1,227,130	(172,870)	1,054,260	43,205	1,097,465
TOTAL EXPENDITURES	3,333,720	100,762	3,434,482	23,485	3,457,967
REVENUES OVER (UNDER) EXPENDITURES	(105,236)	-	(105,236)	18,958	(86,278)
OTHER FINANCING SOURCES (USES):					
Prior year lapses	-	27,775	27,775	-	27,775
TOTAL OTHER FINANCING SOURCES	-	27,775	27,775	-	27,775
REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURES AND OTHER USES	(105,236)	27,775	(77,461)	18,958	(58,503)
UNRESERVED/UNDESIGNATED FUND BALANCES (BUDGETARY BASIS), JUNE 30, 2001	114,861	-	114,861	-	114,861
UNRESERVED/UNDESIGNATED FUND BALANCES (BUDGETARY BASIS), JUNE 30, 2002	$ 9,625	$ 27,775	$ 37,400	$ 18,958	$ 56,358

- The notes to required supplementary information are an integral part of this schedule. -

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Original Budget	Difference	Final Budget	Difference	Actual (Budgetary Basis)
REVENUES:					
State Programs:					
Licenses and fees	$ 12,089	$ 567	$ 12,656	$ (742)	$ 11,914
Fines, penalties and interest	50	-	50	67	117
Investment income	950	52	1,002	(176)	826
Miscellaneous	-	-	-	1	1
TOTAL REVENUES	13,089	619	13,708	(850)	12,858
EXPENDITURES:					
State Programs:					
Direction and supportive services	12,146	-	12,146	(5)	12,141
TOTAL EXPENDITURES	12,146	-	12,146	(5)	12,141
REVENUES OVER (UNDER) EXPENDITURES	943	619	1,562	(845)	717
OTHER FINANCING SOURCES (USES):					
Prior year lapses	-	56	56	-	56
TOTAL OTHER FINANCING SOURCES	-	56	56	-	56
REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURES AND OTHER USES	943	675	1,618	(845)	773
UNRESERVED/UNDESIGNATED FUND BALANCES (BUDGETARY BASIS), JUNE 30, 2001	18,967	-	18,967	-	18,967
UNRESERVED/UNDESIGNATED FUND BALANCES (BUDGETARY BASIS), JUNE 30, 2002	$ 19,910	$ 675	$ 20,585	$ (845)	$ 19,740

- The notes to required supplementary information are an integral part of this schedule. -

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Original Budget	Difference	Final Budget	Difference	Actual (Budgetary Basis)
REVENUES:					
State Programs:					
Licenses and fees	$ 2,134	$ 33	$ 2,167	$ (88)	$ 2,079
Fines, penalties and interest	-	10	10	16	26
Investment income	138	(25)	113	(24)	89
Miscellaneous	1	-	1	-	1
TOTAL REVENUES	2,273	18	2,291	(96)	2,195
EXPENDITURES:					
State Programs:					
Direction and supportive services	2,505	-	2,505	(111)	2,394
TOTAL EXPENDITURES	2,505	-	2,505	(111)	2,394
REVENUES OVER (UNDER) EXPENDITURES	(232)	18	(214)	15	(199)
OTHER FINANCING SOURCES (USES):					
Prior year lapses	-	79	79	-	79
TOTAL OTHER FINANCING SOURCES	-	79	79	-	79
REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURES AND OTHER USES	(232)	97	(135)	15	(120)
UNRESERVED/UNDESIGNATED FUND BALANCES (BUDGETARY BASIS), JUNE 30, 2001	1,639	-	1,639	-	1,639
UNRESERVED/UNDESIGNATED FUND BALANCES (BUDGETARY BASIS), JUNE 30, 2002	$ 1,407	$ 97	$ 1,504	$ 15	$ 1,519

- The notes to required supplementary information are an integral part of this schedule. -

BUDGETARY COMPARISON SCHEDULE
Budgeted Nonmajor Funds
Special Revenue Fund-Workmen's Compensation Administration

For the Fiscal Year Ended June 30, 2002

COMMONWEALTH OF PENNSYLVANIA
(Expressed in Thousands)

	Original Budget	Difference	Final Budget	Difference	Actual (Budgetary Basis)
REVENUES:					
State Programs:					
Taxes, net of refunds	$ 51,635	$ -	$ 51,635	$ 3,549	$ 55,184
Fines, penalties and interest	46	-	46	(26)	20
Investment income	2,028	-	2,028	(1,149)	879
Departmental services	179	-	179	-	179
Miscellaneous	326	-	326	(184)	142
TOTAL REVENUES	54,214	-	54,214	2,190	56,404
EXPENDITURES:					
State Programs:					
Direction and supportive services	51,635	3,800	55,435	(351)	55,084
Economic development	179	-	179	-	179
TOTAL EXPENDITURES	51,814	3,800	55,614	(351)	55,263
REVENUES OVER (UNDER) EXPENDITURES	2,400	(3,800)	(1,400)	2,541	1,141
OTHER FINANCING SOURCES (USES):					
Prior year lapses	-	1,417	1,417	-	1,417
TOTAL OTHER FINANCING SOURCES	-	1,417	1,417	-	1,417
REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURES AND OTHER USES	2,400	(2,383)	17	2,541	2,558
UNRESERVED/UNDESIGNATED FUND BALANCES (BUDGETARY BASIS), JUNE 30, 2001	37,227	-	37,227	-	37,227
UNRESERVED/UNDESIGNATED FUND BALANCES (BUDGETARY BASIS), JUNE 30, 2002	$ 39,627	$ (2,383)	$ 37,244	$ 2,541	$ 39,785

- The notes to required supplementary information are an integral part of this schedule. -

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

Note 1 - Budget Preparation Process

The process of preparing the General Fund Budget for the Commonwealth of Pennsylvania begins nearly one year before the new budget takes effect on July 1 each year. The budget process begins in August of the year previous to the budget year with the distribution of both the Budget Instructions and Program Policy Guidelines by the Office of the Budget and the Governor's Office, respectively. These provide detailed guidelines and define major policy issues to be considered when agencies complete their budget requests. As required by statute, agencies must prepare budgets that indicate the cost of supporting activities at the level expected in the immediate budget year and the ensuing four budget years. The five-year horizon does not include future program changes but considers the requirements and demands of current law, regulation, policy and program decisions.

Agencies submit budget requests to the Secretary of the Budget beginning in early October. From October through January, the Office of the Budget reviews these requests for accuracy and adherence to policy guidelines and prepares funding recommendations for the Secretary of the Budget and the Governor.

During December, the Governor meets with leaders of the General Assembly to inform them of anticipated spending and revenue levels and to discuss related budgetary issues. The Governor then conducts reviews to make the final budget decisions. The Governor's Executive Budget is finalized in January and is submitted to the General Assembly in early February.

After receiving the budget document, the appropriations committees of both houses of the legislature hold hearings to review agency funding requests. The General Assembly passes the budget in the form of a General Appropriations Bill and individual appropriations bills. At the time of passage of these bills and their presentation to the Governor, the official revised revenue estimates for the budget year are issued. If the combined appropriations bills passed by the legislature exceed the revenue estimates, the Governor is required and has the authority to either veto entire appropriations bills or to reduce the amount of appropriations in order to produce a budget that is in balance. The Governor also has the power to reduce or veto any specific appropriation even if the total appropriations do not exceed estimated revenues. The Governor's signing of the appropriations bills and any revenue bills is the last step in the approval stage of the budget.

Additional information regarding Pennsylvania's budgeting process may be located at: http://www.oit.state.pa.us/budget

Note 2 – Basis of Budgeting

On the budgetary basis, 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**. These taxes are estimated to be owed to the Commonwealth but are not collected by 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 Budgetary Comparison Schedules represent official estimates while expenditures represent amounts originally adopted or legally amended. Actual amounts are presented on the budgetary basis. Because the budgetary basis differs from the modified accrual basis of accounting for governmental funds, a reconciliation of the differences between budgetary basis and the modified accrual basis of reporting is presented.

Note 3 - Reconciliation of Budgetary to GAAP Basis Amounts

The Commonwealth adopts formal annual budgets for two major governmental funds (**General Fund** and **Motor License Fund**, Special Revenue Fund) and three nonmajor governmental funds (Workmen's Compensation Administration, Banking Department, and Milk Marketing, Special Revenue funds). The Budgetary Comparison Schedules for Budgeted Major and Nonmajor Funds presents comparisons of the legally adopted budget, as amended, with actual data on a budgetary basis, which differs from governmental fund statement information primarily by the omission of certain revenue and expenditure accruals.

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

	Major Budgeted Funds		Nonmajor Budgeted Funds		
	General Fund	Motor License Fund	Workmen's Compensation Administration Fund	Banking Department Fund	Milk Marketing Fund
Budgetary basis — revenues and other sources over (under) expenditures and other uses………………………….	$(193,632)	$(58,503)	$2,558	$773	$(120)
Adjustments:					
To adjust revenues, other financing sources and related receivables and deferred revenue…….…………...	(539,243)	635,499	(1,880)	51	(90)
To adjust expenditures, other financing uses and related accounts payable and and accrued liabilities………………...	(849,752)	(616,530)	6,125	(89)	129
Net adjustments………………………	(1,388,995)	18,969	4,245	(38)	39
Modified accrual basis – net change in governmental fund balance………..	$(1,582,627)	$(39,534)	$6,803	$735	$(81)

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 4 – 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 $287.4 million in supplemental appropriations approved during the fiscal year ended June 30, 2002.

A separately available report, the "*Status of Appropriations*," demonstrates budgetary expenditure compliance for the **General Fund** for the fiscal year ended June 30, 2002. 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 four budgeted Special Revenue funds: **Motor License**, 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.

Total reported actual expenditures for "Total State Programs" included in the Budgetary Comparison Schedule – Major Governmental Funds are based on appropriation, augmentation and lapse amounts reported in the respective June 30, 2002 "*Status of Appropriations*" (Total All Current State Ledgers) as follows (in thousands):

	"*Status*" Page Reference	Total Approved Appropriations	+	Total Actual Augmentations	-	Total Actual Lapses	=	Actual Expenditure Amounts
General Fund amounts...........	7[1]	$ 21,749,468		$ 2,326,023		$ 352,869		$ 23,722,622
Less: tax refunds.................	7[1]	(967,200)		-		-		(967,200)
Amount reported.................		$ 20,782,268		$ 2,326,023		$ 352,869		$ 22,755,422
Special Revenue Funds:								
Motor License Fund	50	$ 2,778,590		$ 1,613,493		$ 62,456		$ 4,329,627
less: reductions[2]		(717,564)		(1,294,294)		(42,733)		(1,969,125)
Amount reported.................		$ 2,061,026		$ 319,199		$ 19,723		$ 2,360,502
Workmen's Compensation Administration Fund	238	$ 55,435		$ 179		$ 351		$ 55,263
Banking Department Fund.......	87	$ 12,146		$ -		$ 5		$ 12,141
Milk Marketing Fund	93	$ 2,505		$ -		$ 111		$ 2,394

Total actual expenditures for "Federal Programs" for the **General Fund** are derived from the **General Fund** "*Status*," pkt page 222, page no. 222 "Summary of All Current Federal Ledgers by Character of Expenditure" as follows (in thousands): Commitments of $1,250,411 and Expenditures of $10,283,326, for a total of $11,533,737.

Total actual expenditures for "Federal Programs," Special Revenue funds, are derived from the Special Funds "*Status*" as follows (in thousands): **Motor License -** $1,097,465 (calculated in footnote 3 below) for a total of $1,170,345.

[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***:**" 010-003-102-01-1; 010-008-051-01-1; 010-008-053-01-1; 010-008-181-01-1; 010-003-198-01-2; 010-038-230-01-2; 010-008-212-01-2; 010-008-214-01-2; 010-008-217-01-2; and 010-008-230-01-2 through 010-008-289-01-2.

[3] Consists of $1,290,985 in Year-to-Date "Total Federal Funds" on page 116 of "*Report of Revenues and Receipts*" less $193,520 in Year-to-Date Federal Funds amounts for the following revenue codes (also on page 116 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 5 – Restatement of June 30, 2001 Unreserved/Undesignated General Fund Fund Balance (Budgetary Basis)

The Budgetary Comparison schedule reflects a restatement of $1 million to the June 30, 2001 budgetary basis Unreserved/Undesignated fund balance. The restatement includes in fund balance the result of a transfer of spending authority from a prior year appropriation to a new appropriation created in the 2001-2002 fiscal year. This appropriation was created to provide emergency and disaster relief to victims of Tropical Storm Allison, which occurred in June of 2001.

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Schedule of Expenditures of Federal Awards

Commonwealth of Pennsylvania

COMMONWEALTH OF PENNSYLVANIA

Schedule of Expenditures of Federal Awards - June 30, 2002

CFDA #	CFDA Name		Federal Expenditures (000's)
10.551	FOOD STAMPS	686,054	
10.561	ST. ADMIN. MATCHING GRANTS - FOOD STAMP PROG.	117,818	
	TOTAL FOOD STAMP CLUSTER		803,872
10.553	SCHOOL BREAKFAST PROGRAM	39,503	
10.555	NATIONAL SCHOOL LUNCH PROGRAM	180,568	
10.556	SPECIAL MILK PROGRAM FOR CHILDREN	823	
10.559	SUMMER FOOD SERVICE PROGRAM FOR CHILDREN	15,891	
	TOTAL CHILD NUTRITION CLUSTER		236,785
10.568	EMERGENCY FOOD ASSIST. PROGRAM (ADMIN.COSTS)	2,071	
10.569	EMERGENCY FOOD ASSIST. PROGRAM (FOOD COMM.)	12,688	
	TOTAL EMERGENCY FOOD ASSISTANCE CLUSTER		14,759
10.025	PLANT & ANIMAL DISEASE, PEST CONTROL & ANIMAL CARE		637
10.064	FORESTRY INCENTIVES PROGRAM		11
10.156	FEDERAL-STATE MARKETING IMPROVEMENT PROGRAM		21
10.162	INSPECTION GRADING & STANDARDIZATION		54
10.250	AGRICULTURAL & RURAL ECONOMIC RESEARCH		65
10.450	CROP INSURANCE		129
10.550	FOOD DONATION		30,629
10.557	SPECIAL SUPP. NUTRITION PROGRAM FOR WIC		136,540
10.558	CHILD AND ADULT CARE FOOD PROGRAM		42,899
10.560	STATE ADMIN. EXPENSES FOR CHILD NUTRITION		3,024
10.570	NUTRITION PROGRAM FOR THE ELDERLY		7,244
10.572	WIC FARMERS' MARKET NUTRITION PROGRAM		2,258
10.574	TEAM NUTRITION GRANTS		186
10.664	COOPERATIVE FORESTRY ASSISTANCE		1,461
10.665	SCHOOLS AND ROADS - GRANTS TO STATES		4,831
10.902	SOIL AND WATER CONSERVATION		369
	TOTAL DEPARTMENT OF AGRICULTURE		**$1,285,774**
11.307	ECONOMIC ADJUSTMENT ASSISTANCE		200
11.419	COASTAL ZONE MGMT. ADMIN. AWARDS		1,038
11.450	INTEGRATED FLOOD OBSERVING & WARNING SYSTEM		98
11.457	CHESAPEAKE BAY STUDIES		116
	TOTAL DEPARTMENT OF COMMERCE		**$1,452**
12.112	PAYMENTS TO STATES IN LIEU OF REAL ESTATE TAXES		120
12.400	MILITARY CONSTRUCTION - NATIONAL GUARD		1
12.401	NATIONAL GUARD MILITARY OPERATIONS & MAIN. PROJECTS		21,584
	TOTAL DEPARTMENT OF DEFENSE		**$21,705**
14.228	COMMUNITY DEVELOPMENT BLOCK GRANTS/STATE'S PROGRAM		60,891
14.231	EMERGENCY SHELTER GRANTS PROGRAM		2,387

- See Notes to Schedule of Expenditures of Federal Awards -

CFDA #	CFDA Name		Federal Expenditures (000's)
14.239	HOME INVESTMENT PARTNERSHIPS PROGRAM		16,360
14.241	HOUSING OPPORTUNITIES FOR PERSONS WITH AIDS		1,204
14.401	FAIR HOUSING ASSISTANCE PROGRAM - STATE & LOCAL		716
	TOTAL DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT		**$81,558**
15.605	SPORT FISH RESTORATION	2,926	
15.611	WILDLIFE RESTORATION	8,251	
	TOTAL FISH AND WILDLIFE CLUSTER		11,177
15.250	REGULATION OF SURFACE COAL MINING		12,670
15.252	ABANDONED MINE LAND RECLAMATION PROGRAM		15,345
15.612	ENDANGERED SPECIES CONSERVATION		46
15.616	CLEAN VESSEL ACT		5
15.625	WILDLIFE CONSERVATION AND RESTORATION		4
15.808	U.S. GEOLOGICAL SURVEY - RESEARCH AND DATA ACQ.		29
15.810	NATL. COOP. GEOLOGIC MAPPING PROGRAM		100
15.904	HISTORIC PRESERVATION FUND GRANTS-IN-AID		1,077
15.916	OUTDOOR RECREATION - ACQ. DEV. & PLANNING		778
	TOTAL DEPARTMENT OF THE INTERIOR		**$41,231**
16.004	LAW ENF. ASSIST - NARC. & DANGEROUS DRUGS TRNG.		146
16.007	STATE DOMESTIC PREPAREDNESS EQUIP. SUPPORT PROG.		1,356
16.523	JUVENILE ACCOUNT. INCENTIVE BLOCK GRANTS		7,985
16.540	JUVENILE JUSTICE & DELINQUENCY PREV. - ALLOC. TO STATES		1,946
16.548	TITLE V - DELINQUENCY PREVENTION PROGRAM		1,443
16.549	PART E - STATE CHALLENGE ACTIVITIES		519
16.550	STATE JUSTICE STATISTICS PROG. FOR STAT. ANAL. CENTERS		25
16.554	NATIONAL CRIMINAL HISTORY IMPROV. PROGRAM		2,098
16.560	JUSTICE RESEARCH EVAL. AND DEV. PROJECT GRANTS		12
16.564	CRIME LAB IMPROVEMENT - DNA INDEX SYSTEM		401
16.572	STATE CRIMINAL ALIEN ASSISTANCE PROGRAM		425
16.574	BYRNE EVALUATION PARTNERSHIP PROGRAM		6,973
16.575	CRIME VICTIM ASSISTANCE		15,843
16.576	CRIME VICTIM COMPENSATION		1,797
16.579	BYRNE FORMULA GRANT PROGRAM		24,981
16.582	CRIME VICTIM ASSISTANCE - DISCRETIONARY GRANTS		357
16.588	VIOLENCE AGAINST WOMEN FORMULA GRANTS		3,497
16.589	RURAL DOMESTIC VIOLENCE & CHILD VICTIM ENF. PROGRAM		290
16.592	LOCAL LAW ENFORCEMENT BLOCK GRANTS PROGRAM		3,120
16.607	BULLETPROOF VEST PARTNERSHIP PROGRAM		590
16.727	ENFORCING UNDERAGE DRINKING LAWS PROGRAM		293
16.999	MISCELLANEOUS		1,866
	TOTAL DEPARTMENT OF JUSTICE		**$75,963**

- See Notes to Schedule of Expenditures of Federal Awards -

CFDA #	CFDA Name		Federal Expenditures (000's)
17.207	EMPLOYMENT SERVICE	33,308	
17.801	DISABLED VETERANS OUTREACH PROGRAM	3,512	
17.804	LOCAL VETERANS EMPLOY. REP. PROGRAM	3,776	
	TOTAL EMPLOYMENT SERVICES CLUSTER		40,596
17.258	WIA ADULT PROGRAM	17,982	
17.259	WIA YOUTH ACTIVITIES	22,369	
17.260	WIA DISLOCATED WORKERS	24,444	
	TOTAL WIA CLUSTER		64,795
17.002	LABOR FORCE STATISTICS		2,725
17.005	COMPENSATION AND WORKING CONDITIONS		42
17.203	LABOR CERTIFICATION FOR ALIEN WORKERS		884
17.225	UNEMPLOYMENT INSURANCE		3,076,299
17.235	SENIOR COMMUNITY SERVICE EMPLOY. PROG.		4,611
17.245	TRADE ADJUSTMENT ASSISTANCE - WORKERS		42,792
17.246	EMP. & TRNG. ASSIST. - DISLOCATED WORKERS		4,155
17.249	EMP. SVCS. & JOB TRNG. - PILOT & DEMO. PROGRAMS		744
17.253	WELFARE-TO-WORK GRANTS TO STATES & LOCALITIES		19,282
17.255	WORKFORCE INVESTMENT ACT		67,633
17.600	MINE HEALTH AND SAFETY GRANTS		603
17.999	MISCELLANEOUS		194
	TOTAL DEPARTMENT OF LABOR		**$3,325,355**
20.205	HIGHWAY PLANNING AND CONSTRUCTION	1,338,464	
23.003	APPALACHIAN DEV. HIGHWAY SYSTEM	17,762	
	TOTAL HIGHWAY PLANNING AND CONSTRUCTION CLUSTER		1,356,226
20.600	STATE & COMMUNITY HIGHWAY SAFETY	8,611	
20.601	ALCOHOL TRAFFIC SAFETY & DRUNK DRIVING PREV. GRANTS	1,089	
	TOTAL HIGHWAY PLANNING AND CONSTRUCTION CLUSTER		9,700
20.005	BOATING SAFETY FINANCIAL ASSISTANCE		1,389
20.006	STATE ACCESS TO THE OIL SPILL LIAB. TRUST FUND		242
20.106	AIRPORT IMPROVEMENT PROGRAM		18,289
20.218	NATIONAL MOTOR CARRIER SAFETY		4,720
20.219	RECREATIONAL TRAILS PROGRAM		877
20.308	LOCAL RAIL FREIGHT ASSISTANCE		5
20.505	FEDERAL TRANSIT - METROPOLITAN PLANNING GRANTS		2,562
20.509	FORMULA GRANTS FOR OTHER THAN URBANIZED AREAS		8,517
20.513	CAP. ASSIST. PROG. - ELDERLY & PERSONS WITH DISABILITIES		4,076
20.514	TRANSIT PLANNING AND RESEARCH		53
20.700	PIPELINE SAFETY		254
20.703	INTER. HAZARDOUS MATL. PUBLIC SECTOR TRNG. GRANTS		386
20.999	MISCELLANEOUS		25
	TOTAL DEPARTMENT OF TRANSPORTATION		**$1,407,321**

CFDA #	CFDA Name	Federal Expenditures (000's)
23.002	APPALACHIAN AREA DEVELOPMENT	100
23.008	APPALACHIAN LOCAL ACCESS ROADS	-115
23.011	APPALACHIAN ST. RESEARCH, TECH. ASSIST. & DEMO. PROJ.	554
	TOTAL APPALACHIAN REGIONAL COMMISSION	**$539**
30.002	EMPLOYMENT DISCRIMINATION - ST. & LOCAL FAIR EMP. PRAC.	1,356
	TOTAL EQUAL EMPLOYMENT OPPORTUNITY COMMISSION	**$1,356**
39.003	DONATION OF FED. SURPLUS PERSONAL PROPERTY	4,744
	TOTAL GENERAL SERVICES ADMINISTRATION	**$4,744**
45.015	PROMOTION OF THE ARTS - FOLK ARTS	34
45.025	PROMOTION OF THE ARTS-PARTNERSHIP AGREEMENTS	589
45.310	STATE LIBRARY PROGRAM	5,374
	TOTAL NATIONAL FOUNDATION ON THE ARTS AND HUMANITIES	**$5,997**
64.010	VETERANS NURSING HOME CARE	366
64.014	VETERANS STATE DOMICILIARY CARE	3,404
64.015	VETERANS STATE NURSING HOME CARE	18,935
64.111	VETERANS EDUCATION ASSISTANCE	823
	TOTAL DEPARTMENT OF VETERANS AFFAIRS	**$23,528**
66.001	AIR POLLUTION CONTROL PROGRAM SUPPORT	4,487
66.032	STATE INDOOR RADON GRANTS	373
66.419	WATER POLLUTION CONTROL - STATE & INTERSTATE	6,115
66.432	STATE PUBLIC WATER SYSTEM SUPERVISION	6,318
66.438	CONSTRUCTION MANAGEMENT ASSISTANCE	397
66.454	WATER QUALITY MANAGEMENT PLANNING	748
66.458	CAPITALIZATION GRANTS FOR STATE REVOLVING FUNDS	73,595
66.460	NONPOINT SOURCE IMPLEMENTATION GRANTS	5,722
66.461	WETLAND PROGRAM DEV. GRANTS	177
66.463	WATER QUALITY COOPERATIVE AGREEMENTS	337
66.466	CHESAPEAKE BAY PROGRAM	3,013
66.467	WASTEWATER OPERATOR TRNG. GRANT PROG.	67
66.468	CAP. GRANTS FOR DRINKING WATER ST. REVOLVING FUND	22,338
66.470	HARDSHIP GRANTS PROGRAM FOR RURAL COMM	636
66.500	ENVIRONMENTAL PROTECTION - CONSOLID. RESEARCH	250
66.606	SURVEYS STUDIES INVEST. & SPEC. PURPOSE GRANTS	1,108
66.700	CONSOLID. PESTICIDE ENFORCEMENT COOP. AGREEMENTS	673
66.707	TSCA TITLE IV STATE LEAD GRANTS	340

CFDA #	CFDA Name		Federal Expenditures (000's)
66.708	POLLUTION PREVENTION GRANTS PROGRAM		39
66.801	HAZARDOUS WASTE MGMT. STATE PROG. SUPP.		5,335
66.804	STATE UNDERGROUND STORAGE TANKS PROGRAM		238
66.805	LEAKING UNDERGROUND STOR. TANK TRUST FUND		1,450
	TOTAL ENVIRONMENTAL PROTECTION AGENCY		**$133,756**
77.003	ENH. TECH. TRANSFER & DISS. OF NUCLEAR ENERGY		11
	TOTAL NUCLEAR REGULATORY COMMISSION		**$11**
81.041	STATE ENERGY PROGRAM		1,281
81.042	WEATHERIZATION ASSIST. FOR LOW-INCOME PERSONS		10,164
81.105	NATIONAL INDUST. COMP. - ENERGY ENV. & ECON.		218
81.111	ALTERNATIVE FUEL TRANS. PROGRAM		48
81.119	STATE ENERGY PROGRAM SPECIAL PROJECTS		241
81.999	MISCELLANEOUS		18
	TOTAL DEPARTMENT OF ENERGY		**$11,970**
83.010	NATIONAL FIRE ACADEMY EDUCATIONAL PROGRAM		11
83.105	COMMUNITY ASSIST. PROG. - STATE SUPPORT		37
83.536	FLOOD MITIGATION ASSISTANCE		43
83.539	CRISIS COUNSELING		13
83.543	INDIVIDUAL AND FAMILY GRANTS		826
83.544	PUBLIC ASSISTANCE GRANTS		5,797
83.547	FIRST RESPONDER COUNTER-TERRORISM TRNG. ASST.		67
83.548	HAZARD MITIGATION GRANT		2,696
83.550	NATIONAL DAM SAFETY PROGRAM		59
83.552	EMERGENCY MANAGEMENT PERFORMANCE GRANTS		4,173
83.999	MISCELLANEOUS		737
	TOTAL FEDERAL EMERGENCY MANAGEMENT AGENCY		**$14,459**
84.027	SPECIAL EDUCATION - GRANTS TO STATES	220,394	
84.173	SPECIAL EDUCATION - PRESCHOOL GRANTS	13,782	
	TOTAL SPECIAL EDUCATION CLUSTER		234,176
84.002	ADULT EDUCATION - STATE GRANT PROGRAM		23,158
84.010	TITLE I GRANTS TO LOCAL EDUCATIONAL AGENCIES		322,064
84.011	MIGRANT EDUCATION - BASIC STATE GRANT PROGRAM		6,805
84.013	TITLE I PROGRAM FOR NEGLECTED & DEL. CHILDREN		757
84.048	VOCATIONAL EDUCATION - BASIC GRANTS TO STATES		41,741
84.063	FEDERAL PELL GRANT PROGRAM		497
84.126	REHAB. SERVICES - VOC. REHAB.GRANTS TO STATES		100,849
84.162	IMMIGRANT EDUCATION		1,069

- See Notes to Schedule of Expenditures of Federal Awards -

CFDA #	CFDA Name		Federal Expenditures (000's)
84.169	INDEPENDENT LIVING - STATE GRANTS		757
84.177	REHAB. SERVICES - IND. LIVING SERVICES FOR OLDER IND.		1,649
84.181	SPEC. EDUC. - GRANTS FOR INFANTS AND FAM. WITH DISAB.		13,504
84.184	SAFE AND DRUG-FREE SCHOOLS & COMM. - NATL. PROG.		93
84.186	SAFE AND DRUG-FREE SCHOOLS & COMM - STATE GRANTS		18,375
84.187	SUPPORTED EMP.SERV. FOR INDIV. WITH SEVERE DISAB.		1,544
84.194	BILINGUAL EDUCATION SUPPORT SERVICES		114
84.196	EDUCATION FOR HOMELESS CHILDREN & YOUTH		1,640
84.213	EVEN START - STATE EDUC. AGENCIES		8,421
84.215	FUND FOR THE IMPROVEMENT OF EDUCATION		159
84.216	CAPITAL EXPENSES		1,919
84.243	TECH-PREP EDUCATION		4,408
84.265	REHAB. TRNG. - ST. VOC. REHAB. UNIT IN-SERVICE TRNG.		271
84.276	GOALS 2000 - ST. & LOCAL EDUC. SYSTEMIC IMPROV. GRANTS		10,239
84.281	EISENHOWER PROF. DEV. STATE GRANTS		14,005
84.282	CHARTER SCHOOLS		3,473
84.298	INNOVATIVE EDUCATION PROGRAM STRATEGIES		14,595
84.314	EVEN START - STATEWIDE FAMILY LITERACY PROGRAM		510
84.318	TECHNOLOGY LITERACY CHALLENGE FUND GRANTS		18,490
84.323	SPEC. EDUC. - STATE PROG. FOR CHILDREN WITH DISAB.		1,547
84.324	SPEC. EDUC. - RESEARCH FOR CHILDREN WITH DISAB.		23
84.330	ADVANCED PLACEMENT PROGRAM		94
84.331	GRANTS TO STATES FOR INCARCERATED YOUTH OFFENDERS		47
84.332	COMPREHENSIVE SCHOOL REFORM DEMO.		10,382
84.338	READING EXCELLENCE		11,751
84.340	CLASS SIZE REDUCTION		67,069
84.346	OCCUPATIONAL & EMPLOYMENT INFO. STATE GRANTS		285
84.348	TITLE I ACCOUNTABILITY GRANTS		2,414
84.352	SCHOOL RENOVATION GRANTS		75
84.999	MISCELLANEOUS		26
	TOTAL DEPARTMENT OF EDUCATION		**$938,995**
89.003	NATL. HISTORICAL PUB. & RECORDS GRANTS		50
	TOTAL NATIONAL ARCHIVES AND RECORDS ADMINISTRATION		**$50**
93.044	SPECIAL PROG. FOR AGING - TITLE III PART B	24,482	
93.045	SPECIAL PROG. FOR AGING - TITLE III PART C	23,114	
	TOTAL AGING CLUSTER		47,596
93.575	CHILD CARE AND DEVELOPMENT BLOCK GRANT	86,382	
93.596	CHILD CARE MANDATORY & MATCHING FUNDS	113,182	
	TOTAL CHILD CARE CLUSTER		199,564
93.775	STATE MEDICAID FRAUD CONTROL UNITS	3,292	
93.777	ST. SURVEY & CERT. OF HEALTH CARE PROV.& SUPPLIERS	6,979	

CFDA #	CFDA Name		Federal Expenditures (000's)
93.778	MEDICAL ASSISTANCE PROGRAM	6,824,298	
	TOTAL MEDICAID CLUSTER		6,834,569
93.003	PUBLIC HEALTH & SOCIAL SVCS. EMERGENCY FUND		1,225
93.041	SPECIAL PROG. FOR AGING - TITLE VII CH. 3		308
93.042	SPECIAL PROG. FOR AGING - TITLE VII CH. 2		590
93.043	SPECIAL PROG. FOR AGING - TITLE III PART F		1,104
93.048	SPECIAL PROG. FOR AGING - TITLE IV - TRNG.		26
93.052	SPECIAL PROG. FOR AGING - TITLE IIIE NFCSP		6,125
93.103	FOOD & DRUG ADMINISTRATION - RESEARCH		15
93.110	MATERNAL & CHILD HEALTH FED. CONSOL. PROG.		70
93.116	PROJ. GRANTS & COOP. AGREEMENTS FOR TUBER. CONT.		661
93.127	EMERGENCY MEDICAL SERVICES FOR CHILDREN		113
93.130	PRIMARY CARE SERVICES - RESOURCE COORD. & DEV.		229
93.136	INJURY PREVENTION AND CONTROL RESEARCH		64
93.150	PROJ. FOR ASSIST. IN TRANSITION FROM HOMELESSNESS		1,371
93.161	HEALTH PROG. FOR TOXIC SUB. & DISEASE REGISTRY		77
93.165	GRANTS FOR STATE LOAN REPAYMENT		208
93.197	CHILDHOOD LEAD POISONING PREVENTION PROJECTS		2,446
93.230	CONSOLID. KNOWLEDGE DEV. & APPL. PROGRAM		10
93.234	TRAUMATIC BRAIN INJURY - STATE DEMO. GRANT PROG.		48
93.235	ABSTINENCE EDUCATION		2,486
93.240	STATE CAPACITY BUILDING		240
93.241	STATE RURAL HOSPITAL FLEXIBILITY PROGRAM		410
93.268	IMMUNIZATION GRANTS		6,306
93.283	CENTERS FOR DISEASE CONTROL & PREV. - INV. & TECH. ASST.		5,132
93.556	PROMOTING SAFE & STABLE FAMILIES		11,108
93.558	TEMPORARY ASSISTANCE FOR NEEDY FAMILIES		622,201
93.563	CHILD SUPPORT ENFORCEMENT		90,201
93.566	REFUGEE & ENTRANT ASSISTANCE - ST. ADMIN. PROG.		9,599
93.568	LOW-INCOME HOME ENERGY ASSISTANCE		114,268
93.569	COMMUNITY SERVICES BLOCK GRANT - DISC. AWARDS		25,021
93.571	COMMUNITY SERVICES BLOCK GRANT - COMM. FOOD & NUTR.		142
93.576	REFUGEE & ENTRANT ASSIST. - DISC. GRANTS		1,797
93.584	REFUGEE AND ENTRANT ASSISTANCE - TARGETED ASST.		971
93.585	EMPOWERMENT ZONES PROGRAM		6,773
93.590	COMMUNITY-BASED FAMILY RESOURCE & SUPPORT GRANTS		811
93.597	GRANTS TO STATES FOR ACCESS AND VISITATION PROG.		81
93.600	HEAD START		309
93.602	NEW ASSETS FOR INDEP. DEMO. PROGRAM		1,204
93.603	ADOPTION INCENTIVE PAYMENTS		659
93.630	DEV. DISAB. BASIC SUPPORT & ADVOCACY GRANTS		2,774
93.631	DEV. DISAB. PROJECTS OF NATIONAL SIGNIFICANCE		6
93.645	CHILD WELFARE SERVICES - STATE GRANTS		10,590
93.658	FOSTER CARE - TITLE IV-E		292,658
93.659	ADOPTION ASSISTANCE		45,901

Schedule of Expenditures of Federal Awards - June 30, 2002

CFDA #	CFDA Name	Federal Expenditures (000's)
93.667	SOCIAL SERVICES BLOCK GRANT	105,312
93.669	CHILD ABUSE AND NEGLECT STATE GRANTS	346
93.671	FAMILY VIOLENCE PREVENTION & SERVICES	2,887
93.674	CHAFEE FOSTER CARE INDEPENDENT LIVING	6,775
93.767	STATE CHILDREN'S INSURANCE PROGRAM	101,097
93.779	CMS RESEARCH DEMO. AND EVAL.	1,775
93.917	HIV CARE FORMULA GRANTS	22,783
93.919	COOP. AGREEMENTS FOR STATE CANCER PROGRAMS	2,636
93.940	HIV PREVENTION ACTIVITIES - HEALTH DEPT. BASED	4,916
93.944	HIV/AIDS SURVEILLANCE	429
93.945	ASST. PROG. FOR CHRONIC DISEASE PREV. & CONTROL	80
93.958	BLOCK GRANTS FOR COMM. MENTAL HEALTH SERVICES	18,851
93.959	BLOCK GRANTS FOR PREV. & TREAT. OF SUBSTANCE ABUSE	57,606
93.965	COAL MINERS RESP. IMPAIRMENT TREATMENT CLINICS	432
93.977	PREV. HEALTH SERVICES - SEXUALLY TRANS. DIS. CONTROL	2,517
93.988	COOP. AGREEMENTS FOR STATE-BASED DIABETES CONTROL	232
93.991	PREV. HEALTH & HEALTH SERVICES BLOCK GRANT	8,070
93.994	MATERNAL & CHILD HEALTH SVCS. BLOCK GRANT	24,877
93.999	MISCELLANEOUS	789
	TOTAL DEPARTMENT OF HEALTH AND HUMAN SERVICES	**$8,710,477**
94.003	STATE COMMISSIONS	206
94.004	LEARN AND SERVE AMERICA - SCHOOL & COMM. BASED PROG.	1,190
94.006	AMERICORPS	5,863
94.007	PLANNING AND PROGRAM DEVELOPMENT GRANTS	26
94.009	TRAINING & TECHNICAL ASSISTANCE	184
	TOTAL CORPORATION FOR NATIONAL AND COMMUNITY SERVICE	**$7,469**
96.001	SOCIAL SECURITY - DISABILTY INSURANCE	65,872
96.999	MISCELLANEOUS	406
	TOTAL SOCIAL SECURITY ADMINISTRATION	**$66,278**
	GRAND TOTAL	**$16,159,988**

- See Notes to Schedule of Expenditures of Federal Awards -

INDEX TO NOTES

Page

Notes to the Schedule of Expenditures of Federal Awards - June 30, 2002

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 basic financial statements. However, the State System of Higher Education (SSHE), the Pennsylvania Higher Education Assistance Agency (PHEAA), the Pennsylvania Housing Finance Agency (PHFA), and the Philadelphia Shipyard Development Corporation (PSDC) are required to submit their own single audit reports to the federal Audit Clearinghouse 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)
17.258	Workforce Investment Act – Adult Program (L&I Only)
17.259	Workforce Investment Act – Youth Activities (L&I Only)
17.260	Workforce Investment Act – Dislocated Workers (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 Donation, 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 November 15, 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, 2002.

Subrecipient expenditures reported under CFDA #14.228, Community Development Block Grants; CFDA #14.239, HOME Investment Partnerships Program; and CFDA #14.231, Emergency Shelter Grants, 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 of the federal property transferred to recipients by the Commonwealth.

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 cash disbursements.

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, 2002. 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 both in print and on the CFDA website. In accordance with the Commonwealth's policy, the schedule of expenditures of federal awards for the year ended June 30, 2002 reflects CFDA changes issued through December 2001.

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, 2002 was $4.4 million for CFDA #10.550, Food Donation Program, and $1.3 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 November 15, 2000.

The value of donated federal surplus property on hand at June 30, 2002 was $12.1 million, which represents the federal government's original acquisition cost of the property. When the related surplus property is transferred to recipients, it is valued at 23.3 percent of its original acquisition cost, 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: $60 thousand under CFDA #81.041, State Energy Conservation; $918 thousand under CFDA #93.568, Low-Income Home Energy Assistance; and $18 thousand under CFDA #81.999, 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, 2002, the Commonwealth had unexpended oil overcharge funds including interest of approximately $3.2 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 provide 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, and Commonwealth general obligation bonds. The Authority is a component unit of the Commonwealth.

Notes to the Schedule of Expenditures of Federal Awards - June 30, 2002

Note F: Pennsylvania Infrastructure Investment Authority (Continued)

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

At June 30, 2002, the Authority had gross outstanding federal loans of $448.6 million for CFDA #66.458 and $77.2 million for CFDA #66.468. No losses were incurred by the Authority on these loans during the fiscal year ended June 30, 2002.

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	$2,589,844
Federal UC Benefits	351,063
Federal Admin.	135,392
Total Expenditures	$3,076,299

Note H: Workforce Investment Act

In accordance with Department of Labor regulations, unexpended funds made available under the Job Training Partnership Act (JTPA) programs were used for transition to and implementation of the Workforce Investment Act (WIA). The expenditures reflected in the schedule of expenditures of federal awards under CFDA 17.255, Workforce Investment Act, include $11.3 million of these JTPA funds.

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Compliance
and
Internal Control

Commonwealth of Pennsylvania

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

The Honorable Edward G. Rendell, Governor
Commonwealth of Pennsylvania
Harrisburg, Pennsylvania

We have jointly audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Pennsylvania, as of and for the year ended June 30, 2002, which collectively comprise the Commonwealth's basic financial statements, and have issued our report thereon dated January 17, 2003.

We did not jointly audit the financial statements of certain component units, which represent 31 percent of total assets and 7 percent of total revenues of the aggregate remaining fund information, 100 percent of the total assets and total revenues of the Pension and Other Employee Benefits Trust Funds, and 99 percent of the assets and 99 percent of the revenues of the aggregate discretely presented component units. We also did not jointly audit the financial statements of two enterprise funds, which represent 1 percent of total assets and 1 percent of total revenues of the aggregate remaining fund information. The financial statements of these component units and enterprise funds were audited by other auditors, including Ernst & Young LLP acting separately, whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those component units and enterprise funds, is based solely on the reports of the other auditors. Ernst & Young LLP has audited separately 6 percent of total assets and 12 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 of America 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 an instance of noncompliance that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and questioned costs as Comment Number 02-4.

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 02-1 through 02-8.

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 02-1, 02-2, 02-3, 02-4, 02-6, 02-7, and 02-8 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 January 17, 2003.

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 17, 2003

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 Edward G. Rendell, 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, 2002. 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 basic financial statements included the operations of the State System of Higher Education, the Pennsylvania Higher Education Assistance Agency, the Philadelphia Shipyard Development Corporation, 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, 2002. Our audit, described below, did not include the operations of these four 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 of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the 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 02-8 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 02-8 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 Food Donation Program (CFDA #10.550), as reported in Finding 02-1, did not comply with federal reporting requirements, allowable costs requirements, and a special test and provision related to processor recordkeeping.

- The Food Stamps Program (CFDA #10.551), as reported in Finding 02-2, did not comply with eligibility and allowable costs requirements.

- The Special Supplemental Nutrition Program for WIC (CFDA #10.557), as reported in Finding 02-4, did not comply with allowable costs requirements.

- The Community Development Block Grants Program (CFDA #14.228), as reported in Finding 02-5, did not comply with federal reporting requirements.

- The Trade Adjustment Assistance Program (CFDA #17.245), as reported in Findings 02-9 and 02-10, did not comply with federal reporting requirements.

- The Welfare to Work Program (CFDA #17.253), as reported in Finding 02-34, did not comply with subrecipient monitoring requirements.

- The Workforce Investment Act Program (CFDA #17.255) and the Workforce Investment Act Cluster (CFDA #17.258, #17.259, and #17.260), as reported in Finding 02-13, did not comply with federal reporting requirements, and as reported in Finding 02-34, did not comply with subrecipient monitoring requirements.

- The Capitalization Grants for Drinking Water State Revolving Fund Program (CFDA #66.468), as reported in Finding 02-32, did not comply with subrecipient monitoring requirements.

- The Vocational Education – Basic Grants to States Program (CFDA #84.048), as reported in Finding 02-17, did not comply with federal reporting requirements.

- The Rehabilitation Services – Vocational Rehabilitation Grants to States Program (CFDA #84.126), as reported in Finding 02-19, did not comply with cash management requirements, and as reported in Finding 02-20, did not comply with allowable costs requirements.

- The Aging Cluster (CFDA #93.044 and #93.045), as reported in Finding 02-33, did not comply with subrecipient monitoring requirements.

- The Temporary Assistance for Needy Families Program (CFDA #93.558) did not comply with eligibility and allowable cost requirements as reported in Finding 02-02, did not comply with federal reporting requirements as reported in Finding 02-24, and did not comply with a special test and provision related to individual assessment requirements as reported in Finding 02-23.

- The Child Support Enforcement Program (CFDA #93.563), as reported in Finding 02-25, did not comply with a special test and provision related to the timeliness of processing on interstate registry cases.

- The Child Care Cluster (CFDA #93.575 and #93.596), as reported in Finding 02-02, did not comply with eligibility and allowable costs requirements, and as reported in Finding 02-26, did not comply with subrecipient cash management requirements.

- The Medical Assistance Program (CFDA #93.778), as reported in Findings 02-02 and 02-30, did not comply with eligibility requirements.

- The Maternal and Child Health Services Block Grant (CFDA #93.994), as reported in Finding 02-31, did not comply with federal reporting requirements.

- For all major federal programs covered by CMIA as reported in finding number 02-36, 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, 2002. 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 02-3, 02-8, 02-11, 02-16, 02-27, and 02-29.

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 02-1 through 02-37.

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 02-1, 02-2, 02-4, 02-5, 02-9, 02-10, 02-12, 02-13, 02-17, 02-19 to 02-21, 02-23 to 02-26, 02-28, 02-30 to 02-34, and 02-36, 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

March 21, 2003

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Schedule of Findings and Questioned Costs

Commonwealth of Pennsylvania

Summary of Auditors' Results - June 30, 2002

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:

Food Donation (CFDA #10.550)
Food Stamps (CFDA #10.551)
Special Supplemental Nutrition Program for WIC (CFDA #10.557)
Community Development Block Grants/State's Program (CFDA #14.228)
Trade Adjustment Assistance - Workers (CFDA #17.245)
Welfare-to-Work Grants to States (CFDA #17.253)
Workforce Investment Act (CFDA #17.255)
WIA Cluster (CFDA #17.258, #17.259, and #17.260)
Capitalization Grants for Drinking Water (CFDA #66.468)
Vocational Education – Basic Grants to States (CFDA #84.048)
Rehabilitation Services – Vocational Rehabilitation Grants to States (CFDA #84.126)
Aging Cluster (CFDA #93.044 and #93.045)
Temporary Assistance for Needy Families (CFDA #93.558)
Child Support Enforcement (CFDA #93.563)
Child Care Cluster (CFDA #93.575 and #93.596)
Medical Assistance (CFDA #93.778)
Maternal and Child Health Services Block Grant (CFDA #93.994)
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)
10.550	Food Donation	$ 30,629
10.551 and 10.561	Food Stamp Cluster	803,872
10.553, 10.555, 10.556, and 10.559	Child Nutrition Cluster	236,785
10.557	Special Supplemental Nutrition Program for WIC	136,540
10.558	Child and Adult Care Food Program	42,899
14.228	Community Development Block Grants/State's Program	60,891
14.239	HOME Investment Partnerships Program	16,360
15.250	Regulation of Surface Coal Mining	12,670
15.252	Abandoned Mine Land Reclamation Program	15,345
17.225	Unemployment Insurance	3,076,299
17.245	Trade Adjustment Assistance – Workers	42,792
17.253	Welfare-To-Work Grants to States	19,282
17.255	Workforce Investment Act	67,633
17.258, 17.259, and 17.260	WIA Cluster	64,795
20.205 and 23.003	Highway Planning and Construction Cluster	1,356,226
66.458	Capitalization Grants for State Revolving Funds	73,595
66.468	Capitalization Grants for Drinking Water	22,338
84.027 and 84.173	Special Education Cluster	234,176
84.048	Vocational Education – Basic Grants to States	41,741
84.126	Rehabilitation Services – Vocational Rehabilitation Grants to States	100,849
93.044 and 93.045	Aging Cluster	47,596
93.558	Temporary Assistance for Needy Families	622,201
93.563	Child Support Enforcement	90,201
93.575 and 93.596	Child Care Cluster	199,564
93.658	Foster Care Title IV-E	292,658
93.659	Adoption Assistance	45,901
93.667	Social Services Block Grant	105,312
93.767	State Children's Insurance Program	101,097
93.775, 93.777 and 93.778	Medicaid Cluster	6,834,569
93.994	Maternal & Child Health Services Block Grant	24,877
	Total Federal Expenditures – Major Programs	$ 14,819,693

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 Basic Financial Statement Comments - June 30, 2002

Comment No.	Comment	Impacted State Agency	Comment Page	CAP Page
02-1 **	Internal Control Weakness Over Financial Reporting in the Lottery Fund (A Similar Condition Was Noted in Prior Year Comment #01-2)	OB/CS	**127**	280
02-2 **	Internal Control Weaknesses Over Reporting Highway and Bridge Infrastructure and Related Depreciation in the Government-Wide Financial Statements	PADOT	**128**	288
02-3 **	Internal Control Weakness Over Reporting Inter- and Intrafund Activity in the Basic Financial Statements	OB/BFM	**130**	280
02-4 **	Noncompliance With Pennsylvania Laws Governing Authorized Investments for Participants in the INVEST Program (A Similar Condition Was Noted in Prior Year Comment #01-3)	TREAS	**132**	288
02-5 *	Weakness in Internal Controls over State Workers' Insurance Fund (SWIF) Investments	L&I	**135**	285
02-6 **	Internal Control Weaknesses Result in Improper Payments in the Tobacco Settlement Fund	DPW	**136**	286
02-7 **	Improving Financial Reporting Over Accounts Payable	OB/BFM	**138**	280
02-8 **	Lack of Documentation and Internal Control Weaknesses Over Contracting and Procurement (A Similar Condition Was Noted in Prior Year Comment #01-5)	OB/OA	**139**	280

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

Comment 02 – 1:

Executive Offices
Office of the Budget – Central Services Comptroller Office

Internal Control Weakness Over Financial Reporting in the Lottery Fund (A Similar Condition Was Noted in Prior Year Comment #01 - 2)

Condition: The Commonwealth's BFS contained misstatements in the Lottery Fund that required adjusting entries by the auditors. Because of an internal control weakness in the preparation of Lottery's GAAP package within the CS Comptroller Office, the misstatements overstated liabilities by $6 million and overstated accounts receivable by $4.5 million prior to the adjustments.

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

Cause: The misstatements were caused by clerical errors in the CS Comptroller Office's 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: Lottery account balances in the government-wide and fund financial statements were misstated and required auditor adjustments. In addition, the noted weakness in internal review procedures could result in additional misstatements in the future.

Recommendation: CS should evaluate its methodology and its internal review procedures for accruing and reporting Lottery activity in the BFS to ensure that correct amounts are reported.

Agency Response: The errors were the result of 1) A spreadsheet formula that was incorrect and 2) Incomplete "game" information. The Spreadsheet has already been corrected and we are working with the Department of Revenue to ensure that we receive all "game" information at the end of the year. In addition, we will strengthen our internal review procedures.

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

Comment 02 – 2:

Department of Transportation

Internal Control Weaknesses Over Reporting Highway and Bridge Infrastructure and Related Depreciation in the Government–wide Financial Statements

Condition: For the fiscal year ended June 30, 2002, Commonwealth management implemented *GASB Statement No 34-Basic Financial Statements–and Management's Discussion and Analysis–for State and Local Governments* in its financial reporting process. As a result, in the government-wide financial statements, PADOT reported its highway and bridge infrastructure balances along with related depreciation for the first time.

Overall, PADOT management is to be commended for its first-year efforts in developing and reporting over 20 years worth of retroactive infrastructure and depreciation balances with the implementation of GASB 34. We noted, however, from our discussions with PADOT officials and our audit of PADOT's infrastructure files that internal control weaknesses were present in the development of these first-year balances; and auditor adjustments were necessary for proper presentation in the BFS.

In particular, we noted the following control weaknesses in the preparation of PADOT's infrastructure and depreciation amounts:

- PADOT's initial development of its beginning and ending infrastructure balances excluded the breakout for the construction-in-progress (CIP) account. As a result, construction costs for certain bridges and highways not yet placed into service were being depreciated in the government-wide statements, causing an overstatement of current-year depreciation expense and an understatement of the year-end infrastructure balance. Furthermore, the CIP estimates subsequently developed by PADOT as a result of auditor requests did not adhere to management's established methodology and were found to contain numerous errors which required material auditor adjustments to the financial statement amounts. Discussions with PADOT officials disclosed that an in-house review process was not established to ensure first-year CIP balances in the BFS were correct.

- There was no established process in place during our audit period for identifying and reporting infrastructure under PADOT's management and control which was originally constructed by other outside entities, such as local governments or the Turnpike Commission, a discretely-presented component unit. As a result, an adjustment was necessary for Turnpike. There was also no established process for identifying and excluding infrastructure constructed by PADOT, but managed and maintained by other outside entities, such as local governments. To ensure future compliance with GASB 34, formalized agency-wide processes need to be put in place in PADOT to ensure that these two situations involving PADOT infrastructure which was originally constructed by one entity, but actively managed and maintained by a different entity, are correctly accounted for in the Commonwealth's BFS.

- During our audit period, there were no established agency-wide procedures for monitoring the effect of PADOT's highway and bridge replacement activity on its infrastructure balances reported in the BFS. Although no adjustments to the current-year statements were found to be necessary as a result of replacement activity, a formalized agency-wide review and monitoring process needs to be established within PADOT to identify this activity and ensure that the costs of replaced highway and bridge assets, if any, are removed from future infrastructure balances as required by GASB 34 for financial reporting purposes.

- PADOT's supporting schedules for infrastructure and depreciation balances contained errors requiring correction during the course of our fieldwork. We noted, for example, that the cost of land was included in depreciable infrastructure, but should not have been and had to be adjusted out. We also noted that, due to either miscommunication or confusion on the part of management, depreciation was not consistently calculated on these supporting schedules and several revisions were necessary to the depreciation methodology used. We also found several clerical errors on the supporting schedules. Overall, we noted that PADOT management needs to establish formalized procedures and controls over the preparation and review of its supporting schedules for infrastructure and related depreciation to ensure accurate amounts are reported in the BFS in the future.

Comment 02 – 2: (continued)

- In its overall preparation of infrastructure and depreciation balances in the BFS, PADOT management did not plan the necessary procedures in a timely fashion to ensure amounts were properly reported in accordance with the provisions of GASB 34. As a result, management's reporting process was not conducted in a timely fashion, its methodology required numerous revisions, and accurate balances were not developed by management without extensive auditor input. In addition, management did not complete its reporting responsibilities until well after our original planned audit completion date. Overall, we noted the need for management to better organize and plan its own preparation and review procedures in the future to ensure infrastructure balances are properly and timely developed and adequately reviewed in-house before inclusion in the BFS.

Criteria: GAAP requires infrastructure and depreciation amounts to be accurately and properly reported in the Commonwealth's BFS. Internal controls should ensure that accounting transactions are properly presented in the BFS in accordance with GAAP.

Cause: Discussions with personnel in PADOT disclosed that new procedures and internal controls for the timely development of infrastructure and depreciation in the BFS in accordance with GASB 34 had not been formally established for our audit period. Although materially correct account balances were eventually developed after extensive auditor input during the course of our audit, the control weaknesses identified above caused PADOT's infrastructure and depreciation balances to be materially misstated and required auditor adjustment in the BFS.

Effect: Infrastructure and related depreciation amounts in the BFS were materially misstated for the fiscal year ended June 30, 2002, and material auditor adjustments were necessary. These balances may be materially misstated in future years if the internal control weaknesses are not corrected.

Recommendation: We recommend that PADOT establish and implement formalized planning, preparation, and review procedures over the development of infrastructure and related depreciation balances in the BFS. Strong internal controls should be established to ensure the accuracy of these amounts reported.

Agency Response: The Department agrees in principal with Comment 02-2. The Department will review the methodology and the procedures used for reporting the initial GASB Statement 34 highway and bridge infrastructure and related depreciation amounts to ensure that these amounts are accurately reported. We look forward to working with you as we begin this review process to enhance our internal controls.

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

Comment 02 – 3:

Executive Offices
Office of the Budget – Bureau of Financial Management

Internal Control Weakness Over Reporting Inter– and Intrafund Activity in the Basic Financial Statements

Condition: For the fiscal year ended June 30, 2002, Commonwealth management implemented *GASB Statement No. 34 – Basic Financial Statements–and Management's Discussion and Analysis—for State and Local Governments* in its financial reporting process. GASB 34 contains specific provisions covering the reporting of inter– and intrafund (or internal) activity in both the government–wide and fund financial statements. Internal transactions between various funds and agencies within the Commonwealth reporting entity cause the simultaneous recording of revenues in receiving funds/agencies and expenditures/expenses in the paying funds/agencies on the Commonwealth's accounting system. Because these transactions are between Commonwealth funds/agencies only and do not involve the receipt of monies from or the payment of monies to outside parties, they are not revenues or expenditures/expenses for the Commonwealth as a whole, and GASB 34 mandates that these transactions not be reported in the BFS.

Our audit of the Commonwealth's BFS prepared by OB for the fiscal year ended June 30, 2002, disclosed that much of the Commonwealth's internal activity was properly not reported in the BFS in accordance with GASB 34. Therefore, OB management is to be commended in its first-year implementation of the new GASB reporting standard since procedures were clearly in place to exclude or eliminate these transactions from the reporting process. However, our detail testwork also identified other internal transactions which were inappropriately included in the government-wide Statement of Activities and in the related fund statements; and auditor adjustments were necessary to ensure these financial statements were presented in accordance with GASB 34.

Criteria: GAAP requires internal activity to be accurately and properly accounted for in the Commonwealth's BFS. Internal controls should ensure that these accounting transactions are presented in the financial statements in accordance with GAAP.

Cause: OB–BFM officials stated that they initially believed that many of the internal transactions which remained in the BFS were "interfund services provided and used" as defined in GASB 34 and, therefore, should not have been excluded from financial reporting. After reviewing these transactions, we determined they were not "interfund services provided and used" as defined in GASB 34 and should not have been reported. Therefore, auditor adjustments to the BFS were necessary. Our testwork also disclosed that the review and consideration of internal transactions within OB-BFM and the various Comptrollers' Offices during the preparation of the BFS was not sufficient in scope to ensure all material internal transactions were accounted for in accordance with GASB 34.

Effect: As a result of the internal control weakness, the BFS were not materially correct with regard to internal activity, and numerous auditor adjustments were necessary to correct the BFS. Furthermore, if the internal control weakness is not corrected, the BFS will continue to be misstated in the future. The accurate reporting of internal activity is especially critical in the new Statement of Activities required by GASB 34, which must now present total and net revenue and expenditure/expense information by individual function.

Recommendation: We recommend that internal controls be strengthened over the reporting of internal transactions in OB's preparation of the BFS. All internal transactions should be considered and reviewed during OB's BFS preparation process and those that do not meet the GASB 34 definition of "interfund services provided and used" should be either excluded or eliminated from the BFS. We also recommend strengthened monitoring and oversight of internal transactions by BFM to ensure the Comptrollers' Offices report correct amounts.

Comment 02 – 3: (continued)

Agency Response: We disagree with including intrafund transactions as part of the finding as our longstanding protocol (that predates GASB 34) is to eliminate all intrafund transactions. Further, we continue to disagree that all internal transactions (those with non-outside entities) must be eliminated. We do not agree that GASB 34 mandates that all such transactions be eliminated. On the contrary, the standard paragraph 112.a. of GASB 34 specifically mentions *interfund* activities so there is clearly no requirement that all *interfund* transactions be eliminated.

The auditors concluded that there are almost no instances of "interfund services provided and used" in the Commonwealth. Commonwealth funds do provide and use services to one another. Our auditors contend that our interfund transactions are almost always reimbursements, as defined in paragraph 112.b., (2), which must be eliminated from both fund and government-wide statements. We contend that these transactions fall into paragraph 112.a., (2) and, therefore, do not require elimination. Given the lack of clear guidance on this issue, we intend to revisit internal activities reporting as part of preparing financial statements for the fiscal year ending June 30, 2003.

Auditors' Conclusion: Auditor adjustments were necessary to correct intrafund as well as interfund transactions to ensure the BFS were presented in accordance with GASB 34. Longstanding protocol on intrafund transactions in prior years which precede GASB 34 has no impact on our current year conclusions, so intrafund transactions remain part of this finding for our current-year under audit.

We do not agree with BFM's statement that the Commonwealth's internal transactions fall under GASB 34 paragraph 112.a. (2), *Interfund Services Provided and Used*, and therefore, do not require elimination. We also disagree that there is a lack of clear guidance on this issue. We believe our testwork clearly demonstrated that the internal transactions initially reported in the BFS by management fell under GASB 34, paragraph 112.b. (2), *Interfund reimbursements*, or paragraph 59 as allocations of overhead or other costs to the appropriate funds or departments, responsible for paying the costs. We also noted other GAAP technical literature which, in our judgement, clearly explains how to report internal activity in the BFS (e.g., GASB Question and Answer Guides) and supports our conclusions. When we compared the Commonwealth's internal transactions to the current GAAP literature, we found overall existing guidance to be clear enough for our purposes, and concluded that these transactions represented reimbursement/allocation activities required to be eliminated from the BFS.

As a result, our finding and recommendation, 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.

Comment 02 – 4:

Department of Treasury

Noncompliance With Pennsylvania Laws Governing Authorized Investments for Participants in the INVEST Program (A Similar Condition Was Noted in Prior Year Comment #01-3)

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 auditors 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 for the current year ended December 31, 2001, disclosed investments which do not appear to have been authorized by Pennsylvania laws governing the investments of the INVEST participants. In particular, at the January 1, 2001, beginning of our current audit period, we noted $145.5 million in unauthorized investments; and at the December 31, 2001, end of the audit period, we found $12.4 million in similar unauthorized investments. 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 January 1, 2001. The $12.4 million consisted of two types of U.S. Government agency obligations included in underlying collateral for a repurchase agreement totaling $266.6 million at December 31, 2001. 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 agreements themselves were unauthorized investments for participants in the INVEST program.

Comment 02 – 4: (continued)

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

	January 1, 2001	December 31, 2001
Federal Home Loan Bank (FHLB)	$101.3 million	$11.9 million
Federal Farm Credit Bank Funding Corp. (FCSB)	42.1 million	–
Financing Corporation (FICO)	1.9 million	–
Resolution Funding Corporation (REFC)	.2 million	.5 million
Total	$145.5 million	$12.4 million

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 amounts at the beginning and end of our current audit period, 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 amounts identified above, Treasury officials stated that the U.S. Government agency obligations in the collateral pools 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 agreements in question matured in early January of 2001 and 2002, 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.

Comment 02 – 4: (continued)

Treasury officials indicated that they are seeking statutory amendments to applicable laws to clarify this matter. Further, the Treasurer decided in January 2002 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. Government or U.S. Government agency securities unless they are backed by the full faith and credit of the U.S. Government.

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.

Recommendation: We agree with the Treasurer's decision, beginning in January of 2002, 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. Until statutory amendments are made, this will ensure compliance with the existing state law quoted in the finding.

Agency Response: As noted in the above comment, the Treasury Department believes all the U.S. Government agency obligations in the collateral pool were authorized investments for INVEST participants and continues to seek statutory amendments to applicable laws to clarify this matter. As pointed out, Treasury also decided in January 2002 that pending a resolution of this dispute, and for any concerns the pool participants have related to this matter, it would be prudent to take a more conservative approach of limiting underlying securities for such repurchase agreements to short-term U.S. agency securities unless they are backed by the full faith and credit of the U.S. Government.

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

Comment 02 – 5:

Department of Labor and Industry – State Workers' Insurance Fund

Weakness in Internal Controls Over State Workers' Insurance Fund (SWIF) Investments

Condition: SWIF uses its own in-house accounting system, known as the Parex system, to track and financially report the fund's investments. During the current year ended December 31, 2001, we detected errors on the Parex system, which were the result of an internal control weakness in SWIF's procedures. Although no adjustment was considered necessary to the financial statements in the current year, we noted that the following internal control weakness was present.

SWIF personnel did not have formalized procedures in place for routinely and consistently reconciling its in-house Parex system investments to its custodian's records to detect differences, and timely follow up to make the necessary corrections. As a result, SWIF was either not identifying incorrect balances on these systems or was not timely following up to correct identified errors.

We noted that during the current year ended December 31, 2001, SWIF personnel made a concerted effort to identify errors either on its Parex system or in custodian's records, and make the necessary corrections to ensure balances were accurate. SWIF is to be commended for its efforts in this regard. However, we found that more follow up is necessary on known reconciling items, and a formal reconciliation procedure was not routinely or timely performed during our audit period.

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: SWIF personnel indicated that the differences were due to various reasons including the change in ownership of companies, companies merging, stock splits, etc. SWIF personnel also noted that the investment managers were not consistently forwarding trade tickets and information related to the mergers, etc., so that SWIF could properly adjust their Parex investment accounting system. In addition, SWIF personnel indicated that they previously identified reconciling differences between their records and the custodian's records, but did not actively pursue them since they felt the differences were not significant in relation to SWIF's total investment balance. SWIF noted that during the year ended December 31, 2001, there was some effort made to investigate these differences. However, not all of the differences were corrected.

Effect: If the internal control weakness identified above is not corrected, SWIF's investment balances may be materially misstated in its future financial statements.

Recommendation: We recommend that internal controls be strengthened in SWIF's accounting and financial reporting of investments to ensure that accurate amounts are reported in future financial statements. As part of this process, SWIF should routinely and consistently ensure that its Parex system agrees with the custodian's records.

Agency Response: The Comptroller's Office has had formal procedures in place since February 2002 and reconciles the Parex investment system to Mellon Bank on a monthly basis.

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

Comment 02 – 6:

Department of Public Welfare

Internal Control Weaknesses Result in Improper Payments in the Tobacco Settlement Fund

Condition: Our testing of uncompensated care (UC) payments to hospitals in the Tobacco Settlement Fund disclosed internal control weaknesses at DPW which caused improper payments from the Tobacco Settlement Fund as noted below.

Our review of the list of payments under the extraordinary expense (EE) portion of UC (Section 1105 reimbursements under Act 77 of 2001) disclosed that payments to three of the smaller hospitals appeared excessive. Charles Cole Memorial, Titusville, and Butler County Memorial hospitals in total received over $4.3 million (or 38.4%) of the $11.4 million in total EE payments. Further inquiry disclosed that, after the fiscal year end, Charles Cole Memorial returned its $1,070,619 EE payment to DPW with interest because of inaccuracies in its EE data. DPW subsequently acknowledged that the data submitted by all three of these small hospitals noted above overstated their EE costs. Both Titusville and Butler County Memorial decided to retain the EE payments received from DPW pending the outcome of separate audits.

In addition, our review of the regular UC payments (Section 1103 reimbursements under the Act) of $64,665,601, disclosed that when calculating the number of Medicare SSI days as a percentage of total inpatient days, DPW inappropriately used different fiscal years in the numerator vs. the denominator. DPW used Medicare SSI days for the fiscal years 98, 99, and 00 in the numerator, but total inpatient days in the denominator were for fiscal years 97, 98 and 99. Further, the DPW calculation of the one time UC payment of $15 million made to several hospitals under Section 5101(a)(4) of the Act used Medicare SSI days for the fiscal years 99, 00, and 01, and total inpatient days for the fiscal years 94, 95, and 96 to calculate the Medicare SSI percentage. These inconsistencies may have caused improper eligibility determinations and payments to the hospitals in question.

Criteria: The Tobacco Settlement Fund Act 77 of 2001 states:

Section 1105. Reimbursement for extraordinary expense.

(d) Payment methodology. Payment to a hospital under this section shall equal the lesser of the cost of:

(1) The extraordinary expense claim; or

(2) The prorated amount of each hospital's percentage of extraordinary expense costs as compared to all eligible hospitals' extraordinary expense costs, as applied to the total funds available in the Hospital Extraordinary Expense Program for the fiscal year.

Section 1103. Hospital uncompensated care payments.

(b) Department responsibilities. The department has the following powers and duties:

(3) Calculate uncompensated care scores for eligible hospitals under Section 1104(c).

Section 1104. Eligibility and payment.

(c) Uncompensated care scoring. The department shall annually calculate the uncompensated care score of each eligible hospital from collected data. If information necessary to determine the uncompensated care score of an eligible hospital is unavailable due to the refusal of the hospital to provide the information, the hospital shall not be eligible for payment from the Hospital Uncompensated Care Program. If the department determines that such data cannot be provided after due diligence, the department shall use the average of the collected data. An eligible hospital's uncompensated care score shall be the sum of the following, using three-year average data as determined by the department:

Comment 02 – 6: (continued)

(2) The number of Medicare SSI days as a percentage of total inpatient days based on the most recent data available to the department.

Cause: DPW personnel stated that the EE data used to calculate payments was confirmed via inquiry only with the hospitals in question, but no data verification procedures were performed by DPW to support the propriety of the payments.

Regarding the use of different fiscal years in the calculation of Medicare SSI percentages DPW personnel stated they used the latest data available without regard to consistency between the numerator and the denominator of the equation.

Effect: The above data discrepancies caused improper UC payments to hospitals from the Tobacco Settlement Fund. If the noted internal control weaknesses are not corrected, these improper payments may continue into the future.

Recommendation: DPW should establish procedures to ensure that data submitted by hospitals is valid and properly supports payments from the Tobacco Settlement Act. In addition, DPW should recalculate the UC payments made to hospitals in the current year under audit after ensuring that they are based on correct and accurate data, and make the necessary payment adjustments to each hospital. Further, DPW's calculations of its regular UC payments should be based on a methodology which is reasonable and avoids the inconsistencies in fiscal years identified above.

Agency Response: The Extraordinary Expense (EE) payments in question (Charles Cole Memorial, Titusville, and Butler County Memorial) are currently under review by the Auditor General's Bureau of State-Aided Audits. We are awaiting the outcome of their audit before finalizing calculations and making payment decisions. The Legislation requires staff to utilize data from the Pennsylvania Health Care Cost Containment Council (PHC4). The PHC4 has taken steps to improve their data validation system and has demonstrated to our staff their process. At this time, they have assured the Department this situation will not be present in future data used in calculations of EE.

As stated in the Tobacco Settlement Act 77 of 2001, Section 1104 (c) 2, the Department was to use the most recent data available in its calculations for Uncompensated Care (UC). The decision was made to use differing years in an attempt to provide the most up-to-date data available. The statistical variance in using different base years would not be significant enough to cause a change in the outcome of eligibility. The Department's goal is to use consistent data when available. The Department is confident the hospitals received the tobacco payment due to them based on our calculations.

The Department continues to follow the criteria outlined in the Tobacco Settlement Act of 2001, and will strive to consistently use the best available data. In addition, the Department has initiated an internal and external validation process. For FYE 2002 tobacco payments, the Department had an internal validation process that included computer programming cross checks to ensure the accuracy of data outcomes and a core team of personnel who individually analyzed the calculations for facilities. As an external validation, all data was sent to each facility for verification and the final calculations where accepted by the hospital industry. Currently, we are pursuing a contract with an independent entity, Tucker Alan, Inc., as an additional external validator of the calculations.

Auditors' Conclusion: Our recommendation for action by DPW on current-year UC payments made to hospitals remains as stated, regardless of other outside audits being conducted on UC funds, since DPW as the funding agency has the responsibility to ensure that its payments are proper. Any corrective action taken by DPW on future UC payments will be reviewed by us in our subsequent GAAP Audit.

Our finding and recommendation, with the above clarification, 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 02 – 7:

Bureau of Financial Management

Improving Financial Reporting Over Accounts Payable

Condition: There were various funds where accounts payable were not fully recorded in the fund financial statements. These were payables relating to payments made for goods or services received on or before June 30, 2002 but paid beyond sixty days after June 30, 2002.

Criteria: NCGA Statement 1, paragraph 70, (and GASB Interpretation # 6, paragraph 9) requires that a government accrue a governmental fund liability and expenditure for most expenditures and transfers in the period in which the government incurs the liability.

Cause: There was a misunderstanding in OB-BFM with regard to the recognition of accounts payable as a result of the adoption of GASB # 34. As a result, liabilities paid over 60 days beyond year-end were inadvertently excluded from the fund financial statements for various funds in the GAAP packages.

Effect: Accounts payable in various funds were initially materially understated in the fund financial statements. An auditor adjustment was made to adjust the account payable balances to the correct amounts.

Recommendation: We recommend that OB inform its comptroller offices to modify their treatment to not differentiate between accounts payable paid more than 60 days after fiscal year end and those paid within 60 days and to report all accounts payable in fund financial statement.

Agency Response: OB-BFM agrees with the content of the finding.

Auditors' Conclusion: 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 02 – 8:

Office of the Budget
Office of Administration

Lack of Documentation and Internal Control Weaknesses Over Contracting and Procurement (A Similar Condition Was Noted in Prior Year Comment #01–5)

Condition: During our current audit period, we examined the Commonwealth's contracting process through 1) regular sampling of expenditures; 2) a separate review of a $100 million, 5½-year contract for the re-engineering of DPW's Medicaid Management Information System (MMIS), and 3) follow-up audit procedures on four statewide technology contracts awarded by the Governor's Office of Administration in prior audit periods. These prior-year awards consisted of two contracts ($112 million and $51.9 million) that were part of an Enterprise Resource Planning (ERP) project to modernize and upgrade the Commonwealth's statewide information systems technology, a third contract ($515.5 million) for the outsourcing of certain data center computer operations and related services, and a fourth contract ($228 million) for the statewide acquisition of telecommunication services.

As in the prior year (see Comment #01-5), management in the current year continues its policy of refusing to provide us with key procurement documentation to enable us to audit the awarding of contracts to verify compliance with Commonwealth procurement regulations. As a result, we were not able to test the procurement of the statewide technology contracts listed in prior-year Comment #01-5 or the following additional contract awards we requested in our current year audit: a SWIF computerization project; a DCED Foreign Tourism Office Contract, the DPW MMIS computer re-engineering project, a DOH advertising contract for the Tobacco Fund; and four DOH Health Research Non-formula grants awarded from the Tobacco Fund. Documentation again not provided to us for the above contract awards consisted of the following:

- List of proposal evaluation committee members.
- Copies of losing vendor proposals.
- Detailed scoring sheets used by evaluation committee members for each proposal submitted for review.
- Summary documentation to audit the overall scoring and selection process including maximum point values assigned to each major evaluation criterion and the evaluation committee members recommendations for vendor selection.
- Documentation to support that the evaluation committee verified that prospective vendor's cost proposals were reasonable.
- 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, we followed up on internal control weaknesses reported in prior year Comment #01-5 related to awarding Commonwealth contracts. We noted the following weaknesses in the Commonwealth's internal controls over documentation supporting procurement in our current year:

- The STD-21, "Compliance Review Form" was not completed as required. We noted no form was available for the MMIS contract, the DCED tourism contract, or the food distribution contract awarded by the Department of Agriculture. In addition, our review of the food distribution contract noted that the encumbrance was estimated at an amount which was below the threshold for preparation of the STD-21. The contract itself is based on unit cost, and total costs incurred would depend on the level of vendor services needed. We noted that contract costs eventually exceeded the STD-21 threshold, but the department did not require the vendor to complete the form. Commonwealth policy requires that once a contract of this sort reaches or exceeds the threshold, the form is required to be completed.

Comment 02 – 8: (continued)

- In a separate audit engagement, the Department of the Auditor General issued an audit report in 2002 on the Commonwealth's Contractor Responsibility Program (CRP) related to fiscal years prior to our current audit period. This separate engagement found multiple systemic control weaknesses in the statewide CRP which failed to prevent the Commonwealth from contracting with nonresponsible contractors, and based on management's response to the report, these systemic weaknesses existed throughout our current audit period. These control weaknesses include: the failure to adequately track and recoup tax and other liabilities owed by contractors to the Commonwealth; an inadequate statewide database (or Contractor Responsibility File) for tracking and rendering information on nonresponsible contractors; inadequate oversight of the statewide CRP by management; and systemic control weaknesses in agencies' procedures for checking the CRF and verifying that their contractors are responsible in accordance with established CRP mandates.

- The RFP for the DCED tourism contract did not include language that informed potential vendors that the contract term and total compensation may be increased. The RFP indicates that the duration of the contract would be for two years when in fact a five-year term was provided for in the actual agreement. Also, the RFP set total compensation at a maximum of $165,000. Our review of the actual contract noted that two subsequent amendments increased this amount by more than $2.5 million, or over 15 times the original contract award. This large increase calls into question the sufficiency of the original RFP used in competitively bidding the contract.

We also noted in our current-year follow up that the Commonwealth continued to significantly amend the data center, telecommunications, and ERP integrator contracts with increasing costs in the current year, and did not provide documentation to demonstrate that management is adequately monitoring the amendments to ensure the increasing costs are reasonable and properly controlled:

- The data center contract, which was originally awarded for $515.5 million in a prior year, had over 300 amendments (i.e., change orders and addendums) increasing original contract costs by a cumulative $114.3 million as of November 2002. In addition, the original contract was extended for an additional three years in September 2002 for $252.1 million, bringing the cumulative contract total to $881.9 million as of our testwork date. Our examination of a sample of six contract amendments in our current audit (numbers 310, 324, 395, 426, 428, and 444) totaling to $310.3 million (including the three-year extension) disclosed that internal control weaknesses from our prior audit continued since they were not corrected by management. We found no documented support for the estimated costs, including hourly rates, for 5 of the 6 contract amendments we sampled. In addition, none of these five amendments, including the one-time $252.1 million extension mentioned above, was based on an impact study. Management only provided a signed-off change document indicating no impact study was necessary with no documented explanation. For four of the five amendments, no other documentation was provided as support other than the change request form itself. Therefore, for our sampled amendments, there was little or no evidence to clearly demonstrate management's monitoring of the amounts for reasonableness, propriety, or necessity.

- For the telecommunications contract originally awarded for $228 million in a prior year, nearly 100 contract amendments (i.e., change requests) had been made as of October 2002. Management provided no documented evidence of its monitoring of the total of these increasing contract costs since the "Change Request Tracking Form" does not list any cost (actual or estimated) associated with each amendment or the cumulative total cost of all the amendments to date. Therefore, we could not determine the cumulative total estimated cost of this contract at the time of our testwork. Furthermore, based on supporting documentation provided for 8 increasing contract amendments we sampled (change request numbers CR-054, 098, 118, 119, 139, 146, 148, and 149 totaling to $3.8 million), we noted new vendor-proposed rates ranging from $104 per hour to $187 per hour without any documentation from management showing how management analyzed their reasonableness before its approval of the increased costs.

- Change request number CR-098, for the telecommunications contract, contained a mathematical error which resulted in an over-billing by the vendor of $54,000 for help desk services. Because its review of the request was not adequate, the Commonwealth failed to detect this error. Subsequently, the vendor noted the error and initiated change request number CR-153 for a credit billing.

Comment 02 – 8: (continued)

- For change request number CR-139 in the telecommunications contract, no documentation was provided by management to support the increasing projected cost. Furthermore, we noted that the Description Section of the change request form documented increased costs of $781,080 while the Cost Impact Section showed increased costs of $718,080, or a difference of $63,000. Because of the lack of documentation, it is not clear which amount is correct for this change.

- The ERP integrator contract was originally awarded for $112 million and had four increasing amendments (or funding adjustments) totaling $10 million as of November 2002. We reviewed the two funding adjustments that occurred in our current year totaling $3.061 million ($2.776 million in February and $285,000 in June 2002). We noted that $2.683 million of the increased costs, or about 88 percent of the total, were billed at higher manager billing rates of $270 to $337 per hour with no documented justification supporting the necessity of higher-level personnel charging these higher rates for 88 percent of the added costs. In addition, the cost worksheets supporting $1.676 million of the $2.683 million adjustment included a flat $270 hourly rate for all services without documenting which contractor personnel (e.g., senior manager, manager, senior consultant, consultant, etc.) would be providing the services to support the $270 rate per hour. As a result, we noted poor documentation to support management's control over these higher-level costs being added on to the contract.

- A log of contract change requests was not maintained by the ERP integrator as required by the ERP system integrator contract. In addition, management did not provide a change request log in lieu of a contractor log. We noted that 50 change requests, including the four funding adjustments mentioned above, had been submitted by the integrator as of March 2003.

- For the data center and telecommunications contract changes, we noted that a weakness from our prior-year audit remained uncorrected since none of the amendments tested in the current-year included documented evidence of review and approval other than one bureau director within OA. Without evidence of additional supervisory review of these contract amendments, internal controls continue to appear weak over monitoring of these increasing costs.

Criteria: The Commonwealth established procurement policy and procedures in the "Field Procurement Handbook" (M215.3 as Amended). Commonwealth agencies are required to adhere to this handbook when awarding contracts. Part III, 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 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….*

Governor's Executive Order (EO) 1990-03, dated June 29, 1990, established the statewide Contractor Responsibility Program (CRP) to "identify, evaluate, and sanction appropriately, contractors that do not meet the standards of responsibility, that render deficient performance, or that engage in wrongdoing or other activity adversely affecting their fitness to contract with Commonwealth agencies." Commonwealth Management Directive (MD) 215.9 was issued by the Governor's Office on July 17, 1990 in order to implement the CRP within the Commonwealth as directed by EO 1990-03.

Comment 02 – 8: (continued)

The stated purpose of MD 215.9 was *"To ensure that the Commonwealth's contractors are competent and responsible and that the contracting process is free of fraud, waste, and abuse. To identify, declare ineligible, and sanction contractors that have rendered deficient performance or engaged in other activities that adversely affect their fitness to contract with Commonwealth agencies."* This MD applied to all departments, boards, and commissions under the Governor's jurisdiction.

A strong system of internal control should ensure that contract amendments and related costs are properly justified and supported and adequately reviewed prior to amending original contracts. Strong internal controls should also ensure that the CRP is functioning as intended by Governor's EO 1990–03 and Commonwealth MD 215.9 to ensure that Commonwealth agencies only contract with responsible vendors.

Cause: Management maintains that the identity of evaluation committee members, committee scoring sheets, SERB participation, losing proposals and other documents listed above are considered confidential information that we are not entitled to review. Management also maintains that these documents are not within the scope of a financial statement audit.

For the other issues above, management indicated that the Commonwealth's sign-off on the change documents applicable to the ERP systems integrator, state telecommunications, and data center contracts, is the key evidence of management's detailed review that is necessary and appropriate. The documentation supporting the contract amendments is considered by management to be adequate. Also, management considered the change orders affecting the ERP systems integrator contract to be too limited in number to warrant an official log record.

Concerning the STD–21, management indicated that this prior-year weakness was corrected, but DPW could not provide the document or a reason for the lack of it. In addition, management for DCED considered the STD–21 document to be inappropriate for this international contract since compliance would be difficult to enforce while management for the Department of Agriculture did not consider it applicable since the original encumbrance was below the $50,000 threshold amount. However, according to the Commonwealth's accounting system, payments to the vendor totaled $478,000 for the 2001-02 fiscal year.

Regarding the CRP, management stated that it did not agree with the separate audit report mentioned above, and claimed that the CRP collected approximately $61.7 million in liabilities owed the Commonwealth since its inception. Management further stated that the CRP should be strengthened in the future with the statewide implementation of its new ERP system involving automated key controls and maintaining better suspension and debarment records.

Effect: By refusing to provide the requested documentation, management has prevented the Department of the Auditor General from performing duties required of it 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 position that the invocation of confidentiality supersedes these constitutional and statutory directives.

Without the necessary documentation, we could not verify that management adhered to Commonwealth procurement standards and laws, or exercised due diligence in awarding the contracts disclosed above. 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 imposed scope limitations on our audit procedures.

Comment 02 – 8: (continued)

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)*

We again noted that the system of internal controls over the review and approval of changes to contract terms and increasing total costs is weak. Documentation supporting a proper review of contract changes and increasing costs by management is lacking. Change order documents contain errors which should have been detected and corrected during a proper review prior to management approval. STD-21 forms are not being prepared as required. 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. Close scrutiny over contract change requests is critical to effective contract cost management. Otherwise, management may not realize the desired savings and other benefits intended by the guidelines set forth in the Field Procurement Handbook.

As noted in the separate audit of the CRP, the Commonwealth is contracting with nonresponsible contractors and is not recouping tax and other liabilities owed the Commonwealth as required by the CRP in MD 215.9.

Recommendation: We recommend that management more closely monitor its statewide technology contracts to ensure Commonwealth funds are being properly committed at the most reasonable cost. The fiscal impact of amendments and their amounts should be better justified and documented, and proper support should be adequately reviewed and approved by management prior to amending the contracts; all required contract forms should be filed timely; 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, internal controls need to be strengthened within the CRP to ensure that Commonwealth agencies are adequately following the provisions of MD 215.9 in procuring and awarding contracts to outside parties.

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 practice of withholding documentation in order to allow the Department of the Auditor General to perform its constitutional and statutory duties, and to provide the public and other interested stakeholders with assurance that laws and policies are being properly followed in the procuring of goods and services.

Agency Response: Management's position is accurately and sufficiently stated in the Comment's "Cause" section. However, Management must correct several misleading statements contained in the Comment's "Effect" section:

1. Management does not take the position that the invocation of confidentiality supersedes the Auditor General's constitutional and statutory directives. Rather, Management first disagrees with the Auditor General's interpretation of the scope of its authority and, second, maintains that the documents requested are not necessary for the Auditor General to review in order to perform its proper duties.

2. Management has not imposed scope limitations on the Auditor General's audit procedures. Rather, Management does not believe that it is within the scope of the Auditor General's authority, particularly in the GAAP audit, to "verify that management adhered to Commonwealth procurement standards and laws, or exercised due diligence in awarding contracts," or to "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." These verifications have nothing to do with the fiscal status of these existing contracts (the procurement of which has never been legally challenged), nor are they relevant to the presentation of the Commonwealth's financial statements.

Comment 02 – 8: (continued)

3. Management's refusal to provide procurement documentation to the Auditor General is not a violation of the Commonwealth Procurement Code. The Code states that "*In accordance with applicable law,* all retained documents shall be made available to the . . . Auditor General . . . upon request." (62 Pa.C.S.A. § 563). The emphasized phrase clearly only authorizes the Auditor General to review documents which are within the proper scope of the Auditor General's legal authority. Again, Management disagrees with the Auditor General on the scope of this authority.

For the MMIS contract, the DPW acknowledges the STD-21 – "Compliance Review Form," was not provided to the Department of the Auditor General as requested. The STD-21 is now available for review. For the DCED tourism contract, an STD-21 does not exist for this contract. It has never been this Department's practice to send STD-21 forms to international contractors. The purpose of the STD-21 is to assist in determining the contractor's compliance with the Nondiscrimination/Sexual Harassment clause contained in the contract. Paragraph one of that clause refers only to discrimination against any citizen of the Commonwealth. While the other paragraphs in that clause do not contain the same restriction, it is unlikely that the Commonwealth would have the resources or would be successful in enforcing compliance overseas, or in this particular instance, in Germany. For the food distribution contract, the Agriculture Bureau of Food Distribution, working with the Contracts and Procurement Office, will include as part of its contracting process for food distribution services, a requirement that all successful vendors complete the STD-21. The Contracts and Procurement Office will formally request the completion of the STD-21 by all vendors currently under contract to provide food distribution services for the Bureau of Food Distribution.

For the Contractor Responsibility Program, the Office of Budget responded to the special audit and stated that we did not agree with the Auditors' Conclusion to our response to the draft findings. Therefore, we had no response to the final special audit of the Commonwealth's Contractor Responsibility Program. We went on to state that it is our opinion that the Contractor Responsibility Program has been of benefit to the Commonwealth by collecting approximately $61.7 million since its inception. In addition, we will continue to strengthen this program as the Commonwealth implements SAP by automating key controls and maintaining suspensions and debarment records for a longer period of time.

Contract renewal language absent from RFP for the DCED tourism contract - This was an oversight on the part of the Department. Although the Department started out with the standard RFP format, the format was severely modified, with the approval of the LECS Comptroller's Office, because the bidding was occurring overseas and many of the provisions were simply not applicable. It was always the Department's intent to give itself the discretion to extend the contract beyond the two-year period referenced in the RFP.

Regarding the data center contract:

- The Auditor refers to these changes as "contract amendments." As mentioned in prior communications with the Auditor and as supported by Commonwealth counsel the Commonwealth procurement code clearly permits the execution of additional contractual services via the formal Change Order process. 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.

- The BCCS' position is that no Change Order involving additional services or costs are approved solely by the Project Manager. An Executive Management Committee remains in place to oversee the project, and all provisions of the contract are being followed.

- Documented support for the estimated costs, including hourly rates, for 5 of the 6 contract Change Orders is not required under the terms of the contract.

For the telecommunications contract:

- There continues to be confusion regarding the auditor's understanding of the nature of this contract. As advised in February 12, 2001 letter to the auditors from OA:

Comment 02 – 8: (continued)

"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 cannot be a total value for this contract, since as a commodity contract, its value is dependent upon the volumes of services the agencies decide to obtain and the length of time billing for each ordered service occurs during the contract's full term. Those values will change month-to-month for the life of the contract.

- Change Requests to the telecommunications contract are also commodities in the particular sense that they cannot be aggregated as part of a "total" cost. This contract is not a total cost contract. Therefore, it is not reasonable to use the Change Request Tracking Form to total individual Change Request cost. Each Change Request is documented, along with its cost, in the Change Request Impact Statement signed and on file at both the Contract Administrator's Office and the Comptroller's Office.

- Further, all of the cost elements of each service under the telecommunications contract, including both those services as defined in the original contract and those services changed or added under the original scope of telecommunications services defined in the procurement and the contract, are contained in the on-line billing system and inventory for the telecommunications contract (ISS). The ISS contains the Product Catalog, which includes each commodity's pricing elements and the detailed billing of all telecommunications services. Each month both itemized billing and totals are produced for Commonwealth review. The billing is reviewed for accuracy and consistency with the contract and applicable Change Requests. These reviews are conducted by the OA at the enterprise level, and each agency reviews its own billing detail. The Department of the Auditor General has been provided with reports from this system as part of a separate audit engagement. Therefore, it is clearly unreasonable to assert that there is not management review and oversight of cost.

- Concerning the eight increasing contract amendments -- Of the Change Requests noted, only two include hourly rates. Most describe technical service(s) billed at a Monthly Recurring Charge (MRC); some may include a Non-Recurring Charge. Of those that included hourly rates, they are quoted specialized, technical personnel (Security Analysts, Network Engineers, etc.) as described in the Change Requests, or where relevant, in Statements of Work (SOW) attached to the Change Request. The rates in Change Requests noted in the Auditor's comment are quotes for different labor categories and different fiscal years as noted in each Change Request.

- For CR-098, human error caused the mistake. The Commonwealth and the contractor review billing each month. In this case, it was the contractor's billing review that caught the error. All billing errors (and there have been relatively few as compared to previous telecommunications contracts) have been corrected by timely credit adjustments.

- For CR-139, the Change Request was fully documented. Further, as explained above, there is not an "increasing project cost" relative to the contract; each Change Request is a separate commodity.

  The noted error in the Change Request occurred in the description of a total amount that is to be billed in 10 monthly installments of $78,108 each. The monthly billing amount is correct, and that amount has been billed correctly as documented in this Change Request. The error in the statement of the total will be documented and the correct total amount of $781,080 will be stated in the formal correction made to Change Request 139.

For the ERP integrator contract:

- Project Change Requests involved one of the following: software version upgrade; new software; new functionality added to scope of the project; improved sign on capability; or reconfiguration to meet requirements of collective bargaining agreements. In all cases, the staffing levels for the consultants were discussed with and validated as

Comment 02 – 8: (continued)

appropriate by the Project Management Office with the respective Commonwealth of Pennsylvania (CoPA) Team Manager. The Project Change Requests that involved software version upgrade, new software, or new functionality added to the scope of the project required the involvement of the consultant Team Lead in partnership with the CoPA Team Manager. The complexity of work required for the Project Change Requests for improved sign-on capability and reconfiguration to meet the requirements of collective bargaining agreements involved Senior Management staff from the consultant team based on the depth of their technical knowledge to develop new or reconfigure existing functionality. The documentation to support management's control of higher costs associated with project change requests is contained in each Project Change Request.

- The ERP system integrator maintains an electronic log as well as a manual log of all Project Change Requests. The Project Director also maintains copies of all approved or disapproved project change requests.

For data center and telecommunications contract changes:

- The Auditor continues to refer to these changes as “contract amendments.” As mentioned in prior communications with the Auditor and as supported by Commonwealth counsel, Commonwealth procurement practices clearly permit the execution of additional contractual services via the formal Change Order process. 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. Until the auditors realize that Change Orders are distinct from amendments and are authorized by the Procurement Code to be executed in the exact manner as the Commonwealth employed, such a finding will continue to be erroneously forthcoming and disputed.

- Under OA’s procedure, no Change Order involving additional services or costs is approved without the required supervisory review; indeed, it is the signature of the Contract Administrator on Change Orders that documents the supervisory review and approval.

Auditors’ Conclusion: Based on our review of the agency response, we provide the following additional comments:

Regarding management’s refusal to provide procurement documentation to us, management’s response provided no new information to resolve the scope limitations in our auditing procedures. We’ve concluded, in our current audit as well as in all of our prior audits, that compliance with applicable procurement regulations is a significant assertion made by management in its basic financial statements. We’ve also concluded that 62 Pa. C.S.A. specifically requires all procurement documents to be made available to the Department of the Auditor General upon request. As we have concluded in our prior audits, management’s interpretation is not supported by any legal authority or reference outside of 62 Pa. C.S.A., is not supported by Generally Accepted Auditing Standards or Government Auditing Standards, and is not a reasonable position to take for our audit which is performed in accordance with those standards.

Regarding the STD-21 Form, there is additional significant information on this form about contractor personnel which is not referred to in management’s response. In addition, we noted no exception in the procurement regulations for this form.

Regarding our disclosures about contract changes or amendments, regardless of how these are termed, characterized, or classified by management in relation to the specific provisions of the Procurement Code, we found poor documentation and internal control weaknesses over increasing contract costs in our testwork which need to be corrected. In its initial awarding of these and other large-dollar statewide contracts in prior audit periods, management’s primary justification was its estimated future savings for Commonwealth agencies over the lives of these contracts. However, management provides little evidence that proper oversight and monitoring is occurring to achieve these estimated cost savings.

For CR-098 and CR-139, the errors we noted were for a sample of CRs for the telecommunications contract and are indications that weaknesses are present in management’s review and approval of change requests.

Comment 02 – 8: (continued)

Management initially informed us that no log of project change requests was available from the ERP system integrator, and a log has not been provided to us to resolve the disclosure in the finding.

For the remaining disclosures in the finding, no new information or documentation has been provided to resolve the internal control weaknesses noted. Therefore, 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.

Index to Federal Award Findings and Questioned Costs - June 30, 2002

Finding No.	CFDA No.	CFDA Name	Finding Title	Questioned Costs	Impacted State Agency	Finding Page	CAP Page
02-1**	10.550	Food Donation Program	Internal Control Weaknesses and Noncompliance with Processor Recordkeeping and Reporting Requirements Result in Questioned Costs of $2,088	$2,088	AGRI	**153**	282
02-2**	10.551 93.558 93.575 93.596 93.778	Food Stamps Temporary Assistance for Needy Families Child Care and Development Block Grant Child Care Mandatory & Matching Funds Medical Assistance	Internal Control Weaknesses at DPW Result in Noncompliance with Federal Regulations		DPW	**157**	286
02-3*	10.557	Special Supplemental Nutrition Program for Women, Infants and Children	Noncompliance and Internal Control Weaknesses in DOH Systems Result in $144,126 in Questioned Costs	$144,126	DOH	**162**	284
02-4**	10.557	Special Supplemental Nutrition Program for Women, Infants and Children	DOH Did Not Obtain Prior Approval from FNS for Project Costs Related to Acquisition and Implementation of a New Automated WIC Database System		DOH	**167**	284
02-5**	14.228	Community Development Block Grants/ State's Program	Performance/Evaluation Report Submitted to HUD Was Inaccurate (A Similar Condition Was Noted in Prior Year Finding #01-2)		DCED	**169**	282
02-6*	14.228 14.239	Community Development Block Grants/ State's Program HOME Investment Partnerships Program	Internal Control Weakness Over Information Reported From Integrated Disbursement and Information System (A Similar Condition Was Noted in Prior Year Finding #01-3)		DCED OB/LECS	**171**	280/ 283
02-7*	14.239	HOME Investment Partnerships Program	DCED Did Not Perform Adequate Monitoring of Community Housing Development Organization Operating Grants (A Similar Condition Was Noted in Prior Year Finding #01-4)		DCED	**173**	283
02-8*	15.250	Regulation of Surface Coal Mining	Unallowable Personnel Charges Result in Questioned Costs of $112 (A Similar Condition Was Noted in Prior Year Finding #01-5)	$112	DEP	**176**	284

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

COMMONWEALTH OF PENNSYLVANIA

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Finding No.	CFDA No.	CFDA Name	Finding Title	Questioned Costs	Impacted State Agency	Finding Page	CAP Page
02-9**	17.245	Trade Adjustment Assistance – Workers	Incomplete Reporting on the ETA 563 Report		L&I	**178**	285
02-10**	17.245	Trade Adjustment Assistance – Workers	Weakness in L&I's Controls Over Preparation and Submission of the Trade Act Participant Report to USDOL (A Similar Condition Was Noted in Prior Year Finding #01-7)		L&I	**180**	285
02-11*	17.245	Trade Adjustment Assistance – Workers	Overpayment of TRA Benefits Resulted in Questioned Costs of $3,989 (A Similar Condition Was Noted in Prior Year Finding #01-6)	$3,989	L&I	**182**	285
02-12**	17.255 17.258 17.259 17.260 93.558	Workforce Investment Act WIA Adult Program WIA Youth Activities WIA Dislocated Workers Temporary Assistance for Needy Families	L&I Did Not Properly Report Federal Expenditures on the Schedule of Expenditures of Federal Awards		OB/LECS	**184**	280
02-13**	17.255 17.258 17.259 17.260	Workforce Investment Act WIA Adult Program WIA Youth Activities WIA Dislocated Workers	Incomplete Reporting on and Inadequate Controls Over the WIA Annual Performance Report		L&I	**186**	285
02-14*	20.205 23.003	Highway Planning and Construction Appalachian Dev. Highway System	Internal Control Weakness Over Expenditure Information Reported on the SEFA (A Similar Condition Was Noted in Prior Year Finding #01-8)		OB/ TRANS	**189**	280
02-15*	66.458 66.468	Capitalization Grants for State Revolving Funds Capitalization Grants for Drinking Water	Internal Control Weakness Over the Preparation of DEP Quarterly Billings to PENNVEST		DEP	**190**	284
02-16*	84.027 84.213 93.994	Special Education – Grants to States Even Start – State Educational Agencies Maternal & Child Health Services Block Grant	Noncompliance and Internal Control Weaknesses at DOH Result in $551,764 in Questioned Costs	$551,764	DOH	**191**	284

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

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Index to Federal Award Findings and Questioned Costs - June 30, 2002

Finding No.	CFDA No.	CFDA Name	Finding Title	Questioned Costs	Impacted State Agency	Finding Page	CAP Page
02-17**	84.048	Vocational Education – Basic Grants to States	Inadequate Controls Over PDE's Voc Ed Consolidated Annual Performance, Accountability, and Financial Status Report Submitted to USDE		PDE	**195**	283
02-18*	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 #01-10)		L&I	**198**	285
02-19**	84.126	Rehabilitation Services – Vocational Rehabilitation Grants to States	$3,890,912 in Excess Funds Were Drawn Down From USDE in Violation of Federal Cash Management Regulations		OB/LECS	**200**	281
02-20**	84.126	Rehabilitation Services – Vocational Rehabilitation Grants to States	Noncompliance and Weaknesses in Internal Controls Over Charging of Personnel Costs Result in Questioned Costs of $11,969 (A Similar Condition Was Noted in Prior Year Finding #01-11)	$11,969	L&I	**202**	286
02-21**	84.126	Rehabilitation Services – Vocational Rehabilitation Grants to States	Internal Control Weakness Over Preparation and Submission of Vocational Rehabilitation Provider Claim Forms to SSA		L&I	**204**	286
02-22*	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 #01-12)		L&I	**205**	286
02-23**	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 #01-13)		DPW	**207**	287
02-24**	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 #01-14)				

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

COMMONWEALTH OF PENNSYLVANIA

Index to Federal Award Findings and Questioned Costs - June 30, 2002

Finding No.	CFDA No.	CFDA Name	Finding Title	Questioned Costs	Impacted State Agency	Finding Page	CAP Page
02-25**	93.563	Child Support Enforcement	Noncompliance and Internal Control Weakness Over the Processing of Interstate Registry Cases (A Similar Condition Was Noted in Prior Year Finding #01-15)		DPW	**215**	287
02-26**	93.575 93.596 93.667	Child Care and Development Block Grant Child Care Mandatory & Matching Funds Social Services Block Grant	Weakness in DPW Monitoring Procedures Results in Over $15 Million in Excess Subgrantee Federal Cash at June 30, 2002 (A Similar Condition Was Noted in Prior Year Finding #01-16)		DPW	**218**	288
02-27*	93.575	Child Care and Development Block Grant	Internal Control Weaknesses and Noncompliance With Federal Earmarking Requirements Result in Questioned Costs of $1,624,404 (A Similar Condition Was Noted in Prior Year Finding #01-17)	$1,624,404	DPW	**223**	288
02-28**	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 (A Similar Condition Was Noted in Prior Year Finding #01-18)		DPW	**225**	288
02-29*	93.767	State Children's Insurance Program	Noncompliance and Internal Control Weaknesses in Federal Reporting and State Matching Procedures Result in $31,576 in Questioned Costs	$31,576	INS OB/CS	**227**	281/ 285
02-30**	93.778	Medical Assistance	Ineligible Payments to MA Beneficiaries Result in Questioned Costs of $27,552	$27,552	DPW	**230**	288
02-31**	93.994	Maternal & Child Health Services Block Grant	DOH Could Not Support Information Submitted to HHS on its Annual Statistical Report		DOH	**232**	284
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CAP - Corrective Action Plan
* - Reportable Condition
** - Material Weakness

COMMONWEALTH OF PENNSYLVANIA

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			Total Questioned Costs	$2,397,580			

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

Finding 02 – 1:

CFDA #10.550 – Food Donation Program

Internal Control Weaknesses and Noncompliance with Processor Recordkeeping and Reporting Requirements Result in Questioned Costs of $2,088

Condition: As part of the FD Program, BFD enters into contracts with processors to convert certain donated commodities into end products. These end products are then distributed by the processors to eligible recipient agencies. Our testing of BFD's system used to account and report for the processing of donated commodities revealed the following:

- We selected a sample of six processor monthly performance reports and one end product from each report. We then selected one recipient agency receiving the end product in order to confirm receipt of the end product. Each performance report also identifies the weight of the donated commodity used in the production of the end product. BFD uses these monthly processor reports to record distributions of donated commodities by individual recipient agency for the year. The total processor distributions of $8,203,805 to all recipient agencies for the current year was recorded on BFD's system and reported by BFD on the SEFA. The total processor distributions in our sample totaled $2,482. Based on our sampling, we noted the following errors for FD expenditures reported on the SEFA:

  - For one of the recipient agencies in our sample, the donated commodity used in the end product as reported by the processor (FD Commodity Code A425P), was not included in BFD's distribution records for the recipient agency. Although the transaction for this commodity was found to be allowable, distributions to this recipient agency totaling $228 were not reported on the SEFA.

  - Also, for another recipient agency in our sample, BFD was unable to provide records to support their recording of the pounds of donated commodity used in the end product (FD Commodity Code A522P) that were valued at $68. Although we performed alternate procedures to verify that the transaction was allowable, we found that since BFD's records could not support this transaction, the SEFA cannot be supported and may not be correct.

- For the Commodity Code A425P discussed above, our detailed tie-in of distributions of this commodity for the year as reported on BFD's summary records (i.e., Agency Summary Report) to its subsidiary records (i.e., Transaction Check Report) for the applicable recipient agency disclosed costs on BFD's summary records which were not supported. BFD's summary records showed $5,272 in distributions of this commodity to a recipient agency, but the subsidiary records by agency showed only $3,184 in distributions of this commodity. Therefore, the reconciling difference of $2,088 is not supported by proper documentation and is considered unallowable.

- We requested a rollforward of the inventory of donated foods balance for each processor under contract with BFD from July 1, 2001 through June 30, 2002. However, BFD was unable to provide us with this rollforward due to problems with their system used to accumulate and report information from the processors monthly performance reports. As a result, FD distributions on the SEFA could not be corroborated with beginning and ending inventory records.

- Processors participating in the FD Program report their distributions of donated commodities in end products to BFD using a refund system, a discount system, or a combination of both. For processors using a refund system, the distributions are to be reported to BFD only when a signed rebate form has been received by the processor from the recipient agency. In order to ensure that processors and BFD are properly reporting distributions under this refund system, we selected one processor that uses this refund system. We then selected a sample of ten signed rebate forms that accompanied the processor's February 2002 monthly performance report. For two of the ten rebate forms, we noted that BFD reported the proper usage of the donated commodity in the end product on their records; however, the usage was reported under the incorrect recipient agency.

Finding 02 – 1: (continued)

- BFD did not submit a Processing Inventory Report to FNS for the quarter ending June 30, 2002. BFD prepared the report but did not submit the report due to numerous errors on the report that they were unable to correct.

- BFD could not provide any documentation to support the performance of on-site monitoring of its in-state processors during the year under audit. Federal regulations require that BFD perform on-site monitoring of at least 50% of its in-state processors each year.

Although our confirmation testwork revealed errors in BFD's recording of distributions by processors, we concluded that processors were accurately reporting their FD distributions to BFD each month and that BFD's costs were allowable under program regulations. However, our overall testwork revealed a major weakness in BFD's system used to accumulate and report inventory information from the processors monthly performance reports.

Criteria: 7 CFR, Part 250.16 (a) regarding maintenance of records, states, in part:

(a) General requirements. (1) Accurate and complete records shall be maintained with respect to the receipt, distribution/use and inventory of donated foods including:

(i) End products processed from donated foods. . .

7 CFR, Part 250.13 regarding processor reporting states:

m. Performance reports. (1) Processors shall be required to submit to distributing agencies monthly reports of performance under each processing contract with year to date totals. . . . The report shall include:

(i) A list of all recipient agencies purchasing end products under the contract;
(ii) Donated-food inventory at the beginning of the reporting period;
(iii) Amount of donated foods received during the reporting period;
(iv) Amount of donated foods transferred to and /or from existing inventories;
(v) Number of units approved end products delivered to each eligible recipient agency during the reporting period and the number of pounds of each donated food represented by these delivered products;
(vi) Donated food inventory at the end of the reporting period.

o. Processing inventory reports. (1) Distributing agencies shall forward to the FNS Regional Office the inventory summary portion of the monthly performance report submitted by the processor in accordance with paragraph (m) (1) of this section for the last month of each fiscal quarter.

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

j. Be adequately documented.

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, in Section ___.510 states in part:

(a) Audit findings reported. The auditor shall report the following as audit findings in a schedule of findings and questioned costs:

(3) Known questioned costs which are greater than $10,000 for a type of compliance requirement for a major program. Known questioned costs are those specifically identified by the auditor. . . . In evaluating the effect of questioned costs on the opinion on compliance, the auditor considers the best estimate of total costs questioned (likely questioned costs), not just the questioned costs specifically identified (known questioned costs). The auditor shall also report known questioned costs when likely questioned costs are greater than $10,000 for a type of compliance requirement for a major program. . .

Finding 02 – 1: (continued)

7 CFR, Part 250.19 pertains to review systems required to be established by distributing agencies and states, in part:

(b) Responsibilities of distributing agencies. (1) Each distributing agency shall establish review procedures encompassing eligibility, food ordering procedures, storage practices, inventory controls, reporting and recordkeeping requirements and compliance with nondiscrimination provisions. The procedures shall include:

iii. An on-site review at least once every 2 years of all processors except those that are multi-State processors as defined in 250.3, with no fewer than 50 percent being reviewed each year.

Cause: BFD indicated that their current system used to accumulate and report the inventory information from the processors monthly performance reports is not adequate. Additionally, we noted that one individual at BFD handled all of the processor recordkeeping, reporting, and monitoring responsibilities during our audit period and there was no manual supervisory review or oversight by BFD of the duties being performed by this individual.

Effect: BFD did not maintain adequate records related to donated commodities used in the production of end products by processors for the fiscal year ended June 30, 2002, and $2,088 in FD costs are questioned. Based on the errors noted in our sampling testwork and based on BFD's inability to provide a rollforward of the inventory balances at the processors, the $8,203,805 in processor distributions reported on the SEFA may not be correct. Additionally, the subrecipient information provided to OB-BOA to track subrecipient audit submission may not be correct.

Further, BFD did not submit a Processor Inventory Report for the quarter ended June 30, 2002 and therefore did not comply with federal reporting requirements. Due to the weaknesses in the system used to accumulate and report information on the Quarterly Processor Reports, there is limited assurance that the remaining reports submitted during the audit period were accurate. Further, BFD did not perform any on-site monitoring of its in-state processors. As a result, BFD has limited assurance that processors are complying with program requirements. Additionally, there is a lack of segregation of duties with respect to the processor recordkeeping, reporting and monitoring by BFD.

Recommendation: We recommend that BFD pursue appropriate settlement of the $2,088 in questioned costs with FNS.

We understand that BFD is in the process of modifying their existing system or developing a new system to improve the accuracy of the recording and reporting of information provided by the processors participating in the FD Program. In the interim, we recommend that BFD implement procedures, including supervisory reviews, to verify the accuracy of the processor information on BFD's system. Additionally, BFD should ensure that procedures are in place and supporting documentation is maintained to comply with federal requirements regarding monitoring of in-state processors. Further, we recommend that BFD work with FNS regarding the submission of the Processor Inventory Report for the quarter ending June 30, 2002.

Agency Response: The two staff members responsible for USDA commodity processing activity retired in 2002. The staff member in-charge retired in July 2002, before Year-End reconciliations were complete, leaving the task to a staff member, unfamiliar with year-end requirements. Only upon examination of the data files in the fall of 2002 was it discovered that data entry errors had occurred and that processing software applications were producing inconsistent summaries.

Nevertheless, BFD will reconcile June 30, 2002 processor inventories, and where determined appropriate, file with USDA Mid-Atlantic Regional Office (MARO) a revised Year-End processor report. BFD will also pursue resolution of the $2,088 in questioned costs.

BFD is also developing new processing software that will reduce and for most processors, eliminate the manual entry of monthly activity. Activity will be electronically transmitted to BFD from each processor and downloaded into BFD's system. In the interim, new procedures have been implemented to accurately record activity for each processor to ensure

Finding 02 – 1: (continued)

accurate Agency Summary Report data for the 2002-2003-program year. One newly trained staff member will enter Year-To-Data from each processor, and the summary data will be reviewed by the Commodity Processing Specialist.

Auditors' Conclusion: Based on the agency response, the finding and recommendation remain as stated above. We will review any corrective action in the 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 02 – 2:

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

Internal Control Weaknesses at DPW Result in Noncompliance With Federal Regulations

Condition: In connection with our audit of the TANF and FS Programs, we reviewed reports issued by other auditors during our audit period in order to determine if the reports had any impact on the programs. Based on our review, we noted that another bureau within the Department of the Auditor General performed separate audits of certain DPW County Assistance Offices (CAOs) in order to determine if public assistance payments for the TANF and FS programs were made only to eligible recipients. Based on our review of these individual CAO audit reports issued during our audit period (which covered various prior audit periods up through June 30, 2002), we noted that the other auditors identified internal control weaknesses which are systemic in nature when evaluated on a statewide basis.

Our review of these other auditor reports and discussions with the other auditors indicated the following:

- The CAO caseworkers are not properly completing or including certain forms required by DPW's Cash Assistance Handbook to support eligibility determinations in the case records. The other auditors did not report the specific eligibility forms that were incomplete or missing; they indicated that completed forms were not on file, so weaknesses exist over CAO support for eligibility determinations.

- The CAO caseworkers do not adequately monitor recipient compliance with court-ordered payment plans for fines, costs and/or restitution. Per state law and DPW's Cash Assistance Handbook, recipients that are not in compliance with the payment plans are not eligible to receive public assistance benefits.

- The CAO caseworkers are not entering or are incorrectly entering social security numbers in case records. Additionally, the caseworkers also are not entering the legally responsible relative's social security number in the State's Income Eligibility and Verification System.

- The CAO caseworkers are not computing the grant award amounts properly due to simple mathematical errors, which are going undetected.

- The CAO caseworkers are not using proper budgeting methods with respect to the calculation of the recipient's monthly income. The monthly income is used to determine the eligibility of the recipient as well as the amount of the grant award.

- The CAO caseworkers are entering the incorrect codes into DPW's Automated Restitution Referral and Computation (ARRC) System, which is used to track and recover overpayments. In most cases, the improper coding stops the system's processing of an overpayment and refunding these overpayments to HHS. Additionally, the CAO caseworkers are not following the procedures relative to investigating suspected overpayments, controlling and documenting investigations, and referring verified overpayments timely.

- System deficiencies in DPW's ARRC system resulted in unprocessed or incorrectly processed overpayments which were not detected or properly followed up on at the CAOs. This system performs calculations to compute cash overpayments and food stamp over-issuances and is designed to track potential overpayments from the point of discovery through the verification/claim calculation process to automated transfer of the claim to the

Finding 02 – 2: (continued)

Commonwealth's OIG. The deficiency cited most frequently in the reports related to the ARRC's 24-month calculation limit that causes overpayments and/or over-issuances occurring more than two years prior to the current date to be computed as zero, and therefore ignored with no follow up.

- The State has established and implemented an Income Eligibility and Verification System (IEVS), which is used for coordinating data exchanges with other federally assisted benefit programs. The CAO caseworkers are required to access this information and compare the information against the case file when making eligibility determinations. However, the CAO caseworkers are not reconciling the information in IEVS to the income information in the case file and are not verifying the information in IEVS with third parties. Additionally, the caseworkers are not using IEVS on eligibility re-determinations.

In analyzing the above results, we noted that the internal control weaknesses which led to these errors would also impact eligibility determinations in the Medical Assistance Program.

In addition to the above weaknesses that were specifically cited in the CAO audits released during our audit period, we also noted that, in a report released after our audit period, the other auditors identified additional weaknesses at the CAOs relative to CAO caseworkers not following DPW childcare regulations regarding unregulated providers. Specifically, CAO personnel did not properly review childcare provider verification forms, did not verify the amounts actually paid by the recipients to the providers, did not verify the hours of childcare actually needed, and did not verify that childcare was provided by the person listed as the provider. These results impact the allowability and eligibility of payments in the Child Care Cluster.

Criteria: Cash Assistance Handbook Section 104.3, "Screening Interview," provides instructions to the caseworkers on assisting the applicant in completing the application (PA 600) for public assistance and states in part:

1. *Explain that every question on the PA 600 must be answered.*

4. *Determine what information needs to be verified and explain what is needed to verify the information.*

Cash Assistance Handbook, Section 104.42, "Responsibilities of the County Assistance Office," provides instructions to the caseworkers on the application process and eligibility determination process and states in part:

5. *Initiate or update the budget group information based on the completed PA 600 and the facts presented during the interview.*

6. *Ensure that each applicant has a social security number (SSN).*

Cash Assistance Handbook Section 178.1, "General Policy," states in part:

The CAO will verify conditions of eligibility, need, income, and resource items at application. The CAO will verify income, resources, and any other eligibility factors which are subject to change at redetermination.

Sources of verification include:

Written evidence;
Public records;
Collateral contracts;
Automated sources; and
Other means which will establish the truth of the client's statement.

Finding 02 – 2: (continued)

DPW regulations and Act 1996-35 state:

Assistance may not be granted to any person who has been sentenced for a felony or misdemeanor offense and who has not otherwise satisfied the penalty imposed on that person by law….

Additionally, Cash Assistance Handbook, Section 104, "Application," Appendix B-1, "Procedure for Criminal History Inquiry," states in part:

An answer to any question which indicates he is on probation or parole and has either not paid all fines, costs and restitution or is not in compliance with an approved payment plan, will result in ineligibility.

Cash Assistance Handbook, Section 183.6, "Authorizing the Childcare Payment" states:

When authorizing a childcare allowance the CAO will:

- *Determine the actual cost of childcare for each eligible child in the budget group. Do a separate calculation for each child.*

- *Verify the childcare costs by using PA 1591 or PA 1583 which has been signed by the childcare provider.*

The DPW Supplemental Handbook (SH), Chapter 910, "Restitution and Disqualification," Section 910.1 "General Policy," states:

An overpayment exists when a client receives assistance for which he is ineligible.
The DPW is responsible by law to identify overpayments and recover overpayments from clients.

In addition, 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: The CAO caseworkers are not following established DPW policies and procedures for maintaining case records and processing information obtained from recipients and collateral sources. Based on our discussions with the other auditors, the errors are the result of caseworkers not being adequately trained and supervised in the performance of their duties.

With regard to the monitoring of compliance with court-ordered payment plans, state law and the Cash Assistance Handbook require the caseworkers to verify compliance with court-ordered payment plans. This occurs at the initial application and at eligibility re-determinations. Since the re-determinations are typically at either a six or twelve-month interval, some recipients make a court-ordered payment at the initial application and at eligibility re-determinations but not during the intervening months. The CAO interprets this as being in compliance and authorizes benefits for months in which no court-ordered payments are made. We further noted that, in the Philadelphia metropolitan area, where by far the largest federal program payments are made, there is little or no enforcement of Act 1996-35 or DPW's Cash Assistance Handbook requiring adherence to court-ordered payment plans to ensure continuing client eligibility.

Regarding DPW's AARC system, DPW has not addressed the system deficiencies and does not have any manual compensating controls at the CAOs in place to ensure that the overpayments and over-issuances are processed accurately and completely.

Finding 02 – 2: (continued)

Effect: Due to the control weakness identified above, there is limited assurance that DPW's eligibility determinations and related benefit payments are being made in accordance with federal regulations and that overpayments and over-issuances are being processed by DPW accurately and completely.

Recommendation: We recommend that, in order to correct the internal control weaknesses identified in the condition above, DPW ensure the CAO caseworkers receive additional training and are more thoroughly supervised to follow established DPW policies and procedures regarding eligibility determinations and re-determinations. We also recommend that DPW and its CAOs strengthen procedures to ensure DPW's compliance with Act 1996-35 and ensure recipient compliance with court-ordered payment plans. Further, we recommend that DPW enhance or develop procedures to ensure that overpayments and over-issuances are processed completely and accurately.

Agency Response: The Single Audit Finding merely duplicates issues contained in 41 County Assistance Office (CAO) Performance Audits conducted on a routine basis by the Department of the Auditor General (AG), Bureau of Public Assistance Audits. The Finding is based upon the review of the 41 CAO audit reports issued during the single audit period, but which actually represent prior audit periods from **May 7, 1997 to October 16, 2001**.

While the Single Audit Finding does provide a summary of the issues contained in the 41 CAO audit reports, the Finding omits a summary of the 41 detailed DPW responses provided to the AG that contains corrective action. By virtue of this omission, it is implied that corrective action has not been implemented.

In addition to the above response, and specific to the audit recommendations, the DPW also provides the following:

Recommend That DPW Ensure the CAO Caseworkers Receive Additional Training and Are More Thoroughly Supervised

The DPW ensures that the CAO caseworkers receive additional training by utilizing the availability of e-learning modules that are offered through Staff Development. Staff now has easy access to current information. Supervisors conduct periodic Comprehensive Supervisory Reviews and Targeted Supervisory Reviews to make sure the staff is following established DPW policies and procedures regarding determining eligibility and redeterminations. These periodic reviews are done on an ongoing basis.

Recommend That DPW and Its CAO's Strengthen Procedures to Ensure DPW's Compliance With Act 1996-35 and Ensure Recipient Compliance With Court-Ordered Payment Plans

The DPW has been working with the Administrative Office of Pennsylvania Courts (AOPC) to establish a data match that would provide information on criminal justice dispositions and clients' compliance with fines, costs, and restitution related to these dispositions. Because there may be some delay in getting the compliance information from the AOPC system, the DPW is working with individual counties as an interim step. The DPW plans to develop matches with the largest counties first, and hopes to be able to have access to information in the near future.

Recommend That DPW Enhance or Develop Procedures to Ensure That Overpayments and Over-Issuances Are Processed Completely and Accurately

The DPW is currently reviewing the process statewide to enhance the procedures. The Automated Restitution Referral and Computation Procedures releases and all other applicable regulations pertaining to overpayments are reviewed with Income Maintenance caseworkers (IMCWs) on a regular basis. IMCWs have been advised of the necessity to comply with the requirements to ensure that overpayments and overissuances are processed completely and accurately.

Finding 02 – 2: (continued)

Auditors' Conclusion: Although DPW states in the agency response that CAO caseworkers are trained and supervisory reviews are being conducted, the findings of the other auditors, including those associated with the ARRC and IEVS Systems, indicate systemic control weaknesses which need to be corrected to ensure compliance with applicable regulations. Regarding the remainder of DPW's agency response, any corrective action will be evaluated in our subsequent audit. Our finding and recommendations, therefore, 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 02 – 3:

CFDA #10.557 – Special Supplemental Nutrition Program For Women, Infants, and Children

Noncompliance and Internal Control Weaknesses in DOH Systems Result in $144,126 in Questioned Costs

Condition: Our review and testing of DOH's systems for food instrument (FI) redemption, calculation of vendor rebates, preparation of the FNS-798 reports, and FI disposition revealed that WIC personnel rely primarily on the Commonwealth's Health Data Center computerized system for internal controls over these areas. However, our reviews of controls over the administration of the WIC Program have found manual controls over the computerized outputs from this system to be inadequate. In addition, on March 11, 2002, DOH implemented a new WIC database system, which converted their old legacy mainframe system to a network based system, thereby increasing the significance of the control weaknesses in the system.

In particular, our testing of Redeemed Food Instruments (RFIs), FI disposition, rebate calculations, and federal reporting revealed unresolved discrepancies with the FI data in WIC's database system as follows.

- **Food Instrument Redemption.** WIC entered into an agreement with a bank to act as a central clearinghouse for all RFIs submitted by banks throughout the Commonwealth. The bank receives the RFIs, reimburses other banks, submits a CD-ROM containing images of redeemed checks along with a daily bank statement, and sends an electronic file of paid checks via File Transfer Protocol (FTP) to request reimbursement from WIC. WIC in turn requests reimbursement for these expenditures from the federal government.

  To ensure accuracy of the reimbursement amount requested by the bank, WIC management stated that they compared information reported by the bank to the actual RFIs on a sample basis for the entire SFYE June 30, 2002. However, during our review of WICs FI check sampling procedures, WIC management indicated that documentation evidencing their daily reviews was inadvertently thrown out for all of the days in calendar year 2001. Therefore, we could not verify that WIC was properly performing this control during the first half of our current fiscal year and that the control was working effectively.

  During our review of FI redemptions, we selected a sample of 15 days to test, 9 of which were prior to the March 11, 2002 new system conversion and 6 of which were after the conversion. For each sampled day, we compared the total amount from the voucher transmittal reimbursement to the bank for the day to the total FIs recorded in WICs database system as redeemed for that day. Our testing disclosed that for the nine days prior to the new system conversion, $794 in total payments were made without supporting RFIs recorded on the database, or an average of $88 in unsupported overpayments per day. For the 6 days tested after conversion, $16,630 in payments were made without supporting FIs on the database, or an average of $2,772 in unsupported overpayments per day. Total unsupported overpayments in our testwork were $17,424. The differences for the days we tested increased significantly after DOH implemented their new QuickWIC FI database system on March 11, 2002.

  WIC management stated that most of the above differences are accounted for on RFI Monthly Error Reports which include FI numbers that do not match records on the system, already voided FIs, already redeemed FIs, and FIs with invalid check digits. However, WIC stated that these error reports are not reviewed to ensure that the RFIs are validly redeemed. In addition, not all of the daily differences for our sample were accounted for by Monthly Error Reports. After implementation of the new QuickWIC system, a problem was disclosed whereby only the first eight digits of the ten digit FI check number were recognized by the system in some instances. When a check is redeemed, it overwrites any other check information in the database with the later check's data if the first eight digits of the ten digit FI number are the same. This caused RFIs to have the wrong redemption data on the system, or caused checks which were not redeemed to be overwritten with the redeemed check data. Some checks were missing from the database entirely and could not be identified.

Finding 02 – 3: (continued)

In addition, FIs that are redeemed and paid but listed as "voided" on WIC's database are reported on the Redeemed/Voided FI Monthly Report, and need further investigation to ensure the payments were allowable. However, WIC personnel stated that this report is not reviewed to ensure that these FIs are valid. When we totaled these monthly reports for SFYE June 30, 2002, we found $121,494 in redeemed but voided FIs on the WIC system, about 50 percent of which related to the period after the new system conversion on March 11, 2002. Since no investigation of these voided RFIs was performed, the entire $121,494 is considered unallowable.

- **Food Instrument Disposition.** A state agency must account for the disposition of all FIs within 150 days of the FIs' first valid date for participant use. The state agency must identify all FIs as either issued or voided and identify issued FIs as either redeemed or unredeemed. Redeemed FIs must be identified as either validly issued, lost or stolen, expired, duplicate, or not matching valid enrollment and issuance records. In order to comply with this requirement, WIC relies on computer generated reports mentioned above – RFI Error Monthly Reports, Redeemed/Voided or Lost or Stolen FI Monthly Reports. However, as stated above, WIC is not reviewing these reports or respective FIs for accuracy and propriety. Also, since implementation of the new QuickWIC computer system in March 2002, DOH could not provide documentation showing that the disposition of <u>all</u> FIs was accounted for within 150 days of the FIs' first valid date for participant use since the reports mentioned above contained no summary data and include only checks with errors, voids, lost, or stolen.

- **Rebate Calculation.** WIC has entered into an agreement with a vendor to receive a rebate for cans of infant formula purchased with FIs. During FYE June 30, 2002, WIC requested rebates from the vendor totaling $36,274,733. Our review of WIC procedures revealed that WIC personnel rely primarily on Health Data Center's computerized system to process food instrument information and perform the rebate calculation. We selected one monthly rebate billing in the amount of $3,505,131 dated January 30, 2002 in order to test the accuracy of the rebate calculation. This rebate billing was an invoice for November 2001 and we selected and tested 5 of the 9 food items, which amounted to $3,395,538, or 97 percent of the monthly total. Out of this $3.4 million tested, we noted $5,208 in rebate underbillings between the invoice and the food instrument data recorded in WIC's computer database system. This $5,208 was never credited to the WIC Program as required. (Note: To ensure that we made a valid comparison in this testwork, we ignored FIs from the rebate invoice redeemed prior to October 1, 2001, since WIC's new QuickWIC computer database system stored data only back through this date.)

- **FNS-798 Report.** In order to comply with FNS requirements for submission of the monthly WIC Financial Management and Participation Report, WIC relies on statistics and reports generated by WIC's computer database system for the reporting of three major reporting categories: Food Outlays, Rebates Billed, and Participation. However, based upon the differences in FI redemptions and rebate calculations noted above the amounts reported on the FNS-798 Report for those categories are not correct.

<u>Criteria</u>: Regarding Food delivery systems, 7 CFR 246.12(a) states:

(1) Management. The State agency is responsible for the fiscal management of, and accountability for, food delivery systems under its jurisdiction.

Regarding Food Instrument redemptions and disposition, 7 CFR 246.12(q) states:

(q) Food instrument disposition. The State agency must account for the disposition of all food instruments as either issued or voided, and as either redeemed or unredeemed. Redeemed food instruments must be identified as validly issued, lost, stolen, expired, duplicate, or not matching valid enrollment and issuance records. In an EBT system, evidence of matching redeemed food instruments to valid enrollment and issuance records may be satisfied through the linking of the Primary Account Number (PAN) associated with the electronic transaction to valid enrollment and issuance records. This process must be performed within 150 days of the first valid date for participant use of the food instruments and must be conducted in accordance with the financial management requirements of Sec. 246.13. The State agency will be subject to claims as outlined in Sec. 246.23(a)(4) for redeemed food instruments that do not meet the conditions established in paragraph (q) of this section.

Finding 02 – 3: (continued)

Further, 7 CFR 246.13 states the following pertaining to financial management systems:

(a) Disclosure of expenditures. The State agency shall maintain a financial management system which provides accurate, current and complete disclosure of the financial status of the Program. This shall include an accounting for all . . . Program funds received and expended each fiscal year.

(b) Internal control. The State agency shall maintain effective control over and accountability for all Program grants and funds. The State agency must have effective internal controls to ensure that expenditures financed with Program funds are authorized and properly chargeable to the Program.

(c) Record of expenditures. The State agency shall maintain records which adequately identify the source and use of funds expended for Program activities. These records shall contain, but are not limited to, information pertaining to authorization, receipt of funds, obligations, unobligated balances, assets, liabilities, outlays, and income.

Recordkeeping and Reporting requirements are specified in 7 CFR 246.25:

(a) Recordkeeping requirements. Each State and local agency shall maintain full and complete records concerning Program operations. Such records shall comply with 7 CFR part 3016 and the following requirements:

(1) Records shall include, but not be limited to, information pertaining to financial operations . . . food instrument issuance and redemption . . .

(2) All records shall be retained for a minimum of three years following the date of submission of the final expenditure report for the period to which the report pertains. If any litigation, claim, negotiation, audit or other action involving the records has been started before the end of the three-year period, the records shall be kept until all issues are resolved, or until the end of the regular three-year period, whichever is later.

(b) Financial and participation reports

(1) Monthly reports. State agencies shall submit financial and program performance data on a monthly basis as specified by FNS. Such information may include, but shall not be limited to, actual and projected participation, . . .

OMB Circular A-87, *Cost Principles for State and Local Governments*, Attachment A, Section C.1 states that to be allowable, a cost must meet the following general criteria:

(a) Be necessary and reasonable for proper and efficient performance and administration of Federal awards. . . .
(d) Conform to any limitations or exclusions set forth in these principles, Federal laws, terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items. . . .
(i) Be the net of all applicable credits.
(j) Be adequately documented.

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, in Section ___.510 states in part:

(a) Audit findings reported. The auditor shall report the following as audit findings in a schedule of findings and questioned costs:

(3) Known questioned costs which are greater than $10,000 for a type of compliance requirement for a major program. Known questioned costs are those specifically identified by the auditor. . . .

Finding 02 – 3: (continued)

Cause: In regard to FI redemption, WIC personnel stated that the RFI Monthly Error Reports and Redeemed/Voided FI Monthly Reports are not currently reviewed to ensure that the RFIs are validly redeemed, since years ago when these reports were reviewed, no significant problems were ever found. The discrepancies found during our testing of RFIs increase significantly after March 11, 2002, and appear to be related to problems encountered after implementation of the new QuickWIC database system, including the duplicate eight digit code problem and overwriting of data on the system.

In regard to FI disposition, DOH relies on the WIC computer system to report FIs as issued or voided, issued FIs as redeemed or unredeemed, and redeemed FIs as validly issued, lost or stolen, expired, duplicate, or not matching issuance records. However, WIC has no manual controls to review these computer generated reports or to reconcile all FIs within 150 days of the first valid date for participant use.

In regard to the rebate calculation, WIC stated that these differences are in large part due to the fact that WIC is not billing for laptop produced FIs (LFIs). WIC stated that the remainder of the differences would be time consuming and costly to research since the data was not brought forward into WIC's new data system implemented in March 2002.

Effect: We question $17,424 in WIC payments which are not supported by the WIC database redemption files, and we question $121,494 in paid but voided RFIs on WIC's system which have not been properly investigated. We also question an additional $5,208 in WIC costs for which appropriate rebates were not obtained in the November 2001 rebate invoice. Total questioned costs are $144,126. In addition, without adequate controls, food instruments can be inappropriately redeemed or rebate billing invoices inaccurately prepared without DOH's knowledge which lead to unallowable costs being charged to the federal WIC grants. DOH is also reporting incorrect amounts for FI redemptions and rebates billed to the federal government on the FNS-798 Report.

Recommendation: DOH should pursue appropriate settlement of the $144,126 in questioned costs with FNS, and review its WIC system for additional questioned costs due to the discrepancies identified above, especially after its March 11, 2002, new system conversion, for settlement with FNS. DOH should also consider billing the vendor for the additional $5,208 in rebate amounts due, and review its WIC system for the possibility of obtaining additional rebates due from the vendor.

We also recommend that WIC implement sufficient controls over the FI redemption and disposition process, the rebate calculation, and preparation of the FNS-798 Report. DOH should ensure that problems encountered with the new QuickWIC computer database system are identified, timely followed up on, and properly corrected.

Agency Response: Of the $144,126 of questioned costs in this finding, $17,424 in questioned redemption cost was related to food instruments (FIs) that were redeemed for which appropriate documentation was not found in the QuickWIC database. First, it is important to note there were no FIs that were posted to the accounting system that were not appropriately produced and processed through the Department's banking contractor. As noted in the audit finding, some of the discrepancy was identified on the daily FI error reports. Unfortunately, in the early months of implementation of the QuickWIC system, some problems were encountered where some FI data, after being appropriately posted to the QuickWIC database, was subsequently overwritten or deleted. These problems were identified and fixed. The problems that created this discrepancy no longer exist. It should be pointed out that this total represents less than .013% of the total redemptions processed during the year of $135,079,529.

Of the $144,126 in questioned costs, $121,494 was related to FI records that were redeemed and voided and were not adequately researched by the Department's Program Office. At the inception of the QuickWIC system, the Department did not have a redeemed and voided FI report available. This report is under development and the Department intends to follow up on any FIs appearing on the report.

Of the $144,126 in questioned costs, $5,208 was related to under billings to our infant formula rebate contractor. These under billings were the result of infant formula on laptop-produced checks issued from the Department's old system prior to the implementation of the QuickWIC system. Because the laptop check numbers used by WIC Local

Finding 02 – 3: (continued)

Agency clinic staff in the old system were manually entered into the system, the transposition of numbers could have resulted in inappropriate or inaccurate billings to the infant formula manufacturer. Rather than facing potential litigation with the rebate manufacturer over an extremely small amount of rebate billings, the Department elected not to bill for formula on laptop MFIs. For this reason the Department does not intend to attempt to bill for these past rebates. The circumstances that generated this problem do not exist in the QuickWIC system.

Through the evolution and refinement of the QuickWIC system, the Department has implemented controls that govern the FI redemption and disposition process, the rebate calculation and the FNS-798 report preparation process. The Department will identify and follow up on problems encountered with the QuickWIC system.

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 02 – 4:

CFDA #10.557 – Special Supplemental Nutrition Program For Women, Infants, and Children

DOH Did Not Obtain Prior Approval from FNS for Project Costs Related to Acquisition and Implementation of a New Automated WIC Database System

Condition: On March 11, 2002, DOH implemented a new network-based food instrument (FI) database system called QuickWIC replacing their legacy mainframe database system. Our discussions with DOH WIC Division management disclosed that DOH did not comply with federal regulations since it decided to acquire this new automated system and began charging its costs to WIC prior to obtaining documented FNS approval of its federally-required Advanced Planning Documents (APDs).

DOH began charging costs related to the conversion of the old mainframe system to the new network-based system in FFY 2000-01, and continued to charge costs related to its implementation and maintenance through the June 30, 2002 end of our current audit period. WIC personnel submitted two APDs for QuickWIC to FNS in December 2000, resubmitted them again in May 2001, and revised them in July 2001. FNS then sent its letter of approval of DOH's APDs on September 6, 2001. According to DOH personnel, $3,920,644 in costs were charged to WIC in FFY 2000-01 (October 1, 2000 to September 30, 2001) for this project, most of which occurred prior to the APD approval on September 6, 2001. As part of our audit, we identified $3,766,109 in costs charged to WIC in SFYE June 30, 2002 related to the new QuickWIC system.

In deciding to acquire the new QuickWIC system and charge this new system's costs to the WIC program prior to obtaining documented FNS approval of its APDs, DOH violated federal regulations related to the WIC Program. In addition, DOH officials did not maintain the September 6, 2001, FNS approval letter on file since they had to contact FNS to obtain an unsigned electronic version of this letter after we inquired about the FNS approval during our audit.

Criteria: 7 CFR 246.14 Program Costs

(d) Costs allowable with approval. The following costs are allowable only with the prior approval of FNS:

(1) Automated information systems which are required by a State or local agency except for those used in general management and payroll, including acquisition of automatic data processing hardware or software whether by outright purchase, rental-purchase agreement or other method of acquisition. Approval shall be granted by FNS if the proposed system meets the requirements of this part, A-130, and 7 CFR part 3016. At the time the State agency decides to seek computerization, except for use in general management or payroll, it shall inform FNS and seek approval.

The OMB Circular A-133 Compliance Supplement, Part 4 related to WIC, Section III, Section B on Allowable Costs/Cost Principles, Part 2, Capital Expenditures, states:

Automated Data Processing Projects

WIC State agencies are required to submit an Advanced Planning Document (APD) to request prior approval of automation acquisitions with a total project cost of $500,000 or more. Prior approval from FNS is required for such costs to be allowable charges to the WIC grant.

OMB Circular A-87, Attachment C–1, states, in part:

B. Definitions

1. Approval or authorization of the awarding or cognizant Federal agency means documentation evidencing consent prior to incurring a specific cost.

Finding 02 – 4: (continued)

Cause: DOH WIC Division management stated that FNS was aware of the direction in which it was headed with its WIC system, and FNS approvals were obtained individually for all items related to the QuickWIC system as they were acquired. The APDs approved by FNS in September 2001 gave approval to the overall project. An official in FNS confirmed to us that in May 2000 FNS gave a verbal "conceptual approval" of the computer project, but that documented FNS approval was not given until September 6, 2001. DOH officials believed that this was all that was necessary for the costs to be in compliance under the WIC program.

In the course of our fieldwork, we also noted that DOH did not have strong controls over ensuring that adequate documentation was on file to support federal approval of this computer project. As noted above, a signed federal approval letter was not maintained in DOH's files. In addition, WIC officials could not timely locate the initial APDs submitted to FNS in December 2000. When the APDs were found nearly a year after our request, they were in electronic form only and included unsigned cover letters dated January 22, 2001, not December 2000. There was no documentation provided from DOH files to support its May 2001 resubmission of the APDs or its July 2001 revisions as communicated to us by FNS. We had to rely solely on a letter from FNS to inform us of all the details of its approval process for this new system.

Effect: Since WIC did not obtain prior documented federal approval for costs related to development, implementation, and maintenance of its new QuickWIC system, DOH violated federal regulations in the WIC Program. However, an FNS official confirmed with us that FNS does not consider the costs to be questioned since FNS's verbal approval was actually given prior to the costs being charged, and would not request the return of any funds.

In addition, violation of federal regulations may occur in future periods if DOH does not correct its WIC procedures to ensure adequate documentation is maintained for proper approval of these costs.

Recommendation: We recommend that all future acquisitions of automated data processing projects of $500,000 in federal funds or more be made by DOH only after documented federal approval of the required APDs is obtained. In addition, internal controls should be strengthened to ensure all appropriate documentation is maintained in DOH's files.

Agency Response: The Department has taken steps to insure that any future automated data processing projects utilizing $500,000 or more in federal funds will not be begun until documented federal approval of a required APD is obtained. The Department has also taken steps to insure all appropriate documentation is maintained in DOH files.

Auditors' Conclusion: Based on the agency response 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 02 – 5:

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

Performance/Evaluation Report Submitted to HUD Was Inaccurate (A Similar Condition Was Noted in Prior Year Finding #01-2)

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-01-DC-42-0001 that covered the period from January 1, 2001 to December 31, 2001 to determine if the data presented on the Performance/Evaluation Report was accurate.

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

- The source for drawdown information on the Performance/Evaluation Report is HUD's Integrated Disbursement and Information System (IDIS). The total reported by DCED in Section 1, Line C, "Amount Drawn Down" was $14,211,722. However, the total amount drawn down recorded on (IDIS) was $8,178,368, resulting in a difference of $6,033,354.

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

Cause: DCED personnel stated that they inadvertently used the prior year IDIS amount when completing Section 1, Line C on the current year's Performance/Evaluation Report. Additionally, DCED has no formalized written procedures for the preparation and approval of the Performance/Evaluation Report.

Effect: The Performance/Evaluation Report for Grant Number B-01-DC-42-0001 for the year ended December 31, 2001 was materially inaccurate. Also, the Performance/Evaluation Reports for the other federal grant numbers active in the current year may be materially incorrect since DCED does not have adequate procedures in place for the review and approval of these reports.

Finding 02 – 5: (continued)

Recommendation: We recommend that DCED, in consultation with HUD officials, consider revising their most recent Performance/Evaluation Reports to correct any inaccurate amounts. We further 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, accurate, and properly tie to underlying accounting records in accordance with federal regulations.

Agency Response: DCED has revised the incorrect figure on the Performance/Evaluation Report for Grant Number B-01-DC-42-0001 to accurately reflect the drawdown total of $8,178,368, submitting this corrected page to HUD for their records, as well as adjusting our own records. The incorrect figure was inadvertently included from the previous year's report.

It is also important to note that this error did not have any impact on the fiscal operation of the program. The financial data included in the Performance/Evaluation Report is an annually prepared report that gathers some information from the Integrated Disbursement and Information System (IDIS), and other sources as well. However, the financial data to manage this program is maintained in IDIS. IDIS, used to manage the fiscal operation of the program, was never in error.

In order to put a stronger system of control in place, however, DCED will also implement a new procedure for future PER submissions. Under the new procedure, prior to transmitting the Performance/Evaluation Report (PER) to HUD, a sign off by the Program Compliance Officer, who is responsible for the PER preparation, and by his supervisor, the Chief of Program Development and Technical Support, will be required. This process will serve to provide an additional level of review to verify from IDIS documentation that the figures entered into the PER are accurate.

These procedures will be formally set forth and communicated to relevant staff and a copy of the procedure will be available for the auditor to review as part of the Office's Policy and Procedure file.

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 02 – 6:

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

Internal Control Weakness Over Information Reported From Integrated Disbursement and Information System (A Similar Condition Was Noted in Prior Year Finding #01-3)

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. Additionally, 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.

During our prior year audit, we noted there was no supervisory review or oversight by DCED or LECS Comptroller's Office of the drawdown information prepared by DCED from the IDIS system. Our follow-up for the current year ended June 30, 2002 revealed that LECS implemented supervisory review procedures of the subrecipient drawdown information prepared and reported by DCED from the IDIS system. However, these procedures were not fully implemented until the last quarter of the current year and therefore the weakness cited above existed for most of our current audit period.

It should be noted that no errors were noted on the current year SEFA for the CDBG or HOME Programs as a result of our audit.

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.

Cause: DCED staff and LECS staff met on January 28, 2002 and agreed to implement supervisory reviews of the subrecipient drawdown information prepared and reported by DCED from IDIS. LECS began performing some limited reviews for the third quarter of the fiscal year 2002, however they were unable to fully implement the reviews until the last quarter of the current fiscal year.

Effect: An internal control weakness existed for the majority of the current period under audit since the procedures implemented by DCED and LECS were not fully in effect until the last quarter of the fiscal year 2002.

Recommendation: We recommend that LECS continue performing their supervisory reviews of the drawdown information prepared and reported by DCED from IDIS. We further recommend that LECS enhance existing procedures by performing tests of clerical accuracy of the quarterly spreadsheets prepared by DCED and by verifying the beginning drawdown information on such spreadsheets.

Agency Response: Subsequent to the issuance of the original finding on January 15, 2002, and DCED and LECS meeting on January 28, 2002, additional review procedures were identified and implemented for the quarter ending March 31, 2002, the first available fiscal year quarter to do so. Throughout the subsequent quarter, these review procedures were revised to include verifying the beginning quarterly drawdown balances (by subrecipient as listed on the DCED spreadsheets) on a sample basis. This process was enhanced to include all subrecipients for the Community Development Block Grants and HOME Investment Partnerships Program for the quarter ending September 30, 2002, through the most recent ending quarter to date, December 31, 2002.

Finding 02 – 6: (continued)

As indicated in the **Condition** section of the finding, "no errors were noted on the current year SEFA for the CDBG or HOME programs as a result of our audit." Therefore, it would appear that the existing process is working satisfactorily.

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 02 – 7:

CFDA #14.239 – HOME Investment Partnerships Program

DCED Did Not Perform Adequate Monitoring of Community Housing Development Organization Operating Grants (A Similar Condition Was Noted in Prior Year Finding #01-4)

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, 2002, CHDO operating grants were $236,194, or 1.4 percent of total DCED HOME program expenditures of $16,359,197.

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. In addition, effective January 29, 2002, DCED stated that they were to require CHDO's to provide additional documentation which was to be reviewed by DCED for compliance with HOME regulations and eligibility of operating costs. Additional documentation was to include CHDO's total operating costs for the fiscal year, two expenditure invoices each from categories of travel, training, and equipment purchases, and evidence that a housing project is completed or underway.

During our audit period there were three CHDO operating grants which were closed out by DCED, Indiana County Contract #197-95-0052, Schuylkill County #97-190-0020, and SEDA-COG Housing Development Corporation #96-190-1058. Indiana County was closed out by DCED on September 12, 2001, prior to DCED implementing new closeout procedures. Schuylkill County was closed out by DCED on April 23, 2002, but the county had submitted their final fiscal status report on July 28, 2000, and therefore DCED made the decision not to require Schuylkill to submit additional closeout documentation. DCED closed out SEDA-COG on April 22, 2002, and did request SEDA-COG to submit the additional closeout documentation. However, in a letter to DCED, SEDA-COG stated that they did not invoice the HOME operating grant expenditures since expenditures were charged on a pro-rata cost basis over all their various grant programs and this method had been approved by an outside accounting firm. DCED did not perform any additional follow-up and did not review actual original invoices for these costs.

In addition, during our testing of DCED's closeouts for contracts other than operating grants, we noted that one of the four contract files reviewed did not contain evidence that on-site monitoring was completed. For Bradford County Contract #197-94-0015, DCED's closeout checklist and database indicate that monitoring was performed on April 28, 1999; however, DCED could not provide evidence of the monitoring performed or the results.

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.

Finding 02 – 7: (continued)

24 CFR Part 85.42 provides the following for record retention:

(b) Length of retention period.

(1)€Except as otherwise provided, records must be retained for three years from the starting date specified in paragraph (c) of this section.

(c) Starting date of retention period –

(1) General.

. . . the retention period starts on the day the grantee submits its final expenditure report. If an expenditure report has been waived, the retention period starts on the day the report would have been due.

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. DCED review of invoices to charge operating costs to the HOME operating grant for SEDA-COG Contract #96-190-1058 was not completed since SEDA-COG used a pro-rata cost basis over several grants.

DCED stated that Bradford County Contract #197-94-0015 was monitored on April 28, 1999, but could not locate the monitoring report.

Effect: With no on-site monitoring of CHDO operating grants and/or review of expenditure invoices, HOME funds could be used in violation of regulations or for unallowable activities which would not be detected by DCED. Also, since DCED could not locate the monitoring report for Bradford County we could not determine if it was actually monitored or the results.

Recommendation: We recommend that DCED strengthen its 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. In addition, DCED should ensure that monitoring documentation is properly filed and maintained.

Agency Response: Three HOME CHDO operating grants were chosen to be audited. The closeout procedures implemented by DCED on January 29, 2002 were not in effect for two of the grants audited because these grants were closed or in the process of being closed at the point when new procedures were implemented.

The other audit of SEDA-COG (Contract #96-190-1058) demonstrated that they fulfilled two of the CHDO closeout procedures: 1) regarding annual operating costs not exceeding the limitations in 92.300(f), 50 percent or $50,000 whichever is greater; and 2) evidence of a housing project that is underway or with a commitment of funding. The third item of the closeout procedures was not met in the standard way. This item requires review of specific invoices of a sampling of categories from training, travel or equipment purchases. SEDA-COG stated in their April 2, 2002 letter to DCED that their costs are prorated across all SEDA-COG grant programs and that this has been accepted by independent CPA firms that have audited the agency. DCED accepted SEDA-COG's response. The prorating of supporting costs is based on the salaries, and includes such items as travel, telephone, supplies, printing, postage, equipment maintenance, depreciation, etc. Consequently, individual invoices for these items are not required. Based on the agency's audit, nothing was found to be misappropriately applied to the CHDO operating grant.

The closeout procedures adopted by DCED address each of the HOME requirements for CHDO operating grants by verifying the requirements through the review of appropriate documentation. An on-site monitoring review would not provide any better means of obtaining the documentation than the established procedures since these are administrative

Finding 02 – 7: (continued)

costs not construction activities. Additionally, a significant number of CHDO operating grants fulfill the housing project requirement by completing a CHDO housing project that is funded via PHFA funds, and are not monitored by DCED. DCED's closeout procedures include verification that PHFA provided funding for a CHDO project, thereby justifying the CHDO operating grant.

The results of auditing of these three CHDO operating grants does not warrant changing the procedures that have been established. While there were comments from HUD that DCED should monitor CHDO operating expenditures and invoices of the CHDO operating grant during the on-site monitoring of the CHDO housing project, we believe that issue was not fully discussed with HUD. DCED will confer with HUD further and provide a response once HUD has been fully apprised of the circumstances and our closeout procedures.

Finally, regarding the one missing monitoring report, this was a highly unusual circumstance. Staff completed it and the report was logged in as finished. The paper report however could not be found despite extensive time and effort searching for it.

Auditors' Conclusion: Even though the SEDA-COG prorated operating costs across its various grant programs, this does not relieve DCED of its responsibility to monitor the supporting documentation for these costs. Further, we agree that DCED should further consult with HUD in order to develop adequate monitoring procedures of CHDO operating grants, which should include on-site monitoring as necessary. Based on the agency response, the finding and recommendation remains as previously 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 02 – 8:

CFDA #15.250 – Regulation of Surface Coal Mining

Unallowable Personnel Charges Result in Questioned Costs of $112 (A Similar Condition Was Noted in Prior Year Finding #01-5)

Condition: During the state fiscal year ended June 30, 2002, $5,429,000 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. To follow up on reportable conditions noted in the prior year audit, we performed analytical review procedures for the year and selected 5 employees who charged 2,934 hours to the RSCM program during SFYE June 30, 2002 out of a total population of 277,711 hours charged for the year. Our testing disclosed a discrepancy between the number of hours reported on one employee's timesheets and the hours reported on the AMIS yearly summary report. These errors caused 6 hours to be charged to RSCM for the year that were not supported by the timesheets, which calculates to $112 in unallowable costs. Follow up discussions with DEP personnel on this discrepancy disclosed that weaknesses noted in the prior year audit had not been corrected in the current year.

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 . . .

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, in Section ___.510 states in part:

(a) Audit findings reported. The auditor shall report the following as audit findings in a schedule of findings and questioned costs:

(3) Known questioned costs which are greater than $10,000 for a type of compliance requirement for a major program. Known questioned costs are those specifically identified by the auditor. . . .The auditor shall also report known questioned costs when likely questioned costs are greater than $10,000 for a type of compliance requirement for a major program. . . .

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 and the untimely submission of timesheets could have also contributed to these discrepancies. Regarding the lack of a standard timesheet form, our testing disclosed that the timesheets for this employee did not include a section to input the AMIS work code for the hours incurred. The employee 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. Apparently, the timekeeper did not always assign the proper code.

Finding 02 – 8: (continued)

Effect: The RSCM program was overcharged by $112 which are questioned as unallowable. In addition, due to the control weaknesses noted above, there is limited assurance that salary and benefit costs are being properly allocated to the RSCM program by DEP.

Recommendation: DEP should pursue appropriate settlement with USDOI for the $112 in questioned costs identified above. In addition, DEP should ensure timesheets are prepared timely and should consider standardizing employee timesheet forms to include a section for the employee to record the applicable AMIS work code worked by that employee.

Agency Response: We will refile a corrected final FSR for the Title V - Administrative and Enforcement Grant, to the Department of Interior, for the unallowable costs of $112 due to the discrepancy between the number of hours reported on an employee's timesheet and the hours reported on the AMIS yearly summary report; and will reissue procedures reminding employees and input clerks of the importance of legibility, accuracy and timeliness of AMIS sheets.

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 02 – 9:

CFDA #17.245 – Trade Adjustment Assistance – Workers

Incomplete Reporting on the ETA 563 Report

Condition: L&I is required to submit an ETA 563 Report titled "Quarterly Determinations, Allowance and Reemployment Services Under the Trade Act," to USDOL on a quarterly basis. The ETA 563 report provides information on eligibility determinations, income support payments, reemployment services and training. The data supplied on the ETA 563 is used by USDOL to measure the effectiveness of the TAA and NAFTA-TAA programs in helping adversely affected workers adjust and find new employment. A separate report is required to be filed for each certified petition under which services are provided.

Each quarter, L&I submits the ETA 563 in electronic format to USDOL. The submission includes a separate report for each certified petition under regular TAA and NAFTA-TAA, along with summary pages. In order to test the accuracy of the information submitted to USDOL, we obtained the ETA 563 submitted for the quarter ended 9/30/01 for the NAFTA-TAA petitions. Our testing revealed the following:

- The report for each petition number is to consist of 29 fields of information. The data for 13 of these fields is based on information provided from the career link sites throughout the state. We noted that, for all but one petition number in our testwork, every one of these 13 fields (exception was for field 21 on petition #N04506) reported a zero due to a problem with the information being downloaded from the career link sites.

We were subsequently informed by TAA officials that the problem noted during the quarter we tested existed for the entire year under audit since the career link database is not compatible with the database used by L&I to prepare the ETA 563 report. As a result, incomplete information was submitted to USDOL during the year for the 13 data fields provided by the career link sites.

Criteria: 20 CFR 617.57 states:

(a) *Recordkeeping. Each state agency will make and maintain records pertaining to the administration of the Act as the Secretary requires and will make all such records available for inspection, examination and audit by such Federal officials as the Secretary may designate or as may be required by law. Such recordkeeping will be adequate to support the reporting of TAA activity on reporting form ETA 563 approved under OMB control number 1205-0016.*

Part D, Chapter III of the Handbook on the Trade Adjustment Assistance Program provides the reporting instructions for ETA 563 and states in part:

2. *General Instructions. Each report is for reporting activity under a specified certified petition. A separate report is required for each certified petition under which services are provided.*

Cause: The database used by the career link sites associates information by social security number. However, the database used by L&I to prepare the ETA 563 report associates information by petition number. As of this date, L&I has been unable to convert the data downloaded from the career link sites into the format required for the ETA 563 report.

Effect: L&I submitted incomplete ETA 563 reports to USDOL for the year ended June 30, 2002 and, therefore, did not comply with federal reporting requirements. Additionally, L&I does not have an adequate system in place to accurately report the information being provided from the career link sites.

Recommendation: We recommend that L&I modify their existing system to ensure that information being provided by the career link sites is accurately captured and reported to USDOL. Additionally, once this system is in place, L&I should consult with USDOL and evaluate the feasibility of submitting revised ETA 563 reports for the year ended June 20, 2002 since these reports are used by USDOL to measure the effectiveness of the TAA program.

Finding 02 – 9: (continued)

Agency Response: The data collection systems for the state have been continuously changing since 2000. Because of the changes, a critical piece of information required for reporting the Reemployment and Training services by Petition Number, as required in the ETA-563, has been unavailable. The state is working to make this by-petition information available by March 31, 2003.

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 02 – 10:

CFDA #17.245 – Trade Adjustment Assistance–Workers

Weakness in L&I's Controls Over Preparation and Submission of the Trade Act Participant Report to USDOL (A Similar Condition Was Noted in Prior Finding #01-7)

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 that reported on TAA participants who had exited TAA during the quarter July 1, 2000 through September 30, 2000. We selected ten participants from the TAPR and compared the key data (nine separate data fields) for each participant to supporting documentation. Our testing revealed the following:

- One of the ten participants in our sample was improperly included on the report. The individual was still in training through June 2001 and therefore had not exited the program during the quarter being reported.
- The most recent qualifying separation date was incorrect for two of the participants in our sample. This error resulted in incorrect wages being reported in two of the data fields for both participants.
- One of the participants in our sample had zeros entered in three separate data fields requiring wage information. A large number of other participants on the report also had zeros in these same three data fields. We were informed by TAA personnel that the zeros were entered for these participants only because they did not obtain wage records for these individuals.
- For one of the participants in our sample, we were unable to verify the wage information in two of the data fields since TAA did not retain the supporting wage records.

In addition to the differences noted above, we also noted that the four quarterly reports due during our audit period were all submitted after our audit period, so L&I's reporting process is untimely.

During our prior year audit, we noted the following weaknesses in L&I's controls over preparation and submission of the TAPR. Our follow-up for the current year disclosed that the weaknesses remained throughout our audit period.

- 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 always retain documentation at the time the TAPR is prepared to support the information manually entered onto the individual data sheets.

Finding 02 – 10: (continued)

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. Additionally, L&I does not have procedures in place to verify the accuracy of the information accumulated and transmitted to USDOL.

Effect: Based on the errors noted in the condition, TAA did not comply with federal reporting requirements. Also, the control weaknesses cited in the condition provide 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: We recommend that L&I develop a formal system to collect and accurately report the TAPR data to USDOL. In the interim, L&I should implement procedures to verify the accuracy of the TAPR information that is accumulated and transmitted to USDOL. Additionally, we recommend that L&I ensure that supporting documentation is retained for each participant's data sheet.

Agency Response: Trade Coordination Services is currently in the final stages of testing an automated system. This will be an on-line application procedure that will capture all of the required data for the TAPR. We expect this system to be fully operational by July of this year. In the interim, a program has been developed to pull data from the current system to create a new database. Once the data is stored in this interim database, reports will be generated which will ensure complete and accurate information is obtained for the purpose of preparing the TAPR. The information reported for the TAA participants on the TAPR will be accurate for all participants who exited the program are included on the report.

Regarding the revelations resulting from your testing of 10 participants, these issues are the result of human error, which the new system will alleviate. The finding that documentation was not retained at the time the TAPR was submitted is not completely correct. Documentation that is accurate and complete is retained for all training related issues. Wage records are maintained in the legacy mainframe database. These records are archived on a regular basis but can be retrieved. Currently, Trade Coordination Services makes a request for the archived information for each participant in the reporting period. In the future, wages will be entered in the new system which will maintain that wage information for the audit.

In addition, all reports, including the last one due, have now been submitted. The supervisor is on the floor and overseeing the process.

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 02 – 11:

CFDA #17.245 – Trade Adjustment Assistance–Workers

Overpayment of TRA Benefits Resulted in Questioned Costs of $3,989 (A Similar Condition Was Noted in Prior Year Finding #01 - 6)

Condition: As part of our testing of program expenditures, we randomly selected 25 Trade Readjustment Assistance (TRA) weekly benefit payments made to claimants during SFYE June 30, 2002 and determined whether claimants were eligible for TRA and whether they received the correct benefit amount. Our testing disclosed the following:

- For one of the 25 claimants in our sample, the claimant had completed training but had not satisfied the Extended Benefit work test. This test is a basic condition of entitlement to basic TRA unless the individual is enrolled in or participating in an approved training program. Accordingly, the 11 weekly basic TRA benefits paid to this claimant subsequent to completion of the approved training program (which includes our benefit week selected) are questioned.

Claimant	Weekly Benefit Amount	Weeks in Question	Amount of Overpayment	Total Questioned Costs
A	$389	9	$3,501	$3,501
	261	1	261	261
	227	1	227	227
Total			$3,989	$3,989

The total amount of the 25 benefit payments tested was $7,846, which consisted of payments for basic TRA totaling $7,491 and payments for additional TRA benefits totaling $355. During the period under audit, there were TRA benefit payments made totaling $23,038,941.

Criteria: 20 CFR 617.11 (a) (2) (vi) states, in part, that:

(vi) Extended Benefit work test. (A) The individual must-
(1) Accept any offer of suitable work, as defined in 617.3 (kk), and actually apply for any suitable work the individual is referred to by the State agency, and
(2) Actively engage in seeking work and furnish the State agency tangible evidence of such efforts each week, and
(3) Register for work and be referred by the State agency to suitable work, in accordance with those provisions of the applicable State law which apply to claimants for Extended Benefits and which are consistent with part 615 of this chapter.

20 CFR 617.17(a) and (b) describe the extended benefit work test as follows:

(a) Extended Benefit work test applicable. Except as provided in paragraph (b) of this section, an individual shall, as a basic condition of entitlement to basic TRA for a week of unemployment-
(3) be unemployed, as defined in the applicable State law for UI claimants, and
(4) be able to work and available for work, as defined in the applicable State law for UI claimants, and
(5) satisfy the Extended Benefit work test in each week for which TRA is claimed, . . .

(b) Exceptions
(2) On and after November 21, 1988. The conditions stated in paragraphs (a) (2) and (a) (3) of this section shall not be applicable to an individual who is enrolled in or participating in a training program approved under 617.22

Finding 02 – 11: (continued)

> *(a) or during a break in the training program if the individual participated in the training immediately before the beginning of the break and resumes participation in the training immediately after the break ends.*

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, in Section ___.510 states in part:

(a) Audit findings reported. The auditor shall report the following as audit findings in a schedule of findings and questioned costs:

> *(3) Known questioned costs which are greater than $10,000 for a type of compliance requirement for a major program. Known questioned costs are those specifically identified by the auditor. . . . The auditor shall also report known questioned costs when likely questioned costs are greater than $10,000 for a type of compliance requirement for a major program. . . .*

Cause: L&I indicated that the individual had completed one approved training program and began another program. However, the subsequent training program was not an approved training program as required by federal regulations.

Effect: Since TRA benefits were overpaid to the claimant listed above, there are questioned costs of $3,989. Also, L&I's existing procedures are not adequate for verifying a claimant's participation in an approved training program.

Recommendation: We recommend that L&I repay the questioned costs or pursue appropriate settlement with the U.S. Department of Labor. Additionally, we recommend that L&I provide a detail description of the training information for each claimant on the general annotations section of the TRA Claim Record. This information should then be compared to the weekly Form ETA 8-58A submitted from the training facility to ensure that the claimant is participating in an approved training program.

Agency Response: The attached finding regarding Claimant A is correct, and we do not dispute that there was an error in payment because the claimant did not conduct a work search after her approved training ended. If the claimant had conducted a work search or had been employed part-time by the affected employer, her payment would have been appropriate. However, she was working part-time for an employer other than the affected employer. Also, the school continued to send in Form ETA 8-58A for all weeks up to week ending September 1, 2001. On April 7, 2003, a determination was issued establishing a non-fraud overpayment in the amount of $3,989.00, 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 UCSC staff is aware of their unintentional error.

Auditors' Conclusion: Based on the agency response, the finding and recommendation 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 02 – 12:

CFDA #17.255 – Workforce Investment Act
CFDA #17.258, 17.259 and 17.260 – WIA Cluster
CFDA #93.558 – Temporary Assistance for Needy Families

L&I Did Not Properly Report Federal Expenditures on the Schedule of Expenditures of Federal Awards

Condition: In connection with our audit of the WIA Program (CFDA #17.255) and the WIA Cluster (CFDA #s 17.258, 17.259 and 17.260), we noted several errors relative to the LECS Comptroller Office's reporting of expenditures on the SEFA. Specifically, we noted the following:

- The staff at the Bureau of Employment and Career Services (BECS) provide Rapid Response services for WIA. The charges for the BECS staff are allocated to WIA on a monthly basis. We noted that the charges for such services for fiscal year ended June 30, 2002 were inadvertently reported on the SEFA twice under different CFDA numbers (17.255 and 17.258). Based on our audit and discussions with LECS, we determined that the expenditures should be reported under CFDA #17.255. Accordingly, this error caused the expenditures to be overstated for CFDA #17.258 in the amount of $3,288,000.

- The staff at the Office of Employment Security (OES) provide services for the Youth Programs under WIA. These charges are also allocated to WIA on a monthly basis. We noted that the charges for these services during the fiscal year ended June 30, 2002 were also reported twice on the SEFA and involved three different CFDA numbers (17.255, 17.258 and 17.259). Based on our audit and discussions with LECS, we determined that the expenditures for such services should be reported on the SEFA under CFDA #17.255 and #17.259. Accordingly, this error caused the expenditures to be overstated for CFDA #17.258 in the amount of $1,222,000.

- We also noted that a total of $2,230,000 in expenditures was reported on the SEFA under CFDA #17.258 for a program called the Returner's Initiative. Based on our review of a Memorandum of Understanding between DPW and L&I, we determined that these expenditures related to the TANF Program and accordingly, should have been reported under CFDA #93.558 for the year ended June 30, 2002. This error caused the expenditures to be overstated for CFDA # 17.258 and understated for CFDA #93.558 in the amount of $2,230,000.

The errors noted above went undetected by the LECS Comptroller personnel in their preparation and review of the SEFA. The SEFA was corrected as a result of our audit.

Criteria: 29 CFR 97.20 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.

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.

Finding 02 – 12: (continued)

Cause: LECS informed us that the errors on the SEFA relative to the BECS and OES allocated charges occurred since there were no specific procedures in place for reporting these types of expenditures on the SEFA. With respect to the reporting of TANF Program expenditures under WIA, LECS indicated that this error was due to an oversight.

Effect: The amount reported on the SEFA under CFDA #17.258 for the year ended June 30, 2002, was overstated by $6,740,000. Additionally, the amount reported on the SEFA under CFDA #93.558 for the year ended June 30, 2002, was understated by $2,230,000. As a result, adjustments to the SEFA were necessary for the SYFE June 30, 2002. Also, the weaknesses in internal control may cause additional SEFA misstatements in the future.

Recommendation: We recommend that LECS Comptroller personnel develop specific procedures to address the reporting on the SEFA of charges allocated from BECS and OES. We further recommend that LECS strengthen their supervisory review of the information used for reporting of expenditures on the SEFA for the WIA Program and the WIA Cluster. This will provide better assurance that the expenditures of federal awards on the SEFA are accurate.

Agency Response: We concur that duplicate reporting of expenditures on the SEFA has been a problem with intra-agency reporting. Effective immediately, LECS will adopt the intra-agency position that the secondary provider, the one providing the service, will be responsible for removing the duplicate expenditure from the SEFA. The SEFA will then be checked for completeness and accuracy prior to submission. We will advise the Bureau of Financial Management of our action related to the SEFA.

Auditors' Conclusion: Based on the agency response, the finding and recommendation 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 02 – 13:

CFDA #17.255 – Workforce Investment Act
CFDA #17.258 – Workforce Investment Act Adult Program
CFDA #17.259 – Workforce Investment Act Youth Activities
CFDA #17.260 – Workforce Investment Act Dislocated Workers

Incomplete Reporting on and Inadequate Controls Over the WIA Annual Performance Report

Condition: L&I is required to submit an Annual Performance Report to USDOL for each program year. The report provides participant and performance outcome data for the WIA programs. The report includes a Narrative Section and Tables containing summaries of participant and performance level information. The data (exclusive of wage information), in support of the Tables in the Annual Report is based on a collection of individual records for each participant and is entered directly into L&I's system by the Local Workforce Investment Areas (LWIAs). This data is also required to be submitted to USDOL as part of the Annual Report.

L&I submitted its initial Annual Performance Report during our audit period that covered the Program Year 2000 (7/1/99 to 6/30/00). Based on our review of guidance from USDOL, this initial report was to provide information for all individuals who had exited the WIA program or terminated from JTPA for the period from October 1, 1999 through September 30, 2000. However, our review of the report submitted by L&I revealed that the report covered all individuals exiting for the period from July 1, 2000 through December 31, 2000. Accordingly, the report submitted by L&I to USDOL was incomplete.

In addition, L&I was unable to provide documentation of the procedures in place for the verification and validation of the participant data provided by the LWIAs to ensure that the data is accurate, reasonable, and complete as required by USDOL regulations. We also noted L&I's on-site monitoring of the LWIAs does not include any verification or validation of the participant data.

Criteria: The instructions for the WIA Annual Performance Report are contained in USDOL's Training and Employment Guidance Letter (TEGAL) No. 14-00, and state in part:

4. *Reporting and Record Keeping Information. States are required to submit three different participant reports. They are:*

   1) *The Workforce Investment Act Standardized Record Data (WIASRD). States are required to maintain this collection of individual records containing activity and outcome information for each participant. The WIASRD is the foundation for the quarterly and annual reports. These records are due by December 1 following the end of each program year.*

   3) *The WIA Annual Performance Report. Annual performance reports will contain information on the progress of the State in exceeding negotiated levels of performance, including information on the levels of performance achieved by the State with respect to the core indicators of performance and the customer satisfaction indicators. This report is due by December 1st following the end of each program year.*

In addition, USDOL's Training and Employment Guidance Letter No. 7-99, states in part:

E. *Time Period to be Used for Measurement. To address the time-lags in the use of the UI wage records, States will need to go back in time, prior to WIA implementation to calculate performance measures for actual PY 2000 WIA implementation. The first time period is for all measures that utilize the UI wage record and will involve going back in time three quarters to account for the time-lag. . . . For PY 2000, all States will use the last three quarters of PY 99 and the first quarter of PY 2000 for all measures listed above.*

Finding 02 – 13: (continued)

USDOL's Training and Employment Guidance Letter No. 14-00, Change 1, contains revisions and clarification to TEGAL 14-00 on reporting participant data and states in part:

7. *Changes to Performance Outcome Verification Requirements. States are required to establish basic standard operating procedures for data collection and handling to ensure the quality and integrity of the data over time. At a minimum, states must address data verification and data validation in the established procedures to ensure that the resulting database and reports are certifiably accurate. . . . Performance data submitted on the quarterly and annual reports must be verified and validated at the state level.*

Data verification involves checking the accuracy of all or a sample of the computerized records against the original paperwork or other sources.

Data validation, on the other hand, involves checking the reasonableness of all or a sample of the data entered into the computerized database.

Examples of procedures for data collection and handling to ensure that the resulting database is accurate include:

- Checking the accuracy of the computerized records against the original source, usually hard copies of records;
- Performing logical and reasonableness checks of the data;
- Random call-backs to participants or contacting other sources to verify the accuracy of information collected; and having a trained staff member evaluate data collection efforts by randomly observing interviews and other data collection methods.

Cause: L&I stated that they did not provide adequate instructions to the LWIAs about the time period to be used for reporting information on those who exit the programs. L&I informed us that they discovered the error on their Annual Report prior to submission to USDOL. L&I also indicated that they contacted the ETA Regional Office regarding this error and were instructed to submit the report to USDOL for the incomplete period. Regarding the data verification and data validation procedures, L&I stated that they have procedures in place but were unable to provide any documentation to support the procedures.

Effect: Since the report submitted to USDOL was incomplete, L&I did not comply with federal reporting requirements. Additionally, since L&I was unable to provide documentation to support the procedures in place for the verification and validation of data submitted by the LWIAs, there is no evidence that L&I complied with USDOL regulations.

Recommendation: Based on review of USDOL guidance, L&I is prohibited, at this point, from submitting a revised Annual Report for Program Year 2000 to USDOL. For the future, we recommend that L&I implement procedures to ensure that all USDOL guidance regarding Annual Report requirements, including the correct reporting period, is adequately communicated to the LWIAs. Further, we recommend that L&I establish written procedures and maintain documentation to support the data verification and data validation of participant data submitted by LWIAs to comply with USDOL requirements and to ensure that the report submitted to USDOL is accurate.

Agency Response: It is important to first note that L&I chose to totally restructure its data collection and reporting system under the initial implementation stages of the Workforce Investment Act of 1998. This decision was made prior to Pennsylvania's implementation of WIA in January 2000, and the State continues to be impacted by the ramifications of this approach. This major overhaul delayed system data input and the ability for Local Areas to have accurate and timely information upon which to make decisions. This system change contributed to the State's inability to more timely identify and implement appropriate corrective measures to improve the State's performance. The State sacrificed in the short term for long-term system improvements.

Finding 02 – 13: (continued)

L&I was aware of the time periods for reporting as stated in the referred sections from TEGL 14-00 and TEGL 7-99. The condition stated by the Auditor regarding the data included in the annual report is not totally accurate. There are two different time periods of data that are used in the annual report. The first time period for reporting data for performance is for the Program Year (July 2000 to June 2001). Data and measures for this time period were reported appropriately in the annual report. The second time period for reporting performance data is for measures that require either six-month follow-up or six months of post-exit UC wage record data. The time period for these measures ran from October 1999 through September 2000. Since data prior to July 1, 2000 was not available in the system, the data in our report only had one quarter of program exiters during this time period (July through September 2000). However, as wage record data was available to calculate measures for individuals exiting October 1, 2000 through December 31, 2000, we included those individuals in the calculations also. Once data for the entire PY2000 reporting period was entered into the system, the performance measures for the annual report were recalculated for the appropriate time period. Data for the local areas was also completed at that time. The revised data was then sent to the ETA regional office. Since the revised data was sent after the cut-off date, it was not considered an official replacement for the initial report.

To ensure timely and accurate reporting, training sessions were held with local area staff in the spring and summer of 2002, to help them better understand the reporting system and data entry into the system. Frequent reminders regarding cut-off dates for data entry for quarterly and annual reporting periods were also sent to local areas to ensure the most current data were included in the performance calculations. As a result, the PY2001 Annual Report was submitted by the December 6, 2002 deadline and included data for the appropriate time period.

L&I also commenced disseminating a series of up to nine reports per local area that corresponds with the quarterly federal reports required. These reports show not just the performance numbers obtained, but also who had been counted in the performance measure and what data was being recorded in the WIASRD regarding individual participants that impacted the measure. This allows the local areas and providers to verify their data entry and provide direct input back to us when their records do not match. Investigations are undertaken upon receipt of such information to determine programming/mapping error or validity of local office feedback.

In addition, regarding the statement that L&I was unable to provide documentation to support the procedures in place for the verification and validation of data submitted by the LWIAs, and that there is no evidence that L&I complied with USDOL regulations, this single audit was done on the PY 2000 Annual Report but the reference for data verification and validation is from TEGL 14-00, Change 1 dated November 19, 2001. This TEGL was issued less than two weeks before the due date of the Annual Report for Program Year 2000. The WIA Services Module includes data validation. The data validation included edits on individual fields that do not allow a user to leave a field blank when needed for eligibility and/or reporting purposes. In addition, the system does not allow data to be entered if it causes any inconsistency with another field. All fields' drop-down boxes default to a blank so that a field is not inadvertently missed. Data Validation as required by USDOL National Office will be rolled out sometime in 2003.

Auditors' Conclusion: Although we agree with the information provided in the agency response, the response does not mitigate the condition in the finding. Therefore, the finding and recommendation remain as stated above and we will review any corrective action in the 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 02 – 14:

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

Internal Control Weakness Over Expenditure Information Reported on the SEFA (A Similar Condition Was Noted in Prior Year Finding #01-8)

Condition: The PADOT Comptroller Office prepares various spreadsheets and schedules 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 these spreadsheets. These clerical errors were not material; however, they 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 SEFA review process lacked adequate quality control to detect the errors. According to management, Comptroller personnel changes and retirements, time constraints with GASB 34 implementation, and the constraints caused by SAP implementation contributed to the oversight.

Effect: The amounts reported by PADOT on the SEFA for the HPC cluster were incorrect. The resulting error was immaterial in the current year; however, weak internal controls could potentially cause significant SEFA misstatements in the future.

Recommendation: We recommend that PADOT Comptroller Office strengthen supervisory review of the spreadsheets and schedules 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: PADOT Comptroller's Office indicated that it does maintain a structure of controls to detect clerical errors but because of the impact of retirements and personnel changes, the adequacy of this control was degraded and an immaterial error was made. Personnel in the Comptroller's Office have corrected the error and have taken steps to bolster quality control. This enhanced environment of quality control will be outlined in the corrective action plan that has been developed to specifically address this weakness.

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 02 – 15:

CFDA #66.458 – Capitalization Grants For State Revolving Funds
CFDA #66.468 – Capitalization Grants For Drinking Water State Revolving Fund

Internal Control Weakness Over the Preparation of DEP Quarterly Billings to PENNVEST

Condition: PENNVEST is responsible for drawing CWSRF and DWSRF funds for set aside expenditures incurred by DEP on behalf of PENNVEST. DEP prepares quarterly billings to PENNVEST for reimbursement of these expenditures. Our testing of a DEP quarterly billing disclosed errors in which CWSRF expenditures were mistakenly charged to DWSRF and DWSRF expenditures were mistakenly charged to CWSRF. Inquiry of DEP personnel disclosed that no supervisory review is performed by DEP prior to submission to PENNVEST for reimbursement.

Criteria: Strong internal controls should ensure that billings are accurate and are appropriately reviewed and approved by management.

Cause: The errors noted above went undetected because there is no supervisory review of CWSRF and DWSRF billings performed by DEP.

Effect: The lack of supervisory review provides limited assurance that future DEP quarterly billings to PENNVEST under CWSRF and DWSRF will be accurate.

Recommendation: We recommend that DEP implement supervisory reviews of the quarterly billings to PENNVEST to ensure that CWSRF and DWSRF billings are accurate.

Agency Response: The following is our response to the finding for the fiscal year ending June 30, 2002, for Internal Control Weakness Over the Preparation of DEP quarterly billings to PENNVEST:

To correct the weakness of the quarterly billings to PENNVEST, the Senior Analyst or Bureau Director will be reviewing and analyzing the billings to verify that the costs are correctly charged to the CWSRF and/or DWSRF funding.

Also, with the SAP accounting system being accessible where other Department's may review another Department's expenditures, we are going to suggest to PENNVEST that they go into the specified accounts within DEP and verify the expenditures as need be.

Auditors' Conclusion: Based on the agency response, the finding and recommendation 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 02 – 16:

CFDA #84.027 – Special Education – Grants to States
CFDA #84.213 – Even Start – State Educational Agencies
CFDA #93.994 – Maternal and Child Health Services Block Grant

Noncompliance and Internal Control Weaknesses at DOH Result in $551,764 in Questioned Costs

Condition: During SFYE June 30, 2002, the Governor's Office launched a new initiative called the "I Am Your Child" Campaign, which was primarily designed to encourage parents to take more responsibility for their children's lives. A portion of this initiative was administered through DOH working with the Pennsylvania Department of Corrections' Bureau of Correctional Industries (an Internal Service Fund in the Basic Financial Statements), with costs incurred primarily for the development, printing, and distribution of promotional materials throughout the Commonwealth. We noted that $551,764 in costs related to this initiative were allocated and charged by DOH to three different federal programs during the current state fiscal year: $302,370 to the MCH Block Grant; $149,374 to the Special Education – Grants to States Program; and $100,000 to the Even Start – State Education Agencies Program (which was not audited as a major program).

Our audit found that DOH could not provide adequate documentation to support the reasonableness of the methodology for determining and allocating these amounts to all three federal programs. In addition, although some of the general descriptions of activities in this initiative appeared appropriate for the federal programs involved, DOH documentation failed to properly explain how these costs actually benefited the health and education objectives specific to these three federal programs. As a result, the $551,764 charged to these three federal programs during our audit period is unallowable in violation of federal regulations.

In addition, to the noncompliance reported above, our audit also noted further violations of federal allowability regulations related to the $551,764 in charges:

- This new Governor's Office initiative was not included in the federally-approved MCH Block Grant application for FFY 2002, which is required for the $302,370 charged to MCH.

- Based on our review of DOH's budget of over $1.9 million for its portion of the campaign over several state fiscal years, two cost categories in the budget, one totaling $80,241 for "Administration" and the other $160,482 for "Retained Earnings," or $240,723 in total, provided no tangible benefit to federal programs and are not allowable. The "Administration" category is not program-related, but a general government cost, and "Retained Earnings" in an Internal Service Fund are contingency costs, both of which are specifically deemed unallowable by federal regulations (OMB Circular A-87). Only state funds should be used for these two categories, but without a documented cost allocation method for the $551,764 charged to the three federal programs identified above, DOH cannot support how much of the $240,723 has been, or will be, federally funded in violation of OMB A-87. However, since the current-year federal billing amount of $551,764 is greater than this unallowable portion in the budget, we determined that the entire $240,723 was charged to the three federal programs in violation of OMB Circular A-87 during our audit period.

Criteria: 42 US Code, Chapter 7, Subchapter V, Section 704(a) applicable to MCH provides:

Except as otherwise provided under this section a state may use amounts paid to it . . . for the provision of health services and related activities . . . consistent with its application transmitted under section 705(a) of this title.

Further, Section 705 Regarding Applications for MCH Block Grant funds provides:

(a) *In order to be entitled to payments for allotments under . . . this title for a fiscal year, a State must prepare and transmit to the Secretary an application . . . that-*

Finding 02 – 16: (continued)

(2) includes for each fiscal year –

(B) a description of how the funds allotted to the State under . . . this title will be used for the provision and coordination of services to carryout such plan . . .

34 CFR 80.20(a)(5) allowable Cost applicable to USDE programs states:

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.

OMB Circular A-87, Cost Principles for State and Local Governments, Attachment A, Section A, states:

1. *Objectives. This attachment establishes principles for determining the allowable costs incurred by State, local and federally-recognized Indian tribal governments under grants . . . with the Federal Government. The principles are designed to provide that federal awards bear their fair share of cost recognized under these principles except where restricted or prohibited by law. Provision for profit or other increment above cost is outside the scope of this Circular.*

Attachment A, Section C, outlines basic guidelines governing allowable costs:

1. *Factors affecting the allowability of costs: To be allowable under Federal awards, costs must meet the following general criteria:*

   a. *Be necessary and reasonable for proper and efficient performance and administration of Federal awards.*

   b. *Be allocable to Federal awards under the provisions of this Circular . . .*

   d. *Conform to any limitations or exclusions set forth in these principles . . .*

   j. *Be adequately documented.*

OMB Circular A-87, Attachment A – Section F – Indirect Costs states:

1. *General. Indirect costs are those (a) incurred for a common or joint purpose benefiting more than one cost objective, and (b) not readily assignable to the cost objectives specifically benefited, without effort disproportionate to the results achieved. . . . To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect costs within a governmental unit department or in other agencies providing services to a governmental unit department. Indirect cost pools should be distributed to benefited cost objectives on bases which will produce an equitable result in consideration of relative benefits derived.*

Attachment B, Section Items of Cost, states:

12. *Contingencies. Contributions to a contingency reserve or any similar provision made for events the occurrence of which cannot be foretold with certainty as to time, or intensity, or with an assurance of their happening, are unallowable.*

23. *General government expenses.*

    a. *The general costs of government are unallowable.*

Finding 02 – 16: (continued)

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, in Section ___.510 states in part:

(a) Audit findings reported. The auditor shall report the following as audit findings in a schedule of findings and questioned costs:

(3) Known questioned costs which are greater than $10,000 for a type of compliance requirement for a major program. Known questioned costs are those specifically identified by the auditor. . .

(4) Known questioned costs which are greater than $10,000 for a Federal program which is not audited as a major program. . . . if the auditor does become aware of questioned costs for a Federal program which is not audited as a major program (e.g., as part of audit follow-up or other audit procedures) and the known questioned costs are greater than $10,000, then the auditor shall report this as an audit finding.

Cause: DOH personnel stated that the "I Am Your Child" Campaign was not included in the MCH FY 2002 Block Grant Application because the Application in question was submitted to HHS prior to the Governor's Office launching the Campaign. Regarding the allocation of the costs between the three programs, these allocations were based upon the appropriations signed into law by the Governor. The Administration and Retained Earnings categories were included in the budget by Department of Corrections, and DOH personnel stated they exercised no control over Correctional Industries inclusion of these categories in its budget.

Effect: Since DOH could not provide documentation to adequately support the allocation and reasonableness of the $551,764 charged to the three federal programs noted above, we question the $551,764 in charges as unallowable. In addition, since DOH did not include the "I Am Your Child" Campaign in the MCH FY 2002 Block Grant Application, there is further violation of MCH Block Grant allowability regulations for $302,370 of the $551,764 in allocated costs from this campaign. Also, we found violations of federal allowability regulations in OMB Circular A-87 for $240,723 in costs budgeted in this campaign for general administration and retained earnings in an Internal Service Fund.

Internal control weaknesses at DOH may cause similar unallowable costs from this or other initiatives to be allocated and charged to federal programs in the future.

Recommendation: DOH should pursue appropriate settlement of the $551,764 in questioned costs with the applicable federal awarding agencies involved (HHS and USDE). DOH should also implement procedures to ensure that projects funded by federal grants are equitably allocated to programs based on a documented cost allocation methodology which demonstrates the benefits derived and shows that the types of costs are allowable under the program charged.

We also recommend that appropriate procedures be established by DOH to ensure that all MCH charges are properly included in the federally-approved Block Grant application and cost categories not allowed by OMB Circular A-87 (such as general administration and retained earnings) are appropriately excluded from federal participation.

Agency Response: As lead agency for the Governor's Office "I Am Your Child" (IAYC) Initiative, DOH, following procurement procedures found in the Department of General Services' (DGS) Field Procurement Handbook, M215.3, issued a Field Limited Purchase Order with Pennsylvania Correctional Industries under DGS statewide contract 99-8001 for a total of $1,957,109.67. The Cost Schedule provided by the Correctional Industries details the costs of raw materials, plus an administration charge and retained earnings, which are allowable charges by their agency since they are an Internal Service Fund. DOH took the total amount and determined that to be the complete cost associated with a children's outreach service and distributed it to funds from DOH, the Department of Public Welfare (DPW) and the Pennsylvania Department of Education (PDE) that had been designated to be appropriate and available for this initiative.

Finding 02 – 16: (continued)

The IAYC Initiative was a multi-agency effort, including DOH, DPW and PDE. Each agency committed to the success of this program through the provision of federal funding. The federal resources were identified after a careful analysis was conducted to ensure that the funds were available and allowable, including the determination that no federal limitations or restrictions would be a concern. This analysis was finalized and agreed by all agencies. Using the federal parameters as a guide, the cost allocation for the specific expenditures of this initiative was then implemented.

The Health Resources and Services Administration (HRSA), Maternal and Child Health Bureau, the federal awarding agency of the Maternal and Child Health Block Grant, has routinely advised DOH to utilize discretion with the allotment of the block grant funds, provided that the service or related activity meets the federal guidelines. The nature of the statute and the guidance governing the MCH Block Grant also indicates that this discretion is warranted. Since the primary targets for Block Grant services include mothers with infants, health education and family support services, DOH clearly believes there is a direct link between the IAYC Initiative and the mission of the MCH Block Grant. Lastly, the reporting of activity for the IAYC Initiative was included in DOH's 2003 block grant application/2001 annual report. This document, including the reporting of the IAYC Initiative was approved by HRSA. This was evidenced through the approval and receipt of the 2003 block grant award.

Auditors' Conclusion: DOH claims in its agency response that the administration and retained earnings charges of $240,723 are allowable by the Bureau of Correctional Industries because it is an Internal Service Fund. However, this DOH response ignores the OMB Circular A-87 provisions quoted in the Criteria Section above, which specifically states that these costs are unallowable for federal programs.

DOH also claims that a careful analysis was conducted to ensure the charges were allowable with no federal limitations or restrictions, and cost allocation was implemented. However, this response again fails to explain how DOH complied with the provisions quoted in the Criteria Section above governing costs charged to federal programs. In addition, no documentation was provided to support the amounts allocated to the federal programs reported above or how program-specific objectives were met. Without any required documentation, the costs remain unallowable in violation of OMB A-87.

While the IAYC Initiative was included in the FFY 2003 MCH Block Application, DOH failed to include the initiative in FFY 2002, which is required for the $302,370 charged to MCH. In addition, we also noted that in the 2003 Block Grant application, no funding amount was noted. Further, no evidence was provided to demonstrate the reporting of, and federal approval of, the allocation of the IAYC Initiative costs among the federal programs noted in the finding.

As a result, 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 02 – 17:

CFDA #84.048 – Vocational Education – Basic Grants to States

Inadequate Controls Over PDE's VOC ED Consolidated Annual Performance, Accountability, and Financial Status Report Submitted to USDE

Condition: PDE is required to submit a Consolidated Annual Performance, Accountability, and Financial Status Report, otherwise known as the Comprehensive Annual Report (CAR), to provide VOC-ED performance data to USDE. There are 24 total subindicators reported on Form IV of the CAR. Fifteen are reported under the four Core indicators of performance and the remaining nine are reported as additional measures. Three different bureaus within PDE are responsible for gathering data for preparation of the CAR. Supporting data is received on hard-copy reports, on diskette, or via the Internet from LEAs and outside contractors who administer standardized testing. We sampled 4 of the 24 subindicators in the current-year CAR, and we found inadequate controls at PDE over the compilation and review of CAR data to ensure the data is accurate and complete prior to submission to USDE.

For two of the four subindicators (Code 1S2 – Skill Attainment, Secondary Level; and Code 2S2 – Diploma, Secondary Level), a standardized testing contractor submits test completion data to both PDE and another third party contractor for review. Our inquiries disclosed that PDE places major reliance on the third party contractor reviews of the test completion data for these two subindicators. Although PDE performs its own limited assessment of the data, PDE does not document its review.

For another subindicator, (Code 1S1 – Academic Achievement, Secondary Level) PDE summarizes test score data from another testing contractor for reporting on the CAR. In addition to providing the data to LEAs for their review and correction, PDE has developed internal procedures to analyze the reasonableness of the data at the state level. However, these procedures were not properly documented by PDE staff to support conclusions reached or to support that the data analyses were reviewed and approved in-house prior to submission of the CAR. Additionally, PDE did not perform or document procedures to confirm that the data control totals used for this subindicator on the CAR agreed to the control totals submitted by the test contractor to ensure data on the CAR was complete.

Once the three bureaus gather their CAR data, it is submitted to one individual in the Bureau of Career and Technical Education who completes the actual CAR. Although there is a supervisory signature on the report, we found that the supporting compilations are not reviewed by the supervisor to ensure CAR data is accurately supported and complete, and the data has been properly analyzed for reasonableness.

Criteria: Federal Regulation 34 CFR 80.40 regarding a state's performance reporting, provides, in part:

(1) Grantees shall submit annual performance reports . . .

(2) Performance reports will contain, for each grant, brief information on the following:

(i) A comparison of actual accomplishments to the objectives established for the period . . .

Federal Law 20 USC 2323(c) states:

(c) Report

(1) In general

Each eligible agency that receives an allotment under Section 2321 of this title shall annually prepare and submit to the Secretary a report regarding –

(A) The progress of the State in achieving the State adjusted levels of performance on the core indicators of performance; and

Finding 02 – 17: (continued)

(B) Information on the levels of performance achieved by the State with respect to the additional indicators of performance, including the levels of performance for special populations.

20 USC 2323(b)(2) related to VOC ED State Performance Measures, states:

(2) Indicators of performance

(A) Core indicators of performance

Each eligible agency shall identify in the State plan core indicators of performance that include, at a minimum, measures of each of the following:

(i) Student attainment of challenging State established academic, and vocational and technical, skill proficiencies.

(ii) Student attainment of a secondary school diploma or its recognized equivalent, a proficiency credential in conjunction with a secondary school diploma, or a postsecondary degree or credential.

(iii) Placement in, retention in, and completion of, postsecondary education or advanced training, placement in military service, or placement or retention in employment.

(iv) Student participation in and completion of vocational and technical education programs that lead to nontraditional training and employment.

(B) Additional indicators of performance

An eligible agency, with input from eligible recipients, may identify in the State plan additional indicators of performance for vocational and technical education activities authorized under the subchapter.

In order for PDE to ensure that the CAR is accurate and in accordance with program requirements, strong internal controls should be developed, functioning, and documented for each year's CAR submitted to USDE.

Cause: PDE officials believed at the time of submission of the CAR that the data was accurate and complete and that their compilation and reporting procedures were appropriate.

Effect: As a result of internal control weaknesses and the lack of documentation noted above for three of the four subindicators tested, we were unable to verify the reasonableness, accuracy, or completeness of CAR data reporting VOC ED program results to USDE. The CAR may contain erroneous data that is not being detected and corrected by PDE.

Recommendation: We recommend that PDE review and improve its internal control procedures over the CAR and establish a system to ensure that all CAR data is accurate, complete, adequately supported, and is analyzed and properly reviewed prior to submission. PDE should also ensure that the performance of these control procedures is adequately documented.

Agency Response: The Bureau of Career and Technical Education (BCTE) agrees that part of the recommendation made regarding this finding should be implemented. BCTE will develop an additional internal control mechanism regarding 1S2 skill attainment. However, controls regarding 1S1 academic attainment cannot be implemented by BCTE as they and their contractor are the direct jurisdiction of the Bureau of Curriculum and Academic Services (BCAS). There is also an indication that though the final CAR contains a supervisory signature, it is not reviewed for reasonableness. This is not true. In preparing the document for signature, staff in three Bureaus along with staff

Finding 02 – 17: (continued)

representing two Divisions within Career and Technical Education are engaged in receiving, compiling, analyzing and synthesizing the data. The process entails checking for reasonableness throughout which includes the Director and his staff. However, it is true that no documents exist verifying that reasonableness was established other than the supervisor's signature.

Auditors' Conclusion: Although PDE asserts that various data review procedures are in place for the different subindicators in the CAR, the performance of these various procedures and related conclusions on the data are not adequately documented and cannot be verified in our audit. Therefore, 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 02 – 18:

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 #01-10)

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 added after August 2000 were not debarred or suspended by the federal government. During the current audit, OVR indicated that they added a field called "Debar Review" to the "Supplier Master Display" screen in their computerized vendor system to document the date when new vendors were checked for debarment/suspension. In addition, any time a change is made to a vendor file, a field called "Add/Change Date" is automatically updated.

We selected a sample of 10 vendors to verify whether OVR was documenting its review of the Federal List and noted that for 5 of these 10 vendors, the respective vendor file indicated an "Add/Change Date" after August 2000. However, for all five vendors, there was no indication in the "Debar Review" field that the vendor was reviewed for debarment or suspension.

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.

Finding 02 – 18: (continued)

With respect to the five vendors in question, OVR represented that these were not new vendors and, therefore, they were not checked for debarment/suspension. OVR further noted that any time a change is made to the vendor file (i.e., address, phone number, contact person, etc.) the "Add/Change Date" field is automatically updated. However, there was no other field on OVR's system indicating when the vendor was entered into the system and OVR could not provide any additional documentation to support that these vendors existed prior to August 2000. Therefore, OVR could not support their representation that these were not new vendors and should not have been reviewed for debarment or suspension.

Effect: Since L&I personnel did not adequately document their verification that new service providers were not on the List of Parties Excluded from Federal Procurement and Nonprocurement Programs, a control weakness exists and 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 maintain adequate documentation to support when service providers were added to OVR's computerized vendor file and/or documentation to support that new service providers were checked for debarment or suspension prior to allowing these providers to participate in the RSBS program.

Agency Response: In order to correct this situation, OVR plans to add another date field to the vendor file prior to June 30, 2003. This date will be added to each vendor file at the time they are initially added to the system and will remain unchanged as long as the vendor file is present in OVR's computerized vendor system.

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 02 – 19:

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

$3,890,912 in Excess Funds Were Drawn Down From USDE in Violation of Federal Cash Management Regulations

Condition: Our testing disclosed that on October 5, 2001, the LECS Comptroller's Office received $4,573,942 of RSBS funds under Federal Grant #H126A010056. However, upon further investigation, we determined that only $683,030 should have been drawn down under this Federal grant resulting in an excess federal drawdown of $3,890,912. In addition, this overdraw was not detected by LECS personnel and was not adjusted until we inquired about the excess federal revenue as part of our current audit. We noted that LECS personnel posted an adjustment and returned the excess cash to USDE on July 31, 2002. Therefore, the Commonwealth maintained $3,890,912 in excess federal cash for almost 10 months. Furthermore, LECS supervisory personnel reviewed and approved the documents supporting the initial drawdown, but did not detect the error, indicating a weakness in internal controls.

Criteria: 34 CFR 80.20 provides the following standard for financial management:

(3) Internal control. Effective control and accountability must be maintained for all grant and subgrant cash. . . .

In addition, US Treasury Regulations in 31 CFR 205.7 provide the following regarding requesting and transferring funds:

(d) Limiting the amount transferred. Consistent with a funding technique and with funds transfer procedures in a Treasury–State Agreement, a State and a Federal agency shall limit the amount of funds transferred to a State to the minimum required to meet a State's actual, immediate cash needs.

Cause: An Access database was developed by OB–BMIS and is used for RSBS draw processing. Each day prior to the actual drawdown (i.e., the projected draw date), LECS personnel perform an Access query using a manually input projected draw date. This query is then used to prepare the Transmittal of Revenue and the support for the drawdown the next day. However, when LECS personnel input the projected draw date for this drawdown, they inadvertently input the date as October 11, 2001 instead of the correct projected date of October 4, 2001. Because of the CMIA-mandated draw delay for RSBS, the expenditures supporting the October 5th drawdown were only supposed to include postings to the accounting system up through September 21st. However, because of the additional week included in the October 11th misposting of the projected draw date, the system automatically included an additional week of expenditure postings beyond September 21st in the October 5th drawdown (amounting to $3,890,912). These same $3,890,912 in expenditures were subsequently drawn down again in routine draw requests in accordance with established procedures. With respect to the weakness in internal controls, LECS personnel could not provide a reason as to why their system controls did not prevent the error or why their review and approval process did not detect the error, either at the time of the draw or during the 10-month period subsequent to the draw.

Effect: Due to the error and weakness noted above, L&I violated federal cash management regulations and owes an interest liability to the federal government in accordance with CMIA Treasury-State Agreement. Furthermore, inadequate internal controls over drawdown processing and excess cash could lead to inaccuracies in future draws and not be detected in a timely manner.

Recommendation: LECS should ensure that the appropriate amount of interest payable for the excess cash identified above is reported and remitted to the US Treasury in accordance with CMIA. In addition, LECS should strengthen its internal controls over both the RSBS drawdown process and excess cash recorded on the accounting system to prevent similar undetected errors in the future.

LECS personnel should also perform an overall review of its RSBS drawdowns during our audit period and thereafter to ensure any additional interest owed to the federal government as a result of the above weakness is properly reported and remitted in accordance with CMIA.

Finding 02 – 19: (continued)

Agency Response: The appropriate interest was calculated and reported to the Office of the Budget, Bureau of Financial Management on November 15, 2002. In addition, staff will be double-checking each draw against other documents to insure that a similar situation does not occur again.

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 02 – 20:

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

Noncompliance and Weaknesses in Internal Controls Over Charging of Personnel Costs Result in Questioned Costs of $11,969 (A Similar Condition Was Noted in Prior Year Finding #01-11)

Condition: During the state fiscal year ended June 30, 2002, OVR incurred personnel expenditures of $27,865,000 in salaries and $8,550,000 in fringe benefits, or $36,415,000 in total (federal portion) for the RSBS program. Approximately 98 percent of the 870 employees charging personnel costs to RSBS work only on Vocational Rehabilitation-related activities, and their salaries and benefits are charged 100 percent to RSBS. Based on our sampling and review of job descriptions supporting these costs charged 100 percent, we found the documented grant activities of OVR personnel to be allowable under RSBS. However, although OVR's activities were judged allowable, we noted that OVR was not maintaining properly updated documentation required by OMB Circular A-87 for personnel costs. Specifically, OVR was not obtaining signed semi-annual updates to its job descriptions (or any other semi-annual certification documents) on file to certify that the respective employees worked solely on the RSBS program during the audit period.

In addition, during our prior year audit, we noted a weakness in internal controls related to personnel costs charged less than 100 percent to RSBS for employees doing RSBS-related work, but not actually employed within OVR. OVR could not provide adequate documentation to support the allowability of the salary and fringe benefits of one employee charged to the RSBS program that was employed by the L&I press office. Our follow-up for the current year audit disclosed that salary and benefits totaling $11,969 (including an annual leave payout of $1,628) for this individual were charged to the RSBS program until his resignation on September 28, 2001. In addition, OVR did not implement any corrective action to ensure that personnel costs charged to RSBS for employees doing RSBS-related work, but not actually employed within OVR, were allowable and properly documented.

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 for 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 . . .

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, in Section ___.510 states in part:

(a) <u>Audit findings reported</u>. The auditor shall report the following as audit findings in a schedule of findings and questioned costs:

(3) Known questioned costs which are greater than $10,000 for a type of compliance requirement for a major program. Known questioned costs are those specifically identified by the auditor. . . .

Finding 02 – 20: (continued)

Cause: OVR indicated that they maintain job descriptions, updated once every four years, detailing the respective employees' job duties for the employees charging 100% of their personnel costs to the RSBS program. OVR personnel indicated that they felt these procedures were sufficient and they were not aware of the OMB A-87 requirement to obtain updated certifications on a semi-annual basis.

Regarding the personnel costs charged to RSBS for employees doing RSBS-related work, but not actually employed within OVR, OVR personnel indicated that they had not implemented any corrective action during the current audit period since they were still investigating the best way to monitor these charges.

Effect: Since adequate documentation was not available as required by federal regulations for the individual employed by the press office, $11,969 in salary and fringe benefits is questioned. In addition, because OVR's signed job descriptions or other certification documents are not timely updated on a semi-annual basis as required by OMB A-87 for 100 percent-charged employees, there may be unallowable activities being charged to RSBS which are not being timely detected and corrected by OVR management.

Recommendation: L&I should pursue appropriate settlement with USDE for the $11,969 in questioned costs identified above. In addition, OVR management should strengthen internal controls to ensure that all personnel costs charged to RSBS for employees doing RSBS-related work (including employees working within L&I's Hiram G. Andrews Center) are allowable and properly supported in accordance with OMB Circular A-87.

Agency Response: The questioned costs of $11,969 for the former L & I Press Office employee are a continuation of finding 01–11 for the period ending June 30, 2001. We are in the process of negotiating a resolution of this prior year finding with our Federal partners in the Federal Department of Education. We will attempt to have the $11,969 added to the $33,276 in questioned costs from the prior year finding. If our Federal partner agrees with this approach, we should be able to resolve all questioned costs regarding this matter at one time. Also, since this employee separated from his employment with the Press Office on September 28, 2001, there will be no further continuations on this finding.

Also as relates to this portion of the finding, we looked at responsibility for what occurred and have concluded that OVR needs to be more cognizant regarding circumstances where time sheets need to be kept. However, this particular circumstance, the primary responsibility for seeing that time sheets were kept for this employee belonged to the L & I Press Office, his actual employer. In order to assure that OVR does not get caught up in a similar situation in the future, we plan to issue a memorandum to all supervisory staff regarding circumstances under which time sheets should be kept. We also plan to look at all employees for whom we are paying all or a portion of their salary and benefits to determine that proper documentation, e.g., time sheets, is being kept to justify such payments.

The remaining portion of this finding relates to the OMB Circular A-87 requirement for semi-annual certification for employees working solely on a single program, a condition that applies to most OVR employees. As indicated by the auditor present, OVR staff was not aware of this requirement. We have begun exploration to determine if any options exist other than having to complete a certification form on all such employees twice a year. We have found an implementation guide for A-87 (ASMB C-10) which indicates that this certification requirement can be met through certain payroll codings and time and attendance certifications. We are attempting to determine if our payroll and time and attendance records are sufficient to meet this certification requirement. We hope to have this determination made within the next 3 or 4 weeks; and at that time, we will decide how we need to proceed on this matter.

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 02 – 21:

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

Internal Control Weakness Over Preparation and Submission of Vocational Rehabilitation Provider Claim Forms to SSA

Condition: As part of rehabilitating Social Security beneficiaries, OVR is permitted to request reimbursement from SSA for the costs incurred while serving eligible vocational rehabilitation clients. To request reimbursement, OVR prepares and submits a Vocational Rehabilitation (VR) Provider Claim form to SSA for each eligible client. During the state fiscal year ended June 30, 2002, OVR received approximately $5.8 million in reimbursements from SSA based on the claims submitted. However, while our testing did not disclose any errors with the claims we tested, we noted an internal control weakness since the same individual is responsible for preparing, approving, and submitting the claim forms to SSA. There are no procedures in place for a separate OVR supervisory review and approval of the SSA-VR Provider Claim forms.

Criteria: 34 CFR 80.20 provides the following standard 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.*

In addition, adequate internal controls over the preparation of SSA claims should include a segregation of duties between the preparation and the review and approval of the claims.

Cause: OVR personnel stated that no supervisory review of the claims is performed due to the volume of the claims processed. OVR felt it would be too time consuming for someone to review all of the claims before they are submitted to SSA. In addition, OVR personnel indicated that SSA randomly selects and performs audits on SSA-VR Reimbursement Program cases to ensure that the claims are accurate. However, federal oversight does not compensate for inadequate internal controls at the Commonwealth level.

Effect: If the internal control weakness identified above is not corrected, SSA-VR Provider Claims could be submitted in error and not be timely detected or corrected by management.

Recommendation: OVR management, at its own discretion, should implement a procedure for a separate supervisory review and approval of the SSA-VR Provider Claims to ensure that claims are appropriate and accurate.

Agency Response: OVR has reviewed this finding and plans are to separate the process of preparing the SSA claims from approving and submitting them. OVR's plans are to reassign the preparation work and to have the person presently assigned to this entire task do only the approving and submission of the claims. The time frame for accomplishing these changes is between April 15 and June 15, 2003.

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 02 – 22:

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 #01-12)

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 a prior 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 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. In addition, RSBS funds were being used by participating businesses to purchase job creation equipment for persons who were not properly determined by OVR to be eligible to participate in the program. Because of weaknesses in OVR's monitoring of RSBS subgrantees, these problems were not being detected and corrected by OVR management.

Our follow-up for the current year ended June 30, 2002, disclosed that while OVR had implemented some corrective action steps to address monitoring weaknesses, OVR had not fully implemented their corrective action. In response to the prior year finding, OVR stated that on-site grant monitoring was going to be conducted on a six-month basis. However, OVR indicated that they had not implemented any additional on-site monitoring during our audit period with respect to job creation subgrantees.

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.

Cause: OVR personnel indicated that they did implement some corrective action in the current year such as standardizing job creation grant agreements and notifying subgrantees of lien restrictions. However, other corrective action as indicated above was not implemented due to limits on the availability of trained staff to perform on-site reviews of job creation subgrantees.

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 strengthen it's oversight procedures to ensure that all RSBS-funded equipment is being timely and fully utilized by OVR clients and to ensure that all individuals receiving assistance under job creation grants are appropriately determined to be eligible.

Finding 02 – 22: (continued)

Agency Response: All grantees were notified of the requirement for mandatory lien registration at the time of their grant's renewal with OVR. Grant renewal occurred at varying times throughout the year following the referenced audit. Retroactive filing of liens was required in order to cover the period between cessation of the requirement and its reinstatement. All new grantee contracts contain the referenced requirement, as follows:

> *"The Grantee shall file the Form UCC-1, Uniform Commercial Code Financing Statement with the PA Department of State in order to register OVR's interest in grant-purchased equipment. The Debtor, as identified in the UCC-1 filing, shall pay all filing fees required by the Commonwealth of PA and the Grantee shall furnish OVR with proof that OVR's security interest has been registered in an effective and timely manner…"*

OVR's Job Creation grant contract has been standardized to reduce inconsistencies of practice and application. Changes included standardized data collection/reporting requirements and procedures, equipment management procedures, job finding and placement requirements and re-filling vacated jobs.

Additional personnel were hired in February 2002 and have been introduced to the range of responsibilities associated with their positions as rehabilitation specialists in the OVR Contracts and Grants Management Section. It is OVR's hope that, with the past year's training and experience, OVR will be able to increase the frequency of grantee monitoring.

OVR has instated an equipment reclamation policy. In accordance with that, circumstances under which equipment would be reclaimed include default on the terms of the grant contract and failure to fill vacated job creation positions in a timely manner.

Auditors' Conclusion: Based on the agency response, the finding and recommendation 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 02 – 23:

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 #01-13)

Condition: Our review of active TANF cases in our prior audit (SFYE June 30, 2001) 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. Therefore, DPW could not support compliance with federal welfare reform regulations. Our follow-up of the prior year finding disclosed that the same condition existed during our current audit period (SFYE June 30, 2002).

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 stated that the Department's assessments consist of the RESET Participant Guide to Success (Guide - PA 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. RESET procedures located in the OIM's Cash Assistance Handbook in Section 135, Appendix C, did not require retention of the RESET Guide (PA 1680) in the case file. 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. However, guidance in effect prior to OPS020202, which covered eight months of our current audit period, did not require the retention of the RESET Guide (PA 1680).

Effect: Since DPW did not maintain a copy of the completed RESET Guide (PA 1680) in the client case files we tested, it cannot support compliance with federal regulation 45 CFR 261.11. Further, since the documented assessments were 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 (PA 1680) and retained in each case file as required.

Agency Response: The DPW, Office of Income Maintenance, issued an Operations Memorandum (OPS-02-02-02) on February 13, 2002, to remind caseworkers of the requirements to file and retain the Participant Guide to Success, PA 1680, as part of the client's case record for a period of three (3) years. The PA 1680 is a component of an individual's initial assessment to determine work history, job skills, and ability to work. In addition, an individual participating in a contractor-operated employment and training program is offered a variety of assessments to determine skill, math and reading levels, and employment preferences. In the Memorandum, the caseworker was reminded that the PA 1680, provided to the recipient at the time of the initial Agreement of Mutual Responsibility (AMR), must be completed by the recipient and reviewed by the CAO.

Finding 02 – 23: (continued)

The Memorandum explained that the completed PA 1680 is used at the end of the initial job search, along with the results of the initial job search, as an assessment to assist the cash assistance recipient and the caseworker in planning the next activity and that if the recipient has not found employment by the end of the initial job search, a face-to-face interview must be conducted to review the results of the initial job search and to review the completed PA 1680 before updating the AMR reflected the individual's next activity. The requirement of retaining the completed PA 1680 in the recipient's case record/file was emphasized throughout the Memorandum.

Auditors' Conclusion: Based on the agency response, our current year 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 02 – 24:

CFDA #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 #01 - 14)

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 September 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 September 2001 CIS file reported 12,785 adults as married, living together. Under person-level data-relationship to head of household status (item #38), CIS reported only 4,444 spouses. CIS also reported only 2,672 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 28 cases from the September 2001 CIS data file, performed analytical review procedures, and attempted to trace certain data, as required by the Federal A–133 Compliance Supplement, to documentation in the participant's case file. This testing disclosed the following:

- For 11 of the 28 cases selected, or 39 percent, DPW's Philadelphia CAOs failed to respond to our request to provide TANF case files supporting ACF–199 data during our test period. These case numbers are as follows: 510732031, 510742925, 511336616, 511428356, 511594443, 512217058, 512237254, 512441025, 512455737, 512539775, 512571932. In addition, the file provided for an additional TANF participant from another CAO (Case Number 400240374) did not support the ACF–199 data for this participant since the file was dated December 10, 2002, which is subsequent to our test period.

- Out of the 28 cases reviewed on the data report, 20 cases had no work activity for the period and 8 cases included work activity. However, for 3 of the 8 cases with work activity, or 37.5 percent, the number of unsubsidized weekly employment hours (item #49) reported 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
020814115	37	31	6
370088138	33	*	*
590039260	1	*	*

* The hours worked could not be determined since the check stubs supporting the number of hours the participant worked were not included within the case file.

Finding 02 – 24: (continued)

- One of 28 cases sampled, or 3.6 percent, included job search and job readiness (item #54) activity on the ACF-199 Report; however, case file documentation provided did not support any hours for job search activities. The case was as follows:

Case Number	Number of Hours Reported on the ACF-199 Report
060225598	18

- For 2 of the 28 case files reviewed, or 7.1 percent, the subsidized childcare amounts (item #17) reported on the ACF-199 Report did not agree to the case file. For one of the two cases, the ACF-199 Report indicated that the participant received subsidized day care; however, the supporting CIS file indicated that no subsidized day care was received.

- For 2 of the 28 cases reviewed, or 7.1 percent, the cases were listed as Disposition 2 – Not subject to data collection/listed in error.

  However, documentation received along with the completed TANF application for case #260070607 disclosed that the participant was sanctioned for not complying with Domestic Relations Office requirements, and that she was only receiving assistance for her two children. As a result, the required data and/or activities should have been included on the Report for the adult and children.

  No documentation was received for case #512441025, therefore, we could not determine whether this case was properly not subject to data collection or listed in error.

- For 1 of the 28 case files, or 3.6 percent, the number hours of education (item #58) reported by the ACF-199 Report did not agree to the case file. The case was as follows:

Case Number	Number of Hours Reported on the ACF-199 Report	Number Hours Per Case File	Difference
250262467	10	8	2

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.

<u>**Criteria**</u>**:** 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:

Finding 02 – 24: (continued)

(I) Education.
(II) Subsidized private sector employment.
(III) Unsubsidized employment.
(IV) Public sector employment, work experience, or community service.
(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.

Also, 45 CFR, Part 265.2(b) states:

(b) For data collection and reporting purposes only, family means:

(1) All individuals receiving assistance as part of a family under the State's TANF or separate State program (including noncustodial parents, where required under § 265.3(f)); and

(2) The following additional persons living in the household, if not included under paragraph (b)(1) of this section:

(i) Parent(s) or caretaker relative(s) of any minor child receiving assistance;

(ii) Minor siblings of any child receiving assistance.

Finding 02 – 24: (continued)

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 or the variances in work activity hours. 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.

For the 11 cases that Philadelphia CAOs did not provide TANF files to support ACF–199 data, Philadelphia CAOs had record retrieval problems.

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 September 2001 payments in the case files should actually be reported in the October 2001 ACF-199 Report, and August 2001 payments should appear in the September report. While we did see that retroactive payments from August 2001 were included on the September 2001 ACF-199 Report this was not true for the two cases noted in the condition above. Therefore, 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 2001 may be materially incorrect.

Recommendation: DPW should evaluate the feasibility of submitting revised ACF-199 reports for the FFY 2001. 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 conditions 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

A review of individuals reported as married and living together with their spouse did show that 8,962 individuals were members of a household containing a second individual who was also coded as married and living together with their spouse in a total of 4,481 households.

Finding 02 – 24: (continued)

On the remaining cases, the largest group consisted of 1,999 caretaker relatives, with the most common example being a grandparent exercising care and control over a grandchild. The published guidance for Item #37, Marital Status, states we are to enter the "*one-digit code for the adult's (or minor child head-of-household's) marital status for the reporting month.*" In the case of a grandparent head-of-household caring for a grandchild, if the head-of-household resides with their spouse, regardless of that spouse's membership in the TANF case, it would seem the head-of-household's true marital status should be reported based on the guidance provided. The end result of this is that some cases in which a single adult is identified as married and living with their spouse will not include the expected spouse.

In the remaining cases, the OIM did find an issue with the marital status of individuals not always being updated immediately by the caseworker when a spouse leaves or returns to the household. Reviewing the remaining 1,821 individuals showed that a spouse had left or returned to the household prior to the reporting month. When the spouse was deleted from or added to the case record in the Client Information System (CIS), the marital status of the individual(s) was not updated to reflect the change in a timely manner. As a result, when the 12,785 individuals were identified based on the marital status code of "2" for married and residing with their spouse, the resulting file included individuals in families where the spouse had left the household, while excluding from the resulting file spouses who were actually in the household but were coded as not residing with a spouse. The DPW had previously made changes to the CIS to address this problem; however, based on this audit, the OIM has identified an additional modification that must be made to ensure marital statuses are updated as changes occur in the family composition.

An issue was also found with how the OIM process used to extract information from CIS for the ACF-199 assigns the relationship code, Item 38, for the second parent in those families where both spouses are receiving Supplemental Security Income. In such cases, the OIM found the second spouse was not always being coded as a spouse to the head-of-household, but was instead being identified as a parent to the TANF child(ren). The OIM is currently reviewing this process to resolve this issue.

<u>Employment Hours Reported Could Not Be Supported By Case File</u>

As stated in the response to previous audits, the OIM believes it is in compliance with the federal requirement not to maintain pay stubs in the client case file. The electronic records contained within the CIS, which includes information on wages, salaries, commissions, and income in-kind, are an integral part of the case record. In addition, critical information such as listed above requires the caseworker to identify the means by which said information was verified. For these reasons, the OIM feels a complete case review is only possible when the entire record, as contained in the paper case file and the electronic record, is reviewed. Relying on the paper case record can result in an incomplete assessment of the case.

<u>Employment and Training Activity House Could Not Be Supported By Case Number</u>

As stated earlier, the case file documentation, which includes the CIS, documents the correct number of hours. The hours are entered through the Automated Interface Management System (AIMS) by the employment and training contractor, which becomes the official record. Documentation is not kept in the county assistance offices. In the case of the record cited in the audit, the hours per week recorded in the CIS are the same as those reported on the ACF-199.

<u>Child Care Data Did Not Agree With Information In The Case File</u>

The OIM concurs that subsidized childcare payment information for 51/2455737 for the month of September 2001 was not accurately presented in the ACF-199 report. This problem has been previously identified and changes have already been made to prevent such omissions. Corrected ACF-199 files have been prepared and submitted back to October 2001.

Finding 02 – 24: (continued)

Cases Reported with a Disposition of "Listed in Error"

Reviewing the record that the auditors believed should not have been disposed of as "listed in error" confirmed that there was indeed a sanctioned individual in the household. Had this been an active case during the reporting month, it would have been assigned a disposition code indicating data completion was required. This is why complete information for the case was provided for both July and August 2001. However, as the case record shows, the caseworker had taken action to code the case on August 21, 2001, and based on the guidance for Item #9, Disposition, which states "*a family that did not receive any assistance for the reporting month but was listed on the monthly sample frame for the reporting month is 'listed in error',*" the OIM feels the case was correctly excluded from the sample for September 2001.

Hours of Education Reported Did Not Agree with Case Record

A review of the case file shows that for the review month of September 2001, the recipient was participating an average of 10 hours per week based on information entered through the AIMS. This value is the same as was reported for the individual in Item #58 of the ACF-199.

Auditors' Conclusion: Regarding DPW's statement that the number of hours reported for unsubsidized weekly employment (item #49), job search/readiness (item #54), and education (item #58) 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. Further, in the current and prior Single Audits, we found errors in hours entered on CIS and AIMS when compared to hours worked as documented on pay stubs, with inadequate DPW monitoring to ensure these systems contain accurate and properly supported data. To resolve these weaknesses, DPW needs to pursue appropriate settlement with HHS.

Regarding the disposition of the case "Listed in Error," the case file documentation we reviewed disclosed assistance was paid in September of 2001 for the two children in the household; and the case data should have been reported. 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, therefore, 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 02 – 25:

CFDA #93.563 – Child Support Enforcement

Noncompliance and Internal Control Weakness Over the Processing of Interstate Registry Cases (A Similar Condition Was Noted in Prior Year Finding #01-15)

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 interstate IV-D cases within established timeframes. Our test of 10 responding interstate cases during our test month of September 2001 disclosed that DPW did not meet the 10-day established timeframe for processing the case for one of the items tested as follows:

Case ID	Date Case Received	Date Case Processed	Working Days Between Receipt And Processing
420103857	9/04/01	9/20/01	12

In addition, our test of 10 initiating interstate cases during our test month of September 2001 disclosed that DPW did not meet the 20-day established timeframe for processing the case for 3 of the 10 cases tested as follows:

Case ID	Date Case Initiated	Date Case Processed	# of Days Between Receipt And Processing
245103816	9/11/01	3/22/02	192
816103850	9/23/01	3/06/02	164
577104505	9/24/02	5/13/02	231

Criteria: 45 CFR, Part 303.7(a) and (b), state in part:

(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.

(b) *Initiating State IV-D agency responsibilities.* The IV-D agency must:

(1) If the State has a long-arm statute which allows paternity establishment, use the authority to establish paternity whenever appropriate.

Finding 02 – 25: (continued)

(2) Except as provided in paragraph (b)(1) of this section, within 20 calendar days of determining that the noncustodial parent is in another State, and, if appropriate, receipt of any necessary information needed to process the case, refer any interstate IV-D case to the responding State's interstate central registry for action, including requests for location, document verification, administrative reviews in Federal income tax refund offset cases, wage withholding, and State income tax refund offset in IV-D cases.

Cause: In responding to our prior year finding on this issue, DPW indicated there were timing problems due to employee turnover, but that the problem was corrected in June of 2001. DPW officials did not explain what caused the delay in processing the initiating and responding interstate cases noted above in our current year audit.

Effect: Since DPW did not process the responding and initiating interstate cases within the required timeframes, DPW was not in compliance with federal regulations. In addition, DPW cannot enforce support obligations on behalf of requesting states on a timely basis, or ensure that support obligations are forwarded to other states on a timely basis.

Recommendation: DPW should strengthen its existing controls to ensure that all responding and initiating interstate registry cases are processed within the established timeframes.

Agency Response: The DPW, Office of Income Maintenance, Bureau of Child Support Enforcement's (BCSE), review of the cases cited in the audit finding provides as follows:

Responding Interstate Cases

The BSCE's review of the finding indicates that 90 percent of the single audit sample of responding interstate cases met the 10-day established timeframe. The BCSE also notes that 45 CFR 305.63, Standards for determining substantial compliance with IV-D requirements, Section C, specifies that the BCSE must provide interstate services required under 45 CFR 307 in at least 75 percent of the cases reviewed.

Initiating Interstate Cases

Case ID 245103816 – The case was initiated on 9/11/01 and the PACSES screen ISAD documents that the petition for establishment of a child support order was forwarded to the New York Central Registry on the same day. On 10/23/01 and 11/30/01, the DRS worker continued the pending request. New York acknowledged receipt of the petition on 12/13/01, as indicated on NOTE. On 3/22/02, New York informed the Dauphin County DRS that the NCP was unable to be located. The CP will file a new complaint when the NCP is located. The case was closed on 3/22/02.

Case ID 816103850 – The case was an IV-A referral on 9/23/01 and the PACSES screen ISAD indicates that a petition was created on 9/26/01; however, the petition diary entries were closed as satisfied on the same day. The BCSE's review of DRS case records disclosed that the Plaintiff appeared in the DRS on 9/24/01. The case was filed to California on the same date. California had a hearing scheduled for 3/4/02. The DRS also received a letter from the Plaintiff on 2/25/02 saying the child was now in California with his mother, the NCP. The DRS dismissed the case on 3/6/02 and sent California a copy of the dismissal. The DRS acknowledges that the ISRQ should have remained active until the case was closed and then been canceled.

Case ID 577104505, IV-A Referral of 9/24/01 – Review of case records disclosed that the CP did not appear at the DRS until 5/13/02. The BCSE is still researching this case.

The BSCE's review of the finding indicates that 90 percent of the single audit sample of initiating interstate cases met the 20-day established timeframe. The BCSE also notes that 45 CFR 305.63, Standards for determining substantial compliance with IV-D requirements, Section C, specifies that the BCSE must provide interstate services required under 45 CFR 307 in at least 75 percent of the cases reviewed.

Finding 02 – 25: (continued)

Auditors' Conclusion: Based on review of DPW's response, DPW indicates that Cases 245103816 and 816103850 were processed and/or closed on the same day. However, DPW did not provide documentation to support this claim.

In addition, DPW's response indicates that they are in substantial compliance since 75 percent of the cases were processed within the established timeframe. However, this position is based on the error rates noted within our sample and not the rate for the entire state fiscal year. Since no documentation was provided to support that 75 percent of the cases were processed timely for the state fiscal year, the finding remains 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 02 – 26:

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 $15 Million in Excess Subgrantee Federal Cash at June 30, 2002 (A Similar Condition Was Noted in Prior Year Finding #01 -16)

Condition: Our examination of DPW's procedures for monitoring SSBG and CCDBG/CCDF (Child Care Cluster) 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 93 percent and 76 percent of total CCDBG/CCDF Cluster and SSBG program expenditures, respectively. However, DPW did not adequately monitor these subgrantees for excess cash during the fiscal year ended June 30, 2002.

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 the CCDBG/CCDF Cluster, between July 1 and September 11, 2002, subgrantees returned $15.6 million in year-end excess cash to DPW from advance payments made monthly but not monitored by DPW during SFYE June 30, 2002. Further, our review of DPW's worksheet to support refunds from subgrantees disclosed that 5 of 60 refunds were received after August 31, 2002. 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 02 – 26: (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. In addition, DPW personnel indicated that they withheld approximately $2 million in CCDBG/CCDF Cluster and SSBG funding to child care subgrantees during May and June 2002 in order to reduce cash balances. However, given the fact that refunds for the year were in excess of $15 million, DPW did not adequately implement subgrantee cash management monitoring procedures during SFYE June 30, 2002.

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 $15.6 million in excess funds to DPW at year-end. As a result, DPW provides little assurance of subrecipient compliance with cash management standards. Also, the large amount of refunds ($15.6 million), which is approximately eight 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 three 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.

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

Finding 02 – 26: (continued)

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 24, 2003, 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 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 fiscal year (FY) 2003-04.

Issue 2 – Child Care Program Refunds

The childcare contracts are indeed monitored. The OCYF's improved monitoring procedures have resulted in a reduction of $16.9 million (or 52 percent) of refunded amounts from childcare subgrantees from the prior year. Refunds were reduced from $32.5 million in the prior year to $15.6 million in the audited year.

During the audit period, funds were often transferred between contractors to optimize coverage of the program. During FY 2002-03, 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 $15.6 million in refunds does pertain to the childcare program, only $8.7 million is subsidized childcare for low-income families. The other $7.9 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.

In the first five months of FY 2001-02, Pennsylvania did not have a low-income waiting list. Pennsylvania began to develop a waiting list around November 2001. The DPW did not withhold payments to the subgrantees in Fund A to ensure that the maximum number of low-income children could receive services in the latter part of the fiscal year. Most of the funds returned to the DPW were amounts that could not be annualized by the subgrantees, or were funds dedicated to the families on the waiting list who did not respond within the given time frame. For the current fiscal year, the DPW is 99 percent committed in Fund A. The DPW continues to move funds among the subgrantees to meet demand and assure that there are less unspent funds.

Finding 02 – 26: (continued)

Allocations for Fund C are based on the number of former TANF children who are expected to need service during the fiscal year. The DPW deliberately allocates its funds to assure that no former TANF child has to wait for service or return to TANF. Therefore, the DPW must allocate and advance additional funds to protect former TANF families from losing childcare and returning to TANF. The former TANF childcare demand varies greatly, but has steadily increased over the past year. Due to this increase, and anticipating more of the same, the DPW was hesitant to withhold additional funds from the subgrantees in FY 2001-02. In fact, the DPW added $1.5 million to the Fund C statewide allocation in FY 2002-03 to meet the expected increase in demand.

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, 2002, and the DPW did not withhold payments to those tardy subgrantees. However, the OCYF's enhanced enforcement procedures resulted in an improvement by 20 (or 80 percent) in the timeliness of the refund and expenditure reports from childcare subgrantees when compared to the prior year. The number of tardy reports was reduced from 25 of 60 in the prior year to five of 60 in the audited year.

The DPW maintains that withholding payments to some subgrantees could impair the ability to provide for the delivery of childcare services. The DPW has reviewed and revised the existing contract language, and intends to enforce the section in subgrantee contract Rider 1 that reads: "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.

Lastly, this issue originated as a single audit finding for the FY ending June 30, 1994, with similar conditions being cited in all subsequent fiscal year *Single Audit Reports*, up to the last released single audit for the period ending June 30, 2001. The issue will once again appear in the current single audit period. Each of the aforementioned audit findings has been distributed to the DHHS/PMB for final determination, as is established policy. After eight consecutive years of issuance of this single audit finding, final determination has not been forthcoming. Further issuance of this particular finding appears pointless.

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 prior audit period, and over $310,000 in refunds in the current audit period. This, at a minimum, 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 during the year 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 76 percent of SSBG funds.

Regarding the DPW response related to the return of over $15 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. While DPW significantly reduced year-end refunds for SFYE 6/30/02 during the current year, refunds remain excessive since they were $15.6 million or 7.8 percent of program expenditures. Based on the most recent data, therefore, the weakness in DPW's procedures is material and still needs to be addressed.

Finding 02 – 26: (continued)

Finally, as stated above, although HHS has not yet issued final determination on the prior year findings, HHS-OIG supports our position in this finding. 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 02 – 27:

CFDA #93.575 – Child Care and Development Block Grant

Internal Control Weaknesses and Noncompliance With Federal Earmarking Requirements Result in Questioned Costs of $1,624,404 (A Similar Condition Was Noted in Prior Year Finding #01-17)

Condition: Federal regulations applicable to the Discretionary Fund portion of the CCDF program established an earmark within the FFY 2000 federal award requiring a minimum funding level of $1,624,404 to increase the supply of quality child care for infants and toddlers. Our test of expenditures charged to the FFY 2000 grant which closed out during our audit period on September 30, 2001, disclosed that DPW could not provide documentation to support the amount of expenditures claimed for the infant and toddler earmark. DPW claimed $2,104,931 for infant and toddler quality activities for FFY 2000 on document number CV00064831 dated August 23, 2001 consisting of funds paid to four subrecipients. Total payments to these four subrecipients for the FFY 2000 CCDF grant were actually over $10 million, but DPW retained no documentation to support the infant and toddler portion of this payment total. Since DPW could provide no documentation to support whether any of these subrecipient payments qualified for inclusion in the infant and toddler earmark, DPW cannot support that the $1,624,404 minimum earmark was met for the FFY 2000 grant.

Criteria: The terms and conditions issued with the FFY 2000 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-00-01 regarding the FFY 2000 Final Allotments and Earmarked Funds established Pennsylvania's infant and toddler earmark as $1,624,404.

Cause: Compliance with the infant and toddler earmark was not properly documented, tracked, and monitored by DPW. According to personnel, the earmark was taken into consideration during the budgetary phase of the four subrecipient contracts mentioned above, but actual costs were apparently never tracked by DPW to measure compliance.

Effect: DPW did not retain documentation to support its compliance with federal earmarking regulations. Since the necessary documentation to support compliance with the earmark is not available, DPW cannot demonstrate that any FFY 2000 CCDF funds were spent on federally-mandated infant and toddler child care vs. other CCDF activities. Since costs spent on other CCDF activities are not allowable because of the earmarking requirement, the entire amount of the $1,624,404 earmark is questioned.

Recommendation: We recommend that DPW pursue appropriate settlement with HHS regarding the $1,624,404 of questioned costs. In addition, DPW should establish procedures to adequately document, track, and ensure that infant and toddler earmarks are met within future CCDF grants.

Agency Response: The DPW provided quality grant funds to four regional Child Care Resource Developers (CCRD). The CCRD provided subgrants for quality improvement projects to subrecipients. The DPW was involved in the CCRD's budgeting and subrecipient grant selection process, and the DPW approved all of the CCRD subcontracts. A portion of the quality grants provided to subrecipients by the CCRD were earmarked specifically for infant and toddler quality activities.

Finding 02 – 27: (continued)

The DPW closely monitored CCRD expenditures. The CCRD expenditures were reported to the DPW monthly. The CCRD's summary qualifying subgrant expenditure amounts were provided to the DPW on a quarterly basis. Final expenditure amounts for specific qualifying subgrants were provided and reviewed by the DPW. Final expenditure reports for specific qualifying subgrants were provided to the DPW when requested. Final expenditure reports for the subgrants that pertained to the infant and toddler earmark, totaling $1,731,065, have been provided to the auditors. The DPW has met Pennsylvania's minimum infant and toddler earmark requirement of $1,624,404 for the FFY 2000 grant.

The CCRD has closely monitored the subrecipient quality grant expenditures. The requirements to perform subrecipient monitoring and submit subrecipient grant reports were obligations of the CCRD spelled out in their contracts with the DPW. The CCRD monitored a subrecipient's monthly expenditure reports compared to budget, monthly administrative cost reports, and monthly reports of programmatic success. The CCRD performed periodic on-site fiscal and programmatic reviews on subrecipients. A sample copy of a CCRD subrecipient monitoring procedures manual has been provided to the auditors.

The DPW is planning a review of its procedures in order to ensure adequate documentation, tracking, and monitoring of future infant and toddler earmarked expenditures.

Auditors' Conclusion: None of the expenditure reports provided by DPW substantiate that any of the correction voucher amount of $2,104,931 claimed was actually expended on infant and toddler projects. Furthermore, no final expenditure reports supporting $1,731,065 in infant and toddler expenditures have been provided to us. Finally, no documentation to support monitoring of subrecipient monthly expenditure reports or on-site fiscal and programmatic reviews was given to us. 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 02 – 28:

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 (A Similar Condition Was Noted in Prior Year Finding #01-18)

Condition: Prior to the expiration of each license term, DPW inspects and reissues licenses for all 67 Foster Care County Children and Youth Agencies to whom DPW subgrants funds to perform Foster Care services. To test the licensing of these agencies, we judgmentally selected a targeted sample of 15 of the 67 County Agencies from DPW's inspection lists based on two separate criteria: either an agency received larger dollars in relation to the total population, or the lists showed that the inspections commenced significantly after the prior license expired. Our review of the DPW OCYF administrative controls over 15 of these Foster Care agencies funded during the year under audit disclosed that for 14 of the 15 (93 percent) agencies, the OCYF license renewal was late as follows:

Children and Youth Agency	License Expiration Date	License Renewal Date	Number of Days Delay
Allegheny County	12/31/01	3/13/02	72
Berks County	2/15/02	4/19/02	63
Cumberland County	12/30/01	3/07/02	67
Lackawanna County	12/15/01	9/16/02	275
Luzerne County	12/22/01	4/08/02	107
Lycoming County	4/01/02	4/19/02	18
Mifflin County	4/01/02	6/13/02	73
Northampton County	6/24/01	4/09/02	289
Philadelphia County	2/15/02	3/14/02	27
Snyder County	11/30/01	1/11/02	42
Susquehanna County	5/15/02	12/03/02	203
Warren County	1/01/02	2/06/02	36
Washington County	7/01/01	7/25/01	24
Wayne County	9/01/01	11/20/01	80

As a result, license renewals for these 14 county agencies were untimely and an internal control weakness exists over DPW monitoring of Foster Care subrecipients.

Criteria: 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. . . .

DPW's 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 licensed 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 and licensed prior to the expiration of the prior license.

Effect: Due to shortage of staffing, internal controls at DPW are weak 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.

Finding 02 – 28: (continued)

Agency Response: The county children and youth agency licenses were overdue for one of the following reasons:

Northeast Region licenses were overdue because there were staff vacancies that have now been filled. There was a backlog of licenses when the vacancies were filled and this backlog has been eliminated. The region is at full compliment, and no overdue licenses are anticipated.

Western Region licenses were overdue because of negotiations between the regional office and the counties regarding regulatory citations or acceptable plans of correction. Inspections commenced prior to the date of expiration of the agency license, but the time needed to agree upon acceptable corrective action plans resulted in a delay in processing the license.

Central Region licenses were overdue because many of the staff in the regional office were involved with the federal child and family services review preparation, which is a six-month process culminating with an on-site review that occurred in August 2002. The demands on staff time were extensive and came at the same time as the annual needs-based plan and budget process, which is also very labor intensive. The federal review is not an annual occurrence, and these backlogs have also been eliminated and are not expected to recur.

Auditors' Conclusion: Based on the agency response, 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 02 – 29:

CFDA #93.767 – State Children's Insurance Program

Noncompliance and Internal Control Weaknesses in Federal Reporting and State Matching Procedures Result in $31,576 in Questioned Costs

Condition: Our testing of the quarterly CMS-21 Reports submitted to HHS by the CS Comptroller's Office during our current audit period disclosed reporting errors in the breakout of total CHIP expenditures into federal and state matching amounts. In particular, we noted that the federal/state split for CHIP reported on the CMS-21 Reports did not agree to the federal/state split recorded on the State's ICS accounting system. As a result of our follow up on these errors, we found that the Commonwealth's CHIP Program did not meet state matching requirements for SFYE June 30, 2002, as follows:

	Total CHIP Expenditures Recorded On ICS	FFP Rate	Federal Share	Required State Match
July 1, 2001 – September 30, 2001	$ 35,499,223	67.53%	$ 23,972,626	$11,526,597
October 1, 2001 – June 30, 2002	112,820,372	68.26%	77,011,186	35,809,186
Total July 1, 2001 – June 30, 2002	$148,319,595		$100,983,812	$47,335,783
Actual CHIP Federal Reimbursement Claimed (July 1, 2001 – June 30, 2002)			$101,015,388	
Amount of Federal CHIP Costs Overclaimed			$ 31,576	

As a result, $31,576 in CHIP costs for the year are not allowable federal charges.

Our audit also disclosed that, because CHIP state matching amounts were not routinely being provided by the Pennsylvania Insurance Department (INS) at the time of payment and drawdown of the federal share from HHS, the federal/state split did not comply with state matching requirements throughout the year. We noted, for example, that in our test quarter ended December 31, 2001, the state match recorded on the state's ICS system was over $440,000 short of FFP requirements. This shortage was not properly reflected on the CMS-21 Report for the quarter, which reported that the state match was met (i.e., federal/state split was in compliance with FFP rates). By June 30, 2002, INS had significantly reduced this state match shortage, but as the above table shows, $31,576 in federal CHIP funds were not properly matched with state funds at year end.

Furthermore, although none of the reporting errors in the CMS-21 Reports were considered material in our current year testwork, we noted an internal control weakness in that the CMS-21 Report is prepared by the same person in the CS Comptroller's Office who also certifies the report as accurate and submits it electronically to HHS, with no supervisory review or oversight to ensure the report is accurate and complete. We also noted the same internal control weakness regarding the absence of supervisory review over the PMS-272 Reports.

Criteria: 42 CFR 457.606 Conditions for State allotments and Federal payments for a fiscal year.

(b) Federal payments for States' Children's Health Insurance Program (SCHIP) expenditures under an approved State child health plan are –

(2) Available based on a percentage of State SCHIP expenditures, at a rate equal to the enhanced Federal medical assistance percentage (FMAP) for each fiscal year, calculated in accordance with Sec. 457.622.

Finding 02 – 29: (continued)

42 CFR 457.622 Rate of FFP for State expenditures.

(a) Basis. Sections 1905(b), 2105(a) and 2105(b) of the Act provides for payments to States from the States' allotments for a fiscal year, as determined under Sec. 457.608, for part of the cost of expenditures for services and administration made under an approved State child health assistance plan. The rate of payment is generally the enhanced Federal medical assistance percentage described below.

The enhanced Federal medical assistance percentage is published in the Federal Register Notices as follows:

Federal Register Vol. 65, No. 36 dated February 23, 2000 states enhanced Federal medical assistance percentage effective October 1, 2000 to September 30, 2001 for Pennsylvania is 67.53%.

Federal Register Vol. 65, No. 223 dated November 17, 2000 states enhanced Federal medical assistance percentage effective October 1, 2001 to September 30, 2002 for Pennsylvania is 68.26%.

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, in Section ___.510 states in part:

(a) Audit findings reported. The auditor shall report the following as audit findings in a schedule of findings and questioned costs:

(3) Known questioned costs which are greater than $10,000 for a type of compliance requirement for a major program. Known questioned costs are those specifically identified by the auditor. . . .

42 CFR 457.630 Grant procedures.

(c) Expenditure reports. (1) The State must submit . . . Form CMS-21 (Quarterly State Children's Health Insurance Program Statement of Expenditures for title XXI), to central office (with a copy to the regional office) not later than 30 days after the end of the quarter.

(2) This report is the State's accounting of actual recorded expenditures. This disposition of Federal funds may not be reported on the basis of estimates.

In addition, strong internal controls should ensure that segregation of duties exist between preparation of reports and certification as to completeness and accuracy of reports.

Cause: In regard to the differences found on the CMS-21 Reports, CS Comptroller Personnel stated that when the CMS-21 reports are prepared, only the total expenditures are entered onto HHS's electronic reporting form, and the federal share is automatically calculated and entered by the HHS system. Reporting errors by the preparer went undetected due to lack of supervisory review of the CMS-21 Reports and tie-in of the federal/state split to the ICS Accounting System.

In regard to the state match requirements, INS personnel stated that due to timing differences between federal and state fiscal years and the three year grant period, state match will not always appear to be met during a specific state fiscal year or federal fiscal year, but will be reconciled and met by the time the grant is actually closed. Some types of expenditures such as personnel costs and credit card purchases are initially posted to state appropriations and the federal share is transferred at a later date. Also, sometimes invoices are not coded properly between Federal and State. When mistakes are found expenditure adjustments are then made.

Effect: Federal CHIP expenditures were overclaimed by $31,576 during SFYE June 30, 2002, and therefore, these costs are questioned. In addition, due to the lack of segregation of duties and supervisory review, the CMS-21 Report submitted to HHS contained incorrect data without the knowledge of INS or CS Comptroller's Office management.

Finding 02 – 29: (continued)

Recommendation: INS should pursue appropriate settlement of questioned costs of $31,576 with HHS. Also, INS and Central Services Comptroller's Office should ensure that state match is being met at time of payments, not just when the grant is closed. We recommend that INS and Central Services Comptroller's Office improve procedures to ensure that CMS-21 and PMS-272 Reports are accurate and in agreement with the federal/state split in accounting records, and that proper segregation of duties exist including supervisory review before submission of the reports.

Agency Response: There are no written criteria in the grant, or federal regulations to specify the timing of cost sharing related to SCHIP. If the Federal Agency requires expenditures to be split federal/state at the time of payment this requirement should be clearly defined.

Also, Commonwealth year-end closing procedures support the transfer of estimated personnel expenditures that are chargeable to federal appropriations. In the subsequent fiscal year these charges are adjusted to actual expenditures. Consequently, after-the fact adjustments of the costs associated with these transactions had to be made to achieve a proper match between federal and state expenditures. These adjustments were made in the subsequent reporting period, but prior to the end of the grant period. Therefore, no settlement of the $31,576 of questioned costs is required. The Central Services Comptroller staff will work with the Pennsylvania Insurance Department to ensure that financial transactions chargeable to the SCHIP are appropriately matched according to Enhanced Federal Medical Assistance Percentages (EFMAP).

To maintain separation of duties and ensure proper oversight, the Central Services Comptroller's Office has implemented supervisory review and approval of all financial reports including those that are electronically transmitted. We would also point out the Federal Agency does not provide for the separation of duties because certification of the data entered resides with the user authorized to perform the input. Our recommendation would be to add a separate certification requirement as part of electronic reporting.

Auditors' Conclusion: Based on the Federal CHIP regulations in the criteria above, we believe federal reimbursements are limited to a percentage equal to the enhanced Federal medical assistance percentage (FMAP) of SCHIP expenditures at the time of the claim. Therefore, the Commonwealth should not draw federal funds in excess of the enhanced FMAP rate in effect at the time of payment of SCHIP expenditures.

In addition, no documentation was provided verifying that the proper match between federal and state expenditures was met prior to the end of the grant period. This documentation should be provided to HHS for resolution of questioned costs.

Based on the agency response, the finding and recommendation 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 02 – 30:

CFDA #93.778 – Medical Assistance

Ineligible Payments to MA Beneficiaries Result in Questioned Costs of $27,552

Condition: The MA Program is required to operate a Medicaid Eligibility Quality Control System (MEQC) in accordance with requirements specified by HHS. The DPW MEQC reviews the eligibility determinations made by the caseworkers at the County Assistance Offices (CAOs) and uses statistical sampling methods to select the claims for review and to project the number and dollar impact of payments to ineligible beneficiaries. The DPW MEQC system operates and reports on a six-month sampling cycle.

In order to ensure that payments are made only to eligible recipients for the MA Program, we reviewed and retested the work performed by DPW MEQC during our audit period, including the results of the sampling performed for the six-month period from October 1, 2001 through March 31, 2002. Based on our review, we noted that DPW MEQC identified a total of $27,552 of ineligible payments to MA beneficiaries during the six-month period. The payment error rate calculated by DPW MEQC as a result of these ineligible payments was 5.53%, which when projected over the total population of MA payments, is material to the MA program.

Criteria: 42 CFR Part 431.10 states that:

The State Medicaid agency or its designee is required to determine client eligibility in accordance with eligibility requirements defined in the approved State plan.

The Commonwealth's guidance for eligibility determinations is outlined in the "Medical Assistance Handbook".

In addition, 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.

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, in Section ___.510 states in part:

(a) Audit findings reported. The auditor shall report the following as audit findings in a schedule of findings and questioned costs:

(3) Known questioned costs which are greater than $10,000 for a type of compliance requirement for a major program. Known questioned costs are those specifically identified by the auditor. . . .

Cause: MEQC personnel indicated that the ineligible payments and high payment error rate were primarily due to CAO caseworkers not following the procedures established in the Commonwealth's "Medical Assistance Handbook" regarding the verification of the client's resources. MEQC further stated the resources not being verified primarily relate to bank account information and that the cases most affected by this type of error are nursing home cases.

Effect: Since MEQC identified ineligible payments to MA beneficiaries; there are questioned costs of $27,552. Additionally, due to the control weakness identified above, there is limited assurance that eligibility determinations and related benefit payments are being made in accordance with federal regulations.

Recommendation: We recommend that DPW pursue appropriate settlement with HHS for the $27,552 in questioned costs. We also recommend that DPW's CAOs strengthen controls to ensure that sufficient verification of resources is performed on initial eligibility determinations and on eligibility redeterminations in order to ensure that individuals are eligible and that benefit payments are properly calculated.

Finding 02 – 30: (continued)

Agency Response: Pennsylvania operates the Medicaid Eligibility Quality Control (MEQC) System in accordance with requirements specified by the Department of Health and Human Services (DHHS), Center for Medicare and Medicaid Services (CMS). The MEQC process involves the review of client eligibility and the determination of the payment accuracy of the benefits delivered. Under these requirements, Pennsylvania may be subject to fiscal sanctions if the MEQC error rate exceeds the tolerance established by the DHHS. Pennsylvania is not now, nor has been since the inception of the MEQC process, over the acceptable tolerance, and has never been subject to a fiscal sanction due to the MEQC error rate. The MEQC requirements do not require, nor even suggest, repayment of funds discovered as a result of the MEQC review. The requirements do, however, have expectations on the performance improvement with respect to areas where deficiencies may be concentrated. Pennsylvania has been following Medical Assistance error trends, and has already undertaken a "pilot project" to focus on the reduction of nursing home resource errors. This pilot began with the October 2002 review month and has been approved by the CMS to run until September 2003. Information gathered during this review will be used to target corrective action strategies in error-prone areas across the program, and across the state.

Based on the above explanation, the auditors may wish to reconsider issuance of this finding.

Auditors' Conclusion: DPW's contention that repayment of these questioned costs cited in the finding is not required, is an audit resolution issue which, as stated in the recommendation, should be pursued with HHS for appropriate settlement. The agency response indicates that corrective action on the internal control weakness is being undertaken by DPW after our current audit period, and this will be reviewed in our subsequent audit. Accordingly, 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 02 – 31:

CFDA #93.994 – Maternal and Child Health Services Block Grant

DOH Could Not Support Information Submitted to HHS on its Annual Statistical Report

Condition: As part of its 2002-03 MCH Block Grant Application submitted to HHS in July of 2002, DOH provided an Annual Report of statistical data on the number of individuals served with MCH funds. This statistical data was reported to HHS on three forms as follows:

- Form 6 - Number and Percentage of Newborns and Other Screened, Cases Confirmed, and Treated
- Form 7 - Number of Individuals Served (Unduplicated) Under Title V
- Form 8 - Deliveries and Infants Served by Title V and Entitled to Benefits Under Title XIX

Our audit disclosed that DOH could not support the accuracy, reasonableness, or completeness of the data submitted on these forms due to the following internal control weaknesses:

- DOH did not perform on-site monitoring visits during our current audit period ended June 30, 2002 to the health care providers submitting this statistical data to DOH for inclusion on the above forms. As a result, the data was not reviewed to ensure its accuracy, reasonableness, or completeness at this lower reporting level.

- Regarding the data reported on Form 7, DOH's Bureau of Family Health did not maintain this data on its computer system (known as the CORE System) to support totals reported to HHS. DOH officials informed us that most of the Form 7 totals were recorded on their live database, and the historical information submitted to HHS was overwritten after submission. As a result, certain data categories on Form 7 (Pregnant Women, Children 1 to 22 years of age, Children with Special Health Care Needs) were not supported by underlying records. We also found that data categories in Form 7 were estimated rather than actual totals.

- Form 6 contained several errors in the totals reported, and DOH officials could not explain why their report preparation procedures did not identify and correct these errors prior to submission. As a result, we noted that supervisory review of the report was not adequate.

- While a Deputy Secretary at DOH signed the MCH application to certify its accuracy, completeness, etc., we found weak controls in that there was no overall review performed or documented by the two DOH bureaus responsible for the data reported in the three forms above to verify its reasonableness, accuracy, or completeness prior to submission to HHS.

Criteria: 42 U.S.C. 706(a) provides:

(1) *Each State shall prepare and submit to the Secretary annual reports on its activities under this subchapter. Each such report shall be prepared by, or in consultation with, the State Maternal and Child Health Agency. . . .*

(2) *Each annual report under paragraph (1) shall include the following information:*

(A)(I) The number of individuals served by the State under this subchapter. . . .

Further, 45 CFR 96.30 states, in part:

. . . Fiscal control and accounting procedures must be sufficient to (a) permit preparation of reports required by the statute authorizing the block grants.

Finding 02 – 31: (continued)

Cause: During a prior audit period, DOH implemented a system to accumulate required annual report data. However, the data included in Form 7 of the annual report was extracted without saving or printing the file for future reference. Consequently, the historical data was overwritten and could not be obtained as support for the information reported on the FFY 2001 report. DOH personnel also indicated that due to the reorganization of the Bureau of Family Health during 2001, and the restructuring of duties among program staff, critical backup documentation could not be located in the current year to support those participant numbers that were reported on the federal report. Also, the Bureau of Family Health personnel indicated that they have resumed on-site visits during the SFYE 2002-03 which, among other things, should serve as an important monitoring tool for confirming reliable participant data.

Finally, DOH personnel could not offer explanations for the undetected errors on Form 6 discovered in our audit.

Effect: DOH may have reported an inaccurate number of program participants to HHS. In addition, the inability to support participant data on the annual report may cause such data to be inaccurate and incomplete in the future in violation of federal regulations.

Recommendation: DOH should perform a review of the information on its MCH annual report for FFY 2001 and notify HHS officials if information needs to be corrected. In addition, we recommend that internal controls be strengthened to ensure proper reporting of statistical data to HHS in the future. These controls should ensure that on-site monitoring visits are performed of health care providers and include regular reviews of the data submitted to DOH, Form 7 data on the CORE System is retained to support totals submitted to HHS, supervisory review of the data is adequate, and procedures are performed and documented by DOH to support the reasonableness, accuracy, and completeness of the required data prior to submission to HHS.

Agency Response: The Guidance provided by HHS for Form 7 of the MCHS Block Grant states, *"If an actual number is not available, make an estimate."* However, DOH will inform HHS officials in writing by July 31, 2003 of the results and recommendation of this finding and request their guidance on any required corrective measures to the FFY 2001 MCH annual report.

DOH has collected additional information pertaining to on-site monitoring visits conducted during the fiscal year 2001-2002. However, DOH will ensure the regularity of the on-site monitoring visits and the documentation of supervisory review to ensure proper reporting of statistical data to HHS in the future, commencing with the new block grant reporting period effective July 1, 2003. In addition, starting in November 2002, DOH did begin to annually freeze the CORE System data for the prior fiscal year reporting to better support the totals submitted to HHS.

Auditors' Conclusion: Based on the agency response, our current year 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 02 – 32:

CFDA #66.458 – Capitalization Grants for State Revolving Funds
CFDA #66.468 – Capitalization Grants for Drinking Water

Noncompliance with OMB Circular A-133 Subrecipient Audit Requirements

Condition: As part of our audit of OB's Statewide A-133 subrecipient audit monitoring system, we evaluated the significance of unaudited subrecipient dollars for each of the major programs recorded on OB-BOA's subrecipient universe in the prior fiscal year (SFYE June 30, 2001) for which audits were required to be submitted in the current year (SFYE June 30, 2002). Our testwork disclosed that for the Capitalization Grants for Drinking Water (or DWSRF) program (CFDA #66.468) administered by PENNVEST, $1,412,367 in federal funds subgranted to one entity during the prior SFYE June 30, 2001 remained unaudited in our current year in violation of OMB Circular A-133. The audit report for the entity in question was required for the fiscal year ended December 31, 2000, and was due September 30, 2001. The audit report was more than 17 months late as of our test date in March 2003.

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.*

OMB Circular A-133, Section ___.400, states the following:

(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.*

To ensure Commonwealth enforcement of OMB A-133 for subrecipient noncompliance with 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 Circular 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.*

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 recipient or the final stage of progressive remedial action should be imposed on the recipient.

Finding 02 – 32: (continued)

<u>Cause</u>: BOA's system to identify and track receipt of subrecipient audit reports includes procedures for follow-up on entities not submitting required reports. BOA's procedures are to notify the affected agency and it is then the agency's responsibility to follow-up on the non-submission of audit reports. Our review of PENNVEST's Remedial Action Plan developed in accordance with Commonwealth MD 325.8 disclosed that the plan contains a series of progressive steps to enforce subrecipient compliance with audit requirements, up to and including the termination of contracts. However, the Plan was inadequate because PENNVEST removed specific timeframes for the steps in the period under audit. PENNVEST personnel stated that timeframes were added back to the Remedial Action Plan in December 2002, which was subsequent to our audit period. Our review of the updated Remedial Action Plan disclosed that the plan was still inadequate since there was only a general timeframe of "1 to 120 days" for all steps, instead of specific timeframes for each progressive step.

Documentation provided by PENNVEST personnel indicated that this subrecipient was notified that funds were to be withheld beginning October 7, 2002. Since the subrecipient's audit report was due September 30, 2001, PENNVEST did not notify the subrecipient of the withholding of funds until one year after the audit report was due. By this time, most of the project costs had already been drawn down by the subrecipient and expended.

<u>Effect</u>: Since the Commonwealth did not obtain and review the required audit report, material federal funds in the DWSRF program were not audited in violation of OMB Circular A-133. In addition, a weakness exists in PENNVEST's Remedial Action Plan for all federal funds because specific timeframes have not been established as required by MD 325.8. Material dollars in PENNVEST's major federal programs (DWSRF and CWSRF) may go unaudited in the future without effective remedial action from PENNVEST to enforce compliance.

<u>Recommendation</u>: We recommend that PENNVEST continue its efforts to obtain an A-133 audit from the unaudited entity, and more closely monitor and inform subrecipients of the applicable audit requirements. We also recommend that, if the unaudited amount identified above is not ultimately subjected to audit as required by A-133, PENNVEST consider implementation of other remedial action procedures as outlined in MD 325.8 (such as additional on-site program monitoring). Finally, PENNVEST should ensure that there are specific timeframes in their Remedial Action Plan and should adhere to the timeframes in accordance with MD 325.8.

<u>Agency Response</u>: PENNVEST is in general agreement with the substance of the finding that the PENNVEST Remedial Action Plan (PRMAP) has to be modified to include intermediate time sequences for the progressive actions for audit reporting noncompliance. The progressive steps will be modified to have a 30-day window between each remedial step implementation.

While the established timelines in the PRMAP need refined, it should be noted that the subject loan was notified (November 15, 2001 and August 16, 2002 for FYE 2000 audit; and January 3, 2002 and October 7, 2002 for FYE 2001 audit), funds withheld (last disbursement August 28, 2001), and notified of being placed on the Commonwealth Debarred List on March 21, 2003. It is understood that both audit reports will be submitted within the next two weeks or by April 14, 2003 at the latest.

In the future, PENNVEST will take proactive actions that will more than comply with the updated established PENNVEST Remedial Action Plan timelines for all sub-recipients of the PENNVEST federal loan pool that are subject to the Single Audit Act.

Finding 02 – 32: (continued)

Auditors' Conclusion: As indicated in the Cause section above, PENNVEST did not notify the subrecipient of the withholding of funds until one year after the audit report was due. By that time, most of the project costs had already been drawn down by the subrecipient and expended. In addition, it should be noted that PENNVEST's placement of this subrecipient on the Commonwealth's Debarment Listing occurred subsequent to our inquiries in March 2003. Therefore, the finding and recommendation remain as stated above. We will evaluate the agency's corrective action during the 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 02 – 33:

CFDA #93.044 – Special Programs for Aging – Title III Part B
CFDA #93.045 – Special Programs for Aging – Title III Part C

A Material Weakness Exists in PDA's Subrecipient Audit Resolution Process

Condition: Under the Commonwealth's implementation of the Single Audit Act, review and resolution of OMB Circular A-133 subrecipient audit reports is split into two stages. The Commonwealth receives all A-133 subrecipient audit reports through OB-BOA which ensures the reports meet technical standards through a desk review process. Once they are deemed acceptable by BOA, the reports are transmitted to the various funding agencies in the Commonwealth and each agency in the Commonwealth's resolution system must make a management decision on each finding within six months after the report is transmitted to them to ensure corrective action is taken by the subrecipient. The agency is also responsible for reviewing financial information in each audit report (e.g., SEFA) to determine whether the audit included all pass-through funding provided by the agency and to adjust Commonwealth records, if necessary.

Our testing disclosed that PDA is not issuing management decisions on findings within six months of receipt of audits from BOA. Specifically, we selected and tested five out of 34 audit reports received by PDA, three of which contained findings. (These three audit reports were the only reports with findings received by PDA during FYE 6/30/02.) Of these three audits with findings, one was received from BOA eight months prior to our testwork date and two were received from BOA over nine months prior to our testwork, but all three still remained open at the time of our audit. Our testing also disclosed that PDA did not perform reconciliations of the subrecipients' SEFAs to the Commonwealth's accounting records for all five reports tested. Further inquiry of PDA personnel disclosed that PDA personnel had not performed SEFA reconciliations and had not reviewed any of the 34 audit reports received from BOA during SFYE 6/30/02 as of the time of our audit.

Criteria: The Single Audit Act of 1984 and the Single Audit Act Amendments of 1996 require state and local governments to adhere to provisions of OMB Circular A -133.

OMB Circular A-133, Section 400, states the following:

(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.

Cause: PDA audit resolution personnel stated that they were not resolving OMB A-133 audits within the six month timeframe because other projects within the Department were considered by PDA management to have greater priority.

Effect: Since PDA did not make the required management decisions within six months of receipt to ensure appropriate corrective action was taken on audits received from BOA, PDA subrecipients were not made aware of acceptance or rejection of corrective action plans in a timely manner; and subrecipient noncompliance may recur in future periods. We consider the errors noted above to be material violations of federal regulations in the Commonwealth's overall subrecipient audit monitoring process since no review or resolution of the 34 audits was performed by PDA at the time of our audit.

Finding 02 – 33: (continued)

Recommendation: We recommend that the weaknesses that cause untimely OMB A-133 audit resolution for PDA be corrected to ensure compliance with federal audit resolution requirements and to better ensure subrecipient compliance with program requirements.

Agency Response: PDA agrees with the finding.

As noted within the finding, of the thirty-four Single Audits received in the PA Department of Aging during state fiscal year July 1, 2001 through June 30, 2002, three contained findings which were required to have management decisions completed within six-months of their receipt dates.

Within PDA, an initial review of Single Audits is conducted upon receipt, with audits added to two ongoing listings. One listing records all Single Audit names, the time period of the audit, the date received and ultimately, the date completed. The other listing exclusively lists those Single Audits received which contain findings. This listing includes the name of the Single Audit, the time period of the audit, and a breakdown of the actual finding(s). This information aids the reviewer in determining what criteria may be necessary to formulate a management decision on the finding and its corrective action plan. That is, if there is sufficient information included to render a management decision or if further informational review may be necessary by PDA program personnel.

It should be noted that two of the three test Single Audits containing findings, Lebanon County 12/31/00 and Allegheny County 12/31/00, have subsequently been reviewed and reconciled as of February 13, 2003 and March 21, 2003, respectively, and have had management letters sent out. The third, Luzerne/Wyoming 6/30/2000 is underway and should be completed shortly.

It should be noted that ten Single Audits were completed within 2002, prior to the testing dates of the fieldwork review. Currently, within state fiscal year 2002-2003, five Single Audits have been received which contain findings. All have been reconciled, with management decisions completed. Additionally during this time, four other Single Audits were reviewed, reconciled and processed. It should be noted that all Single Audits received by PDA are reviewed and reconciled, regardless of findings contained therein.

Review of Single Audits is a high priority within the Department of Aging and is considered an important aspect of our fiscal responsibility. Two of the test three Single Audits containing findings were begun back in May and June of 2002, in anticipation of their due dates of November and December 2002. Considerable effort is always made towards meeting our responsibility. In prior fiscal years, all Single Audits having findings were reconciled and completed within the six-month timeframe. Since all Single Audits containing findings received within the current fiscal year have already been addressed, the Department is in compliance with the regulations of OMB Circular A-133. Diligent attention to adherence of this regulation will continue to be a priority.

Auditors' Conclusion: It should be noted that PDA's review of the three subrecipient audit reports with findings occurred subsequent to the inquiries we made in January 2003. However, PDA should ensure that SEFA reconciliations are performed for the remaining 31 subrecipient audit reports without findings which were received during the SFYE June 30, 2002. Also, the ten Single Audits indicated as completed by PDA within 2002 were received by PDA prior to July 1, 2001, and were subject to testing in our prior year audit. Therefore, the finding and recommendation remain as stated above. We will evaluate the agency's corrective action during the 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 02 – 34:

CFDA #17.253 – Welfare–to–Work Grants to States
CFDA #17.255 – Workforce Investment Act
CFDA #17.258, 17.259 and 17.260 – WIA Cluster

Noncompliance With OMB Circular A-133 Subrecipient Audit Requirements (A Similar Condition Was Noted in Prior Year Finding #01-19)

Condition: During our prior year audit, we noted the following noncompliance and internal controls weaknesses in the L&I, Bureau of Workforce Investment's (BWI) oversight of its Welfare–to–Work (WTW) and Workforce Investment Act (WIA) subrecipients:

1) BWI did not adhere to its remedial action plan to ensure that subrecipients received annual Single Audits and submitted the reports to the Commonwealth in a timely manner as required by OMB Circular A-133. Southcentral Employment Corporation or SEC (formerly Susquehanna Employment and Training Consortium or SETCO) had not submitted an audit report since fiscal year ended June 30, 1996. 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.

   Our current year audit procedures disclosed that SEC again did not submit an audit report for fiscal year ended June 30, 2001. This audit report was over 11 months late as of our March 2003 test date. During the state fiscal year ended June 30, 2001, SEC received approximately $6.1 million in federal funds (mostly WTW and WIA) from the Commonwealth.

2) BWI's subrecipient monitoring procedures were not adequate to ensure that high-risk subrecipients not submitting audit reports were administering WIA programs in compliance with federal regulations. Although regularly-scheduled program monitoring of SEC was conducted by BWI in November 2001, there were no enhancements to the scope or frequency of BWI's routine monitoring procedures, 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. No enhanced monitoring, audits, or other oversight procedures were included in BWI's remedial action plan for nonsubmission of subrecipient Single Audit reports. As a result, WIA program funds were being misspent by SEC (as evidenced by findings in the most recent audits received) without proper and timely oversight by BWI.

   Our follow-up in the current year audit disclosed that BWI did not make any changes to their program monitoring procedures for SEC, and no audits of SEC were scheduled or performed by Commonwealth officials in order to compensate for the lack of a Single Audit for SEC.

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) . . .

Finding 02 – 34: (continued)

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.

To ensure Commonwealth enforcement of OMB A-133 for subrecipient noncompliance with the above audit requirements, Commonwealth Management Directive 325.8, <u>Remedies for Recipient Noncompliance With Audit Requirements</u>, 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.

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.

<u>Cause</u>: BWI personnel indicated that SEC had planned to have the fiscal year June 30, 2001 audit performed by now, but they experienced some problems with the accounting firm they initially contracted to perform the audit. SEC has since contracted with another accounting firm to perform audits of both the June 30, 2001 and 2002 fiscal years together as part of one audit. BWI and SEC have agreed to submit the audit of these two fiscal years by May 2003.

Regarding increased monitoring of SEC, BWI requested LECS auditors to evaluate SEC's corrective action for recordkeeping and internal controls issues disclosed in the prior audit reports. However, BWI is still awaiting a response from LECS regarding the adequacy of SEC's corrective action before BWI takes any further remedial action steps against SEC such as withholding funds. Furthermore, BWI personnel indicated they are reluctant to withhold funds since this would deny services to the needy participants in a nine-county area served by SEC.

<u>Effect</u>: Since L&I did not obtain and review the audit report from SEC on a timely basis, federal funds under the WIA Cluster, WIA, and WTW Programs are not being audited in violation of OMB Circular A-133. Since L&I's written remedial action plan includes no steps for enhanced Commonwealth oversight (through increased program monitoring or auditing activities) of subrecipients not submitting Single Audits, L&I is not monitoring higher risk subrecipients like SEC in a timely and reasonable manner. Federal funds may be misspent by these higher-risk subrecipients without appropriate oversight by L&I.

<u>Recommendation</u>: 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

Finding 02 – 34: (continued)

oversight should be placed on the entity 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: Although SEC was late in the submission of the Single Audit reports for the years ending June 30, 1997, 1998, 1999 and 2000, the Bureau of Workforce Investment was aware that the firm of KPMG was in the process of performing the required audits. KPMG requested the McKonly & Asbury audit firm to reconstruct the required records. It was felt that as long as positive action was being taken by SEC, that further action was not necessary. In fact, the required audits have since been completed and received by the Bureau of Audits. LECS Audit Division was involved in the review of the auditor's workpapers to assist BWI in suggesting corrective action. An initial determination of the audit findings for the above period is currently under review within BWI.

The Single Audit for the period ending June 30, 2001, was halted by BWI because of an independence issue with McKonly and Asbury completing the audit after recreating the records. As part of the increased technical assistance, BWI granted $65,299 in technical assistance funds to SEC to help defray the additional costs of the reconstruction of the records and related costs. BWI insisted that another firm be engaged to complete the audit. SEC indicated that this would delay the submission of the audit report, but BWI felt that this area was essential to avoid conflict of interest and to ensure auditor independence.

SEC contracted with another CPA firm to complete their Single Audit for both the 2001 and 2002 program years. According to the auditor and SEC's Executive Director, the reports are to be submitted by May 31, 2003. This will then bring SEC into full compliance by that date.

In addition, LECS Audit Division is involved in reviewing SECs current processing procedures and internal controls to evaluate whether the system can support the necessary elements required by BWI.

Auditors' Conclusion: The agency response describes actions being taken by management specifically to bring SEC into compliance with OMB Circular A-133 audit requirements. Since we were aware that these actions had already been taken during our fieldwork, we did not include any of them in our recommendations above. However, because its corrective action only relates to one subrecipient, management is not addressing any of our recommendations in the finding, which relate to all its subrecipients. L&I needs to amend its written remedial action plan and adhere to and follow through with the remedial action steps to help ensure the timely submission of all subrecipient audit reports. The 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 02 – 35:

CFDA # Various – All Major Programs With OMB Circular A-133 Subrecipients

Lack of Statewide Monitoring of OMB Circular A–133 Subrecipient Audit Report Submission to the Federal Audit Clearinghouse

Condition: The Commonwealth's OB has been assigned statewide responsibility for obtaining and monitoring receipt of subrecipient audit reports in accordance with OMB Circular A–133. OB-BOA has developed a subrecipient universe and audit report receipt tracking system which uses federal identification numbers to match entities receiving funding with entities submitting audit reports. However, our testing disclosed that BOA does not have a system in place to monitor and ensure that subrecipients of the Commonwealth are submitting their data collection forms and Single Audit reporting packages to the Federal Audit Clearinghouse, US Bureau of Census, in accordance with OMB Circular A–133 requirements.

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:

(b) Data Collection. (1) The auditee shall submit a data collection form which states whether the audit was completed in accordance with this part and provides information about the auditee, its Federal programs, and the results of the audit.

(c) Reporting package. The reporting package shall include the:

(1) Financial statements and schedule of expenditures of Federal awards...

(2) Summary schedule of prior audit findings...

(3) Auditor's report(s)...; and

(4) Corrective action plan...

(d) Submission to clearinghouse. All auditees shall submit to the Federal clearinghouse designated by OMB the data collection form described in paragraph (b) of this section and one copy of the reporting package described in paragraph (c) of this section...

The Federal Common Rule, Subpart C, Section ___.40, states the following:

(a) Monitoring by grantees. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable federal requirements...

Finally, an adequate internal control system over subrecipient audits should include procedures to ensure subrecipients submit their audit reports in accordance with federal regulations.

Cause: BOA personnel stated that they had made an inquiry to the Federal government a few years ago as to whether BOA could obtain copies of the data collection form to ensure that subrecipients of the Commonwealth had submitted their Single Audits to the Federal Clearinghouse. BOA was told by OMB personnel that BOA could not request the data collection form since it was a federal form, and the form could only be forwarded to the Federal Clearinghouse.

Effect: The Commonwealth does not gain reasonable assurance that its subrecipients are submitting data collection forms and Single Audit reporting packages to the Federal Audit Clearinghouse in accordance with OMB Circular A–133.

Finding 02 - 35: (continued)

Recommendation: We recommend that BOA, at its own discretion, implement procedures to verify that Commonwealth subrecipients are submitting their data collections forms and Single Audit reporting packages to the Federal Audit Clearinghouse in accordance with OMB Circular A–133 requirements.

Agency Response: We do not believe it is our responsibility to verify that the Commonwealth's subrecipients have submitted their audit reports to the Federal Audit Clearinghouse. This is based on guidance from OMB that the data collection forms are to be submitted to the federal clearinghouse only. In addition, we could find no specific reference in OMB Circular A-133 or other guidance on subrecipient monitoring that requires pass-through agencies to verify federal clearinghouse submissions. We have not been cited in the past for not performing this function, and we are not aware of any change in policy or responsibilities.

We believe we have fully complied with our monitoring responsibilities by ensuring that the Commonwealth's subrecipients have submitted the required audit reports to the Bureau of Audits, and by following up on those subrecipients that have failed to submit an audit report. However, we will pursue this matter with the appropriate federal agencies to determine our level of responsibility and will consider implementing procedures to assist in ensuring that our subrecipients have met the federal reporting requirements.

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 02 – 36:

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 #01-20)

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, 2002:

- 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, 2002 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 02 – 36: (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 02 – 36: (continued)

- For payroll in CFDA #20.205, the Commonwealth has historically selected appropriations that contain payments to CFDA #20.205. In the future, we will continue to ensure that only appropriations pertaining to CFDA #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 chose SAP software and contracted with KPMG Consulting, LLC to serve as the integrator for this project. Implementation began 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 02 – 37:

CFDA #93.558 – Temporary Assistance for Needy Families
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 #93.658 – Foster Care – Title IV–E
CFDA #93.659 – Adoption Assistance
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 $86,290 (A Similar Condition Was Noted in Prior Year Finding #01-21)

Condition: The interest liability on the CMIA Annual Report for SFYE June 30, 2001 which was submitted to the U. S. Treasury during our audit period SFYE June 30, 2002, was understated by a minimum of $86,290 as follows:

- DPW paid interest of $983 on 7 days excess cash of $967,345 in TANF funds which posted to CDS on July 19, 2000 (via document #AM96501995) and which were returned to HHS on July 26, 2000. Our review of #AM96501995 disclosed that these funds were applicable to interagency Memorandum of Understanding (MOU) #ME91134002 between DPW and L&I for the period July 1, 1999 to June 30, 2000. Since the cash balance existed at June 30, 2000, interest on the balance should have been reported for an additional 18 days. Therefore, the CMIA interest liability for TANF was understated by $2,528.

- Within the SSBG program, we noted that DPW transferred $19,412,159 of day care expenditures to the TANF program via document CV00059512 on December 19, 2000. The funds were subsequently drawn from the federal government within the TANF program and were deposited to the Commonwealth's account on December 22, 2000. However, the funds that were drawn within the SSBG program were not returned to the federal government until January 16, 2001. Our review of the CDS-301 Report disclosed that the Commonwealth did not pay interest to the federal government for the 25 days (December 22, 2000 – January 16, 2001) that the $19,412,159 of SSBG cash was actually on hand. As a result, the state's interest liability was understated by $70,469 under SSBG CFDA #93.667.

- Within the CCDF and SSBG programs, we noted that eight VTs (VT #s 02113427 through 02113434) posted on March 1, 2001 included checks totaling $5,800,346 that were never paid. However, we found the PHHS Comptroller requested $5,800,346 in federal funds and deposited the funds in the Commonwealth's account on March 14, 2001. The $5,800,346 was subsequently returned to the federal government on March 29, 2001. Our review of the CDS-301 Report disclosed that the Commonwealth only paid interest to the Federal government for three days, from March 26, 2001 (the date REs 97511364 and 97511386 were posted on ICS to refund the money) until March 29, 2001, the date funds were actually returned to the Federal government. However, the cash was actually on hand for 15 days from March 14 to 29, 2001. As a result, the state's interest liability was understated by $1,056 under SSBG, CFDA #93.667; $4,021 under CCDF, CFDA #93.596; and $5,030 under CCDBG, CFDA #93.575.

- Within our testing of the Foster Care and Adoption Assistance programs, we noted that the State Treasurer's Office red-lined and did not issue checks for $2,767,213 of expenditures ($2,499,164 within Foster Care and $268,049 within Adoption Assistance) from document VT97211771 dated June 23, 2000. As a result, DPW posted document RERR00000015 on July 12, 2000 to reduce the Foster Care and Adoption Assistance expenditures accordingly. However, our review of the Foster Care and Adoption Assistance draws disclosed that when the Commonwealth drew the funds for document VT97211771, they did not reduce the draw by the aforementioned $2,767,213. The Foster Care funds were subsequently received on July 12, 2000 and the Adoption Assistance funds were received on July 13, 2000. Our review of the CDS-301 Report disclosed that the Commonwealth only paid interest for six days from

Finding 02 – 37: (continued)

July 20, 2000, the date RE00000015 posted on ICS until July 26, 2000 when the funds were returned to the Federal government. As a result, the state's interest liability was understated by $2,903 under Foster Care, CFDA #93.658, and $272 under Adoption Assistance, CFDA #93.659.

- Within the CCDF program, we noted that DPW received a refund of $14,963 of day care expenditures that were posted to ICS via document RE00000140 on February 9, 2001, and returned to the federal government on February 14, 2001. However, our review of the CDS-301 Report disclosed that this document was not included on the CDS-301 Report and, therefore, no interest liability was recorded for the five days that this cash was on hand. Although the state's interest liability was understated by only $11 under CCDF, the omission of this document is indicative of a system problem in which interest may not be calculated on federal cash on hand as required by federal regulations.

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. Although our review of major program revenues did not disclose any current year revenue collected in advance issues, our review of revenue collected in advance accounts at the Department of Agriculture, Department of Corrections, State Police, Department of Conservation and Natural Resources and the Executive Offices disclosed that federal cash was collected in advance for non-covered programs. While interest is not due for federal cash on hand in non-covered programs, this is a violation of federal cash management regulations.

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.

Finding 02 – 37: (continued)

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 ME91134002 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.

Cause: 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 red-lining 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 red-lines 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.

Effect: 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, the state and federal interest liability amounts reported on the CMIA Annual Report for SFYE June 30, 2001, are not accurate. Further, our testing disclosed a minimum of $86,290 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.

Finding 02 – 37: (continued)

Recommendation: 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 June 30, 2001 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.

Agency Response: The following is the Office of the Budget's agency response:

- This was a one-time occurrence that was related to the closing of a grant. The Commonwealth agrees that L&I had excess cash on hand for the period in question and will adjust the next Annual Report for the $2,528 understatement of interest liability for CFDA 93.558.

- The Department of Health and Human Services (DHHS) manages its Payment Management System (PMS) to facilitate cash flow to states. The PMS Smartlink system prevents states from returning funds to the federal agency unless offset by at least the same amount in a drawdown for expenditures at the letter-of-credit level. The Commonwealth has previously discussed this shortcoming with PMS representatives individually and at national training events to assure that they are aware of this shortcoming. The Commonwealth requested to return funds to the SSBG program on January 12, 2001. DHHS was not able to process the request until January 16, 2001 due to the weekend and holiday. Therefore, the Commonwealth will adjust next year's interest report for interest incurred until January 12 in the amount of $59,194.

- The Commonwealth agrees there was a delay in refunding the checks back to the program and will adjust the next Annual Report for the following understatements of interest liability: $1,056 for CFDA 93.667, $4,021 for CFDA 93.596, and $5,030 for CFDA 93.575.

- The number and dollar amount of expenditures rejected by Treasury is minimal; therefore, the effect on CMIA interest is immaterial. This rejected voucher transmittal is an extraordinary occurrence. The Bureau of Financial Management has been gathering redline payment information and will perform a study to support this position. The Commonwealth will adjust the next Annual Report for the following understatements of interest liability: $2,903 for CFDA 93.658 and $272 for CFDA 93.659.

- In accordance with CMIA, a state may adopt a transaction threshold not exceeding $10,000, below which a state will not incur an interest liability on a refund transaction. Therefore, CDS does not compute interest for refunds under $10,000. The refunds posted on two separate grants and each was under $10,000. Therefore the Commonwealth does not owe interest on these refund transactions.

- As previously discussed, 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 Bureau of Financial Management has been gathering redline payment information and will perform a study to support this position.

- 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

Finding 02 – 37: (continued)

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.

Overall, our cash drawdown system operates with a high degree of accuracy and complies with CMIA in all material respects.

Auditors' Conclusion: Regarding the response to refunding cash to HHS under SSBG, based on our understanding of CMIA, we believe interest should be paid through January 16, 2001, not January 12, 2001, as BFM states. However, BFM should pursue resolution of this issue with HHS or U.S. Treasury FMS.

We disagree with the response regarding the CCDF refund being less than $10,000 and that the Commonwealth does not owe interest on this refund. Even though this refund was posted to two separate grants, the total refund exceeded the Commonwealth's $10,000 threshold. In addition, per review of the CDS-301 Report, we noted that this report does include interest calculations on transactions less than $10,000. Therefore, it appears that as stated in the finding the omission of this transaction is indicative of a systems problem.

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 on a statewide basis 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

Commonwealth of Pennsylvania

Summary Schedule of Prior Audit Findings as of December 31, 2002
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	Closed – OB/PPR has implemented procedures to correct the timing of drawdowns. OB/PPR utilizes executive authorizations instead of the former restricted account to disburse federal disaster funds. OB/PPR believes no further corrective action is necessary and considers this finding closed per OMB Circular A-133, section 315(b)(4). No similar findings have been issued over the last several years.
DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT (DCED)			
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	Closed – DCED has implemented corrective action. HUD is not currently following up on this finding. DCED considers this finding closed per OMB Circular A-133, section 315(b)(4).
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	Closed – DCED has implemented corrective action. HUD is not currently following up on this finding. DCED considers this finding closed per OMB Circular A-133, section 315(b)(4).
Finding 93	DCA Should Implement Procedures to Ensure That Subgrantees Are Adequately Monitored (A Similar Condition Was Noted in Prior Year Finding #95)	HHS	Closed – DCED has implemented corrective action. HHS is not currently following up on this finding. DCED considers this finding closed per OMB Circular A-133, section 315(b)(4).
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 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. DPW provided additional information to HHS on March 28, 2000, and again on June 14, 2002 in response to HHS letter of May 17, 2002.

Summary Schedule of Prior Audit Findings as of December 31, 2002
Single Audit Findings for Fiscal Year Ended June 30, 1994

STATE AGENCY / FINDING		RESPONSIBLE FEDERAL AGENCY	COMMENTS
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. PADOT considers this finding closed; however, in a letter dated November 7, 2001, FEMA requested additional information on corrective action taken. PADOT is awaiting final action from FEMA.

Summary Schedule of Prior Audit Findings as of December 31, 2002
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	Closed – Similar findings in previous years have been resolved. No further corrective action is necessary. OB/PPR has not received a final determination letter from USDA. However, OB/PPR considers this finding closed per OMB Circular A-133, section 315(b)(4).
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	Closed – OB/PPR has implemented procedures to correct the timing of drawdowns. OB/PPR utilizes executive authorizations instead of the former restricted account to disburse federal disaster funds. OB/PPR believes no further corrective action is necessary and considers this finding closed per OMB Circular A-133, section 315(b)(4). No similar findings have been issued over the last several years.
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	Closed – Corrective action was implemented in the 1995/96 year. PDE fiscal personnel review quarterly expenditure reports filed by subrecipients. Prior year finding with a similar condition was resolved by HHS. Therefore, PDE now considers this finding closed per OMB Circular A-133, section 315(b)(4).
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	Closed – Questioned costs have been resolved and information was provided to HHS. DPW considers this finding closed as more than two years have passed since resolution and HHS is not currently following up with DPW on this finding.
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	Closed – Questioned costs have been resolved and information was provided to HHS. DPW considers this finding closed as more than two years have passed since resolution and HHS is not currently following up with DPW on this finding.

Summary Schedule of Prior Audit Findings as of December 31, 2002
Single Audit Findings for Fiscal Year Ended June 30, 1995

	STATE AGENCY / FINDING	RESPONSIBLE FEDERAL AGENCY	COMMENTS
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	Closed – Questioned costs have been resolved and information was provided to HHS. DPW considers this finding closed as more than two years have passed since resolution and HHS is not currently following up with DPW on this finding.
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 managed in an administratively feasible manner. DPW provided additional information to HHS on March 28, 2000, and again on June 14, 2002.
DEPARTMENT OF TRANSPORTATION (PADOT)			
Finding 40	Costs Were Incorrectly Accumulated During Preparation of PADOT'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's letter of February 5, 2001 states that PADOT has completed all work in accordance with the agreement. FEMA has closed out the disaster account and all parties have agreed to the amount of federally reimbursable funding. PADOT considers this finding closed; however, in a letter dated November 7, 2001, FEMA requested verification of the corrective action taken.

Summary Schedule of Prior Audit Findings as of December 31, 2002
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	Closed – 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. Finding is considered closed per OMB Circular A-133, section 315(b)(4).
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 controls are sufficient and the program is administered efficiently. DPW provided additional information to HHS on March 28, 2000, and again on June 14, 2002.
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's right-of-way manual was approved by FHWA on August 8, 2002. PADOT believes it is in compliance with current federal regulations and will submit a letter to FHWA requesting that the finding be considered resolved.
Finding 18	Weaknesses in PADOT General Computer Controls (A Similar Condition Was Noted in Prior Year Finding #34)	DOT	Closed – Corrective action has been implemented. Security issues have been resolved through outsourcing computer room and tape library operations. The lack of adequate security over data files was resolved by June 30, 1999. Corrective action on the change management system was completed as of December 20, 2002. DOT is not currently following up on this finding. PADOT considers this finding closed per OMB Circular A-133, section 315(b)(4).

Summary Schedule of Prior Audit Findings as of December 31, 2002
Single Audit Findings for Fiscal Year Ended June 30, 1996

	STATE AGENCY / FINDING	RESPONSIBLE FEDERAL AGENCY	COMMENTS
Finding 19	PADOT District Offices Need Improved Procedures to Ensure Subcontracted Work is Approved in Writing Prior to Commencement of Work	DOT	Unresolved – Corrective action has been implemented. The Bureau of Construction & Materials continues to hold labor compliance workshops to inform district personnel of proper procedures. PADOT considers this finding closed and will submit a letter to FHWA requesting concurrence that the finding has been resolved.
Finding 23	PADOT Did Not Properly Report Federal Expenditures on the SEFA for the Flood of 1996 (FEMA 1093-DR-PA)	FEMA	Unresolved – 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 verification of the 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 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 verification of the corrective action taken.

Summary Schedule of Prior Audit Findings as of December 31, 2002
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	Closed – Corrective action has been taken. PEMA provided additional explanation to FEMA in a letter dated June 4, 1999. Finding considered closed per OMB Circular A-133, section 315(b)(4). No further action is warranted because two years have passed since the report was issued, FEMA is not currently following up on the finding, and no management decision was issued.
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	Closed – Corrective action has been taken. Additional explanation provided to HHS in a letter dated July 29, 1999. Finding considered closed per OMB Circular A-133, section 315(b)(4). No further action is warranted because two years have passed since the report was issued, HHS is not currently following up on the finding, and no management decision was issued.
DEPARTMENT OF EDUCATION (PDE)			
Finding 16	PDE is Not Enforcing Timely Corrective Action	USDE	Closed – Corrective action has been taken. PDE considers this finding closed per OMB Circular A-133, section 315(b)(4). Over two years have passed since issuance of the report, USDE is not currently following up on the finding, and USDE did not issue a management decision.
Finding 17	Internal Control Weakness over PDE's On-Site Monitoring of Subrecipients	USDE	Closed – Corrective action has been taken. PDE considers this finding closed per OMB Circular A-133, section 315(b)(4). Over two years have passed since issuance of the report, USDE is not currently following up on the finding, and USDE did not issue a management decision.
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	Closed – Over two years have passed since issuance of the report, DOL is not currently following up on the finding, and DOL did not issue a management decision. Therefore, L&I considers this finding closed per OMB Circular A-133, section 315(b)(4).

Summary Schedule of Prior Audit Findings as of December 31, 2002
Single Audit Findings for Fiscal Year Ended June 30, 1997

	STATE AGENCY / FINDING	RESPONSIBLE FEDERAL AGENCY	COMMENTS
Finding 9	Inadequate Follow-Up on the IRS 940 Federal Unemployment Tax Act Tax Information Received From the IRS	DOL	Closed – Over two years have passed since issuance of the report, DOL is not currently following up on the finding, and DOL did not issue a management decision. Therefore, L&I considers the finding closed per OMB Circular A-133, section 315(b)(4).
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	Closed – Over two years have passed since issuance of the report, DOL is not currently following up on the finding, and DOL did not issue a management decision. Therefore, L&I considers the finding closed per OMB Circular A-133, section 315(b)(4).
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	Resolved – Closed per settlement agreement signed by USDE on August 1, 2000.
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 in part but believes that the controls are sufficient and the program is administered efficiently. DPW provided additional information to HHS on March 28, 2000, and again on June 14, 2002.
Finding 28	DPW Did Not Have Valid Provider Agreements in Effect in Violation of Contracting and Procurement Requirements	HHS	Closed – The same finding in subsequent years was resolved by HHS/HCFA e-mail of February 2, 2000.
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	Closed – DPW implemented corrective action. DPW considers this finding closed as more than two years have passed since resolution, HHS is not currently following up on this finding, and a management decision was not issued.

Summary Schedule of Prior Audit Findings as of December 31, 2002
Single Audit Findings for Fiscal Year Ended June 30, 1997

	STATE AGENCY / FINDING	RESPONSIBLE FEDERAL AGENCY	COMMENTS
DEPARTMENT OF TRANSPORTATION (PADOT)			
Finding 11	Inadequate General Computer Controls (A Similar Condition Was Noted in Prior Year Finding #18)	DOT	Closed – Corrective action has been implemented. Security issues have been resolved through outsourcing computer room and tape library operations. The lack of adequate security over data files was resolved by June 30, 1999. Corrective action on the change management system was completed as of December 20, 2002. DOT is not currently following up on this finding. PADOT considers this finding closed per OMB Circular A-133, section 315(b)(4).
Finding 12	Weakness in PADOT Controls Over Davis-Bacon Monitoring	DOT	Unresolved – PADOT has made great strides over the past three years in increasing the number of wage rate spot-checks as required by the Davis-Bacon Act. PADOT believes it is in compliance with Davis-Bacon requirements and will submit a letter to the FHWA requesting that the finding be closed.
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 – 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 verification of the 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 – 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 verification of the corrective action taken.

Summary Schedule of Prior Audit Findings as of December 31, 2002
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	Closed – Corrective action has been taken. Additional explanation provided to HHS in a letter dated January 11, 2000. OB considers this finding closed per OMB Circular A-133, section 315(b)(4). No further action is warranted because two years have passed since the report was issued, HHS is not currently following up on the finding, and no management decision was issued.
DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT (DCED)			
Finding 3	Inaccurate Performance and Evaluation Report Submitted to HUD	HUD	Closed – DCED has implemented new procedures to correct the problem. HUD is not currently following up on this finding. DCED considers this finding closed per OMB Circular A-133, section 315(b)(4).
DEPARTMENT OF LABOR AND INDUSTRY (L&I)			
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	Resolved – Closed per USDE final determination letter of August 1, 2000.
DEPARTMENT OF PUBLIC WELFARE (DPW)			
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	Resolved – Closed per USDE final determination letter of August 1, 2000.
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. DPW provided additional information to HHS on March 28, 2000, and again on June 14, 2002 in response to HHS letter of May 17, 2002.
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	Closed – Additional information was provided to HHS/HCFA on December 1, 1999. Finding resolved by HHS/HCFA e-mail of February 2, 2000.

Summary Schedule of Prior Audit Findings as of December 31, 2002
Single Audit Findings for Fiscal Year Ended June 30, 1998

STATE AGENCY / FINDING		RESPONSIBLE FEDERAL AGENCY	COMMENTS
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 three years in increasing the number of wage rate spot-checks as required by the Davis-Bacon Act. PADOT believes it is in compliance with Davis-Bacon requirements and will submit a letter to the FHWA requesting that the finding be closed.

Summary Schedule of Prior Audit Findings as of December 31, 2002
Single Audit Findings for Fiscal Year Ended June 30, 1999

	STATE AGENCY / FINDING	RESPONSIBLE FEDERAL AGENCY	COMMENTS
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	Resolved – Closed per USDA/FNS letter of March 7, 2002.
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	Closed – Corrective action has been taken. Additional information provided to HHS in letters dated August 3, 2000 and August 14, 2000. OB considers this finding closed per OMB Circular A-133, section 315(b)(4). No further action is warranted because two years have passed since the report was issued, HHS is not currently following up on the finding, and no management decision was issued.
INSURANCE DEPARTMENT (INS)			
Finding 11	Weakness in Administration of State Children's Insurance Program Subrecipients	HHS	Resolved – On July 28, 2000, INS sent a letter to HHS outlining their response to the finding. HHS has verbally indicated that the INS response was acceptable and HHS procedures do not require a written response to be issued by them.
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. DPW provided additional information to HHS on March 28, 2000, and again on June 14, 2002 in response to HHS letter of May 17, 2002.
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	Closed – Additional information was provided to HHS/HCFA on December 1, 1999. Finding resolved by HHS/HCFA e-mail of February 2, 2000.

Summary Schedule of Prior Audit Findings as of December 31, 2002
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 14, 2002, FEMA requested verification 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 September 13, 2002. OB/BFM is awaiting action from USDA.
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. OB/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. 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 implemented new procedures to monitor subrecipients in January 2002. HUD has not yet contacted DCED to resolve this finding.
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	Resolved – Questioned costs repaid to DOL on January 15, 2002. Finding is resolved.
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	Resolved – Closed per settlement agreement with USDE signed April 1, 2002.

Summary Schedule of Prior Audit Findings as of December 31, 2002
Single Audit Findings for Fiscal Year Ended June 30, 2000

	STATE AGENCY / FINDING	RESPONSIBLE FEDERAL AGENCY	COMMENTS
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	Resolved – Closed per settlement agreement with USDE signed April 1, 2002.
Finding 00-9	Unallowable Costs Charged to a Job Creation Grant Resulting in $63,203 in Questioned Costs	USDE	Resolved – Closed per settlement agreement with USDE signed April 1, 2002.
INSURANCE DEPARTMENT (INS)			
Finding 00-14	The Department of Insurance Failed to Meet Minimum Maintenance of Effort Requirement by Over $9.6 Million	HHS	Resolved – CHIP experienced two penalties for not meeting the Maintenance of Effort (MOE) requirement. HHS assessed the penalties based on Commonwealth spending on CHIP during federal fiscal years 1998 and 1999. The penalties were a factor of the growth curve of the program. Since 1999, the amount the Commonwealth has expended on CHIP has continually grown and is expected to remain well above the MOE requirement. HHS will not issue any further response, but will continually monitor CHIP spending to ensure the MOE requirement is being met.
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 is working with HHS on this finding. No resolution has been reached. DPW provided additional information to HHS on May 31, 2002 in response to HHS letter of May 10, 2002.

Summary Schedule of Prior Audit Findings as of December 31, 2002
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 additional information to HHS on March 28, 2000, and again on June 14, 2002 in response to HHS letter of May 17, 2002.

Summary Schedule of Prior Audit Findings as of December 31, 2002
Single Audit Findings for Fiscal Year Ended June 30, 2001

	STATE AGENCY / FINDING	RESPONSIBLE FEDERAL AGENCY	COMMENTS
OFFICE OF BUDGET (OB)			
Finding 01-8	Internal Control Weakness Over Expenditure Information Reported on the SEFA	DOT/ARC	Unresolved – The necessary adjustments to correct the SEFA have been made. The Comptroller's Office began implementing procedures to review all spreadsheet calculations used in the preparation of the SEFA. OB is awaiting final resolution from DOT.
Finding 01-9	PEMA Did Not Properly Report Federal Expenditures on the SEFA	FEMA	Unresolved – The necessary adjustments to correct the SEFA have been made. OB/PPR has implemented procedures to review all grant CFDA numbers for accuracy. OB/PPR is awaiting final resolution from FEMA.
Finding 01-20	The Commonwealth's Statewide Cash Management System Needs Improvement (A Similar Condition Was Noted in Prior Year Finding #00-17)	HHS/DPM	Unresolved – Additional information provided to HHS in a letter dated June 14, 2002. OB/BFM is awaiting action from HHS.
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)	HHS/DPM	Unresolved – Additional information provided to HHS in a letter dated June 14, 2002. OB/BFM is awaiting action from HHS.
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)	HUD	Unresolved – DCED discussed this finding with HUD and has begun to implement procedures to correct the problem. DCED is awaiting final action from HUD.
Finding 01-3	Internal Control Weakness Over Information Reported from the Integrated Disbursement and Information System	HUD	Unresolved – DCED implemented new procedures for supervisory review of drawdown information. HUD has not yet contacted DCED to resolve this 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)	HUD	Unresolved – DCED implemented new procedures to monitor subrecipients in January 2002. HUD has not yet contacted DCED to resolve this finding.

Summary Schedule of Prior Audit Findings as of December 31, 2002
Single Audit Findings for Fiscal Year Ended June 30, 2001

STATE AGENCY / FINDING		*RESPONSIBLE FEDERAL AGENCY*	*COMMENTS*
DEPARTMENT OF ENVIRONMENTAL PROTECTION (DEP)			
Finding 01-5	Unallowable Personnel Charges Result in Questioned Costs of $1,220	DOI	Unresolved – Questioned costs settled by refiling a Financial Status Report (FSR) for the grant and deducting the questioned amount. DEP is awaiting final resolution from DOI.
DEPARTMENT OF LABOR AND INDUSTRY (L&I)			
Finding 01-6	Overpayment of TRA Benefits Resulted in Questioned Costs of $264 (A Similar Condition Was Noted in Prior Year Finding #00-4)	DOL	Unresolved – Corrective action has been taken through establishment of a non-fraud overpayment. To date, additional funds have not been repaid or recovered. DOL has not yet contacted the Commonwealth concerning this finding.
Finding 01-7	Weakness in L&I's Controls Over Preparation and Submission of the Trade Act Participant Report	DOL	Unresolved – L&I has begun to implement corrective action. DOL has not yet contacted the Commonwealth concerning this finding.
Finding 01-10	Weakness in L&I's Procurement System Related to Debarment and Suspension (A Similar Condition Was Noted in Prior Year Finding #00-8)	USDE	Unresolved – Corrective action has been implemented. USDE has not yet contacted the Commonwealth concerning this finding.
Finding 01-11	Inadequate Documentation to Support $33,276 in Unallowable Personnel Costs	USDE	Unresolved – L&I has entered into the CAROI process with USDE for resolution.
Finding 01-12	Weaknesses in L&I's Monitoring of RSBS Subgrantees (A Similar Condition Was Noted in Prior Year Finding #00-9)	USDE	Unresolved – OVR has discussed this finding with USDE during resolution of similar prior year finding. L&I has developed additional measures to improve its grant monitoring procedures. L&I is awaiting final resolution from USDE.
Finding 01-19	Weaknesses in L&I's Internal Controls Over Subrecipients	DOL	Unresolved – DOL has not yet contacted the Commonwealth concerning this finding.
DEPARTMENT OF PUBLIC WELFARE (DPW)			
Finding 01-1	DPW Did Not Have Adequate Internal Controls at the County Assistance Offices Over Eligibility Determinations	HHS/OARCP	Resolved – Finding resolved per HHS/ OARCP letter of November 20, 2002.

Summary Schedule of Prior Audit Findings as of December 31, 2002
Single Audit Findings for Fiscal Year Ended June 30, 2001

	STATE AGENCY / FINDING	*RESPONSIBLE FEDERAL AGENCY*	*COMMENTS*
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)	HHS/ACF	Unresolved – DPW is working with HHS on this finding. No resolution has been reached. DPW provided additional documentation to HHS on May 31, 2002 in response to HHS letter of May 10, 2002.
Finding 01-14	Inaccurate Reporting on the TANF ACF-199 Data Report (A Similar Condition Was Noted in Prior Year Finding #00-11)	HHS/ACF	Unresolved – DPW is working with HHS on this finding. No resolution has been reached. DPW provided additional documentation to HHS on October 4, 2002 in response to HHS/ACF letter of July 18, 2002.
Finding 01-15	Noncompliance and Internal Control Weakness Over the Process of Responding to Interstate Registry Cases	HHS/ACF	Unresolved – DPW is working with HHS on this finding . No resolution has been reached. DPW provided additional documentation to HHS on May 31, 2002 in response to HHS letter of May 10, 2002.
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)	HHS/DPM	Unresolved – DPW is working with HHS on this finding. No resolution has been reached. DPW provided additional information to HHS on March 28, 2000, and again on June 14, 2002 in response to HHS letter of May 17, 2002.
Finding 01-17	Internal Control Weaknesses and Noncompliance With Federal Earmarking Requirements Result in Questioned Costs of $1,381,114	HHS/ACF	Unresolved – DPW is working with HHS on this finding. No resolution has been reached. DPW provided additional documentation to HHS on October 4, 2002 in response to HHS/ACF letter of July 18, 2002.
Finding 01-18	DPW Office of Children, Youth and Families Should Renew Licensing of Foster Care Agencies in a More Timely Manner	HHS/ACF	Unresolved – DPW is working with HHS on this finding. No resolution has been reached. DPW provided additional documentation to HHS on May 31, 2002 in response to HHS letter of May 10, 2002.

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Corrective Action Plans

Commonwealth of Pennsylvania

Index to Corrective Action Plans - June 30, 2002
Basic Financial Statement Comments

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

COMMONWEALTH OF PENNSYLVANIA

Index to Corrective Action Plans - Federal Award Findings - June 30, 2002

Finding No.	CFDA No.	CFDA Name	Finding Title	Questioned Costs	Impacted State Agency	Finding Page	CAP Page
02-1**	10.550	Food Donation Program	Internal Control Weaknesses and Noncompliance with Processor Recordkeeping and Reporting Requirements Result in Questioned Costs of $2,088	$2,088	AGRI	153	**282**
02-2**	10.551 93.558 93.575 93.596 93.778	Food Stamps Temporary Assistance for Needy Families Child Care and Development Block Grant Child Care Mandatory & Matching Funds Medical Assistance	Internal Control Weaknesses at DPW Result in Noncompliance with Federal Regulations		DPW	157	**286**
02-3*	10.557	Special Supplemental Nutrition Program for Women, Infants and Children	Noncompliance and Internal Control Weaknesses in DOH Systems Result in $144,126 in Questioned Costs	$144,126	DOH	162	**284**
02-4**	10.557	Special Supplemental Nutrition Program for Women, Infants and Children	DOH Did Not Obtain Prior Approval from FNS for Project Costs Related to Acquisition and Implementation of a New Automated WIC Database System		DOH	167	**284**
02-5**	14.228	Community Development Block Grants/ State's Program	Performance/Evaluation Report Submitted to HUD Was Inaccurate (A Similar Condition Was Noted in Prior Year Finding #01-2)		DCED	169	**282**
02-6*	14.228 14.239	Community Development Block Grants/ State's Program HOME Investment Partnerships Program	Internal Control Weakness Over Information Reported From Integrated Disbursement and Information System (A Similar Condition Was Noted in Prior Year Finding #01-3)		DCED OB/LECS	171	**280/ 283**
02-7*	14.239	HOME Investment Partnerships Program	DCED Did Not Perform Adequate Monitoring of Community Housing Development Organization Operating Grants (A Similar Condition Was Noted in Prior Year Finding #01-4)		DCED	173	**283**
02-8*	15.250	Regulation of Surface Coal Mining	Unallowable Personnel Charges Result in Questioned Costs of $112 (A Similar Condition Was Noted in Prior Year Finding #01-5)	$112	DEP	176	**284**

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

COMMONWEALTH OF PENNSYLVANIA

Index to Corrective Action Plans - Federal Award Findings - June 30, 2002

Finding No.	CFDA No.	CFDA Name	Finding Title	Questioned Costs	Impacted State Agency	Finding Page	CAP Page
02-9**	17.245	Trade Adjustment Assistance – Workers	Incomplete Reporting on the ETA 563 Report		L&I	178	**285**
02-10**	17.245	Trade Adjustment Assistance – Workers	Weakness in L&I's Controls Over Preparation and Submission of the Trade Act Participant Report to USDOL (A Similar Condition Was Noted in Prior Year Finding #01-7)		L&I	180	**285**
02-11*	17.245	Trade Adjustment Assistance – Workers	Overpayment of TRA Benefits Resulted in Questioned Costs of $3,989 (A Similar Condition Was Noted in Prior Year Finding #01-6)	$3,989	L&I	182	**285**
02-12**	17.255 17.258 17.259 17.260 93.558	Workforce Investment Act WIA Adult Program WIA Youth Activities WIA Dislocated Workers Temporary Assistance for Needy Families	L&I Did Not Properly Report Federal Expenditures on the Schedule of Expenditures of Federal Awards		OB/LECS	184	**280**
02-13**	17.255 17.258 17.259 17.260	Workforce Investment Act WIA Adult Program WIA Youth Activities WIA Dislocated Workers	Incomplete Reporting on and Inadequate Controls Over the WIA Annual Performance Report		L&I	186	**285**
02-14*	20.205 23.003	Highway Planning and Construction Appalachian Dev. Highway System	Internal Control Weakness Over Expenditure Information Reported on the SEFA (A Similar Condition Was Noted in Prior Year Finding #01-8)		OB/ TRANS	189	**280**
02-15*	66.458 66.468	Capitalization Grants for State Revolving Funds Capitalization Grants for Drinking Water	Internal Control Weakness Over the Preparation of DEP Quarterly Billings to PENNVEST		DEP	190	**284**
02-16*	84.027 84.213 93.994	Special Education – Grants to States Even Start – State Educational Agencies Maternal & Child Health Services Block Grant	Noncompliance and Internal Control Weaknesses at DOH Result in $551,764 in Questioned Costs	$551,764	DOH	191	**284**

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

COMMONWEALTH OF PENNSYLVANIA

Index to Corrective Action Plans - Federal Award Findings - June 30, 2002

Finding No.	CFDA No.	CFDA Name	Finding Title	Questioned Costs	Impacted State Agency	Finding Page	CAP Page
02-17**	84.048	Vocational Education – Basic Grants to States	Inadequate Controls Over PDE's Voc Ed Consolidated Annual Performance, Accountability, and Financial Status Report Submitted to USDE		PDE	195	**283**
02-18*	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 #01-10)		L&I	198	**285**
02-19**	84.126	Rehabilitation Services – Vocational Rehabilitation Grants to States	$3,890,912 in Excess Funds Were Drawn Down From USDE in Violation of Federal Cash Management Regulations		OB/LECS	200	**281**
02-20**	84.126	Rehabilitation Services – Vocational Rehabilitation Grants to States	Noncompliance and Weaknesses in Internal Controls Over Charging of Personnel Costs Result in Questioned Costs of $11,969 (A Similar Condition Was Noted in Prior Year Finding #01-11)	$11,969	L&I	202	**286**
02-21**	84.126	Rehabilitation Services – Vocational Rehabilitation Grants to States	Internal Control Weakness Over Preparation and Submission of Vocational Rehabilitation Provider Claim Forms to SSA		L&I	204	**286**
02-22*	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 #01-12)		L&I	205	**286**
02-23**	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 #01-13)		DPW	207	**287**
02-24**	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 #01-14)		DPW	209	**287**

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

COMMONWEALTH OF PENNSYLVANIA
Index to Corrective Action Plans - Federal Award Findings - June 30, 2002

Finding No.	CFDA No.	CFDA Name	Finding Title	Questioned Costs	Impacted State Agency	Finding Page	CAP Page
02-25**	93.563	Child Support Enforcement	Noncompliance and Internal Control Weakness Over the Processing of Interstate Registry Cases (A Similar Condition Was Noted in Prior Year Finding #01-15)		DPW	215	**287**
02-26**	93.575 93.596 93.667	Child Care and Development Block Grant Child Care Mandatory & Matching Funds Social Services Block Grant	Weakness in DPW Monitoring Procedures Results in Over $15 Million in Excess Subgrantee Federal Cash at June 30, 2002 (A Similar Condition Was Noted in Prior Year Finding #01-16)		DPW	218	**288**
02-27*	93.575	Child Care and Development Block Grant	Internal Control Weaknesses and Noncompliance With Federal Earmarking Requirements Result in Questioned Costs of $1,624,404 (A Similar Condition Was Noted in Prior Year Finding #01-17)	$1,624,404	DPW	223	**288**
02-28**	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 (A Similar Condition Was Noted in Prior Year Finding #01-18)		DPW	225	**288**
02-29*	93.767	State Children’s Insurance Program	Noncompliance and Internal Control Weaknesses in Federal Reporting and State Matching Procedures Result in $31,576 in Questioned Costs	$31,576	INS OB/CS	227	**281/** **285**
02-30**	93.778	Medical Assistance	Ineligible Payments to MA Beneficiaries Result in Questioned Costs of $27,552	$27,552	DPW	230	**288**
02-31**	93.994	Maternal & Child Health Services Block Grant	DOH Could Not Support Information Submitted to HHS on its Annual Statistical Report		DOH	232	**284**
02-32**	66.458 66.468	Capitalization Grants for State Revolving Funds Capitalization Grants for Drinking Water	Noncompliance with OMB Circular A-133 Subrecipient Audit Requirements		PENN- VEST	234	**284**

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

COMMONWEALTH OF PENNSYLVANIA

Index to Corrective Action Plans - Federal Award Findings - June 30, 2002

Finding No.	CFDA No.	CFDA Name	Finding Title	Questioned Costs	Impacted State Agency	Finding Page	CAP Page
02-33**	93.044 93.045	Special Programs for Aging -Title III Pt B Special Programs for Aging -Title III Pt C	A Material Weakness Exists in PDA's Subrecipient Audit Resolution Process		PDA	237	**281**
02-34**	17.253 17.255 17.258 17.259 17.260	Welfare-to-Work Grants to States Workforce Investment Act WIA Adult Program WIA Youth Activities WIA Dislocated Workers	Noncompliance With OMB Circular A-133 Subrecipient Audit Requirements (A Similar Condition Was Noted in Prior Year Finding #01-19)		L&I	239	**286**
02-35*	Various	All Major Programs with OMB Circular A-133 Subrecipients	Lack of Statewide Monitoring of OMB Circular A-133 Subrecipient Audit Report Submission to the Federal Audit Clearinghouse		OB/BOA	242	**281**
02-36 **	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 #01-20)		OB/BFM	244	**281**
02-37*	93.558 93.575 93.596 93.658 93.659 93.667 Various	Temporary Assistance for Needy Families Child Care and Development Block Grant Child Care Mandatory & Matching Funds Foster Care – Title IV-E Adoption Assistance Social Services Block Grant All Major Programs Covered by CMIA	The CMIA Interest Liability Was Understated by a Minimum of $86,290 (A Similar Condition Was Noted in Prior Year Finding #01-21)		OB/BFM	247	**281**
			Total Questioned Costs	$2,397,580			

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

OFFICE OF THE BUDGET (OB)

Comment 02-1: Internal Control Weaknesses Over Financial Reporting in the Lottery Fund (A Similar Condition Was Noted in Prior Year Comment #01-2)

Several steps are being taken to address the items noted in the finding:

1) The Excel spreadsheet formula has been reviewed and the error has been corrected.

2) Any future changes to the spreadsheet formulas will be documented and reviewed to ensure accuracy prior to use.

3) A dialogue will be established between Central Services, Department of Revenue and Lottery to ensure that Lottery fiscal staff are aware of the GAAP reporting requirements prior to fiscal year end.

On May 1, 2003 an initial meeting was held with the Department of Revenue and Lottery fiscal staff. A commitment was made by Lottery to provide "game" information timely and regularly to Central Services staff. Lottery's initial effort consisted of their reconciliation of the International Game Technology (IGT) Liability Audit Report as of March 31, 2003, which includes the on-line games.

Comment 02-3: Internal Control Weakness Over Reporting Inter- and Intrafund Activity in the Basic Financial Statements

The Bureau of Financial Management will be meeting with the auditors to discuss and address this comment.

Comment 02-7: Improving Financial Reporting Over Accounts Payable

The Bureau of Financial Management will provide direction to Comptroller Offices that are responsible for assisting with the preparation of the basic financial statements to report all accounts payable as fund-specific liabilities in the fund financial statements.

Comment 02-8: Lack of Documentation and Internal Control Weaknesses Over Contracting and Procurement (A Similar Condition Was Noted in Prior Year Comment #01-5)

No further information provided. See agency response in the body of the finding.

Finding 02-6: Internal Control Weakness Over Information Reported from Integrated Disbursement and Information System (A Similar Condition Was Noted in Prior Year Finding #01-3)

No further information provided. See agency response in the body of the finding.

Finding 02-12: L&I Did Not Properly Report Federal Expenditures on the Schedule of Expenditures of Federal Awards

No further information provided. See agency response in the body of the finding.

Finding 02-14: Internal Control Weakness Over Expenditure Information Reported on the SEFA (A Similar Condition Was Noted in Prior Year Comment #01-8)

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 these spreadsheets. The clerical errors were not material; however, they went undetected by Comptroller personnel in their preparation and review procedures for the SEFA. The SEFA was corrected as a result of our audit.

Specific steps taken to correct the situation: The necessary adjustments to correct the June 30, 2002 SEFA have been forwarded to and processed by the Bureau of Financial Management. The supervisory review of the spreadsheets and schedules prepared to calculate the SEFA for the HPC cluster and other PADOT federal programs will be strengthened for the preparation of the June 30, 2003 SEFA by adding an additional level of managerial review.

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, 2003.

Finding 02-19: $3,890,912 in Excess Funds Were Drawn Down From USDE in Violation of Federal Cash Management Regulations

No further information provided. See agency response in the body of the finding.

Finding 02-29: Noncompliance and Internal Control Weaknesses in Federal Reporting and State Matching Procedures Result in $31,576 in Questioned Costs

As recommended in the audit findings, Central Services has implemented supervisory review to ensure proper oversight prior to electronic submission of the CMS-21 report. In addition to the internal control recommendation, Central Services will contact Health and Human Services (HHS) to negotiate a resolution for corrective action for the $31,576 overclaim.

Finding 02-35: Lack of Statewide Monitoring of OMB Circular A-133 Subrecipient Audit Report Submission to the Federal Audit Clearinghouse

The Bureau of Audits will implement procedures beginning July 1, 2003 to verify that the Commonwealth's subrecipients submit their data collection forms and audit report packages to the Federal Audit Clearinghouse (FAC), as required by OMB Circular A-133, section 320. The BOA will periodically download information from the FAC database, match it with the database of audit reports submitted to BOA, and follow-up on subrecipients that have not filed with the FAC. To ensure effective implementation, the desk review checklist will be revised to verify submission of the data collection form.

Finding 02-36: The Commonwealth's Statewide Cash Management System Needs Improvement (A Similar Condition Was Noted in Prior Year Finding #01-20)

No further information provided. See agency response in the body of the finding.

Finding 02-37: The CMIA Interest Liability Was Understated by a Minimum of $86,290 (A Similar Condition Was Noted in Prior Year Finding #01-21)

No further information provided. See agency response in the body of the finding.

DEPARTMENT OF AGING (PDA)

Finding 02-33: A Material Weakness Exists in PDA's Subrecipient Audit Resolution Process

Under the Commonwealth's implementation of the Single Audit Act, review and reconciliation of OMB Circular A-133 subrecipient audit reports is split into two stages. The Commonwealth receives all A-133 subrecipient audit reports through OB/BOA, which ensures the reports meet technical standards through a desk review process. Once they are deemed acceptable by BOA, the reports are transmitted to the various funding agencies in the Commonwealth and each agency in the Commonwealth's resolution system must make a management decision on each finding within six months after the report is transmitted to them to ensure corrective action is taken by the subrecipient. The agency is also responsible for reviewing financial information in each audit report (e.g., SEFA) to determine whether the audit included all pass-through funding provided by the agency and to adjust Commonwealth records, if necessary. PDA received thirty-four audits during the test period, of which five were selected as test audits. Three of the five audits had findings which were not completed within the six-month time frame. It was recommended that PDA ensure compliance with federal audit resolution requirements.

As noted in the Agency response, two of the three audits with findings have been reconciled and resolved subsequent to the audit review, with the third underway.

Review of Single Audits is a high priority within the PDA and is considered an important aspect of our fiscal responsibility. Diligent attention to adherence with this regulation will continue to be a priority. To that end, stricter attention will be given to ensure compliance with the six-month guidelines.

Currently within PDA, upon receipt of a Single Audit, an initial review is conducted with audits placed on two ongoing listings, as applicable. One listing records all Single Audit names, time period of the audit, date received and ultimately, the date completed. The other listing exclusively lists those Single Audits received which contain findings. This listing includes much of the same information as the other, but with the additional detail of the nature of the finding. This information assists the reviewer in determining what criteria or additional research may be necessary to formulate a management decision on the finding and its corrective action plan.

To ensure stricter adherence with the six-month review guidelines, three new steps will be implemented to enhance this process, effective immediately. First, the two audit listings will be run and reviewed monthly instead of quarterly as is currently done. This will refresh the reviewer's awareness, on a more timely basis, of the number and status of audits received. Secondly, a tickler of the second Tuesday of each month will be established on the reviewer's computer calendar by clerical support who prepare the audit listings. This will serve as an initial date to commence a Single Audit with a finding, thus ensuring enough time towards completion of the audit should there be complications. Lastly, instead of just recording the due date of an audit within the calendar system as is currently done, another tickler will be placed a month prior to the due date.

The additional audit review steps will ensure more reminders to the reviewer by the reviewer herself and by clerical support staff posting updates to the reviewer's calendar. Additionally, supervisory staff will review the monthly reports.

DEPARTMENT OF AGRICULTURE (AGRI)

Finding 02-1: Internal Control Weaknesses and Noncompliance with Processor Recordkeeping and Reporting Requirements Result in Questioned Costs of $2,088

No further information provided. See agency response in the body of the finding.

DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT (DCED)

Finding 02-5: Performance/Evaluation Report Submitted to HUD Was Inaccurate (A Similar Condition Was Noted in Prior Year Finding #01-2)

In the Department of Community and Economic Development's Single Audit Finding response, it was indicated that DCED would implement a new procedure for future Performance/Evaluation Report (PER) submissions. Under the new procedure, prior to transmitting the PER to HUD, a sign off by the Program Compliance Officer, who is responsible for the PER preparation, and his/her supervisor, the Chief of Program Development and Technical Support, will be required. This process will serve to provide an additional level of review to verify from IDIS documentation that the figures entered into the PER are accurate. The procedure would be formally set forth and communicated to relevant staff. A copy of the procedure will be available for the auditor to review as part of the office's Policy and Procedures file. DCED has completed its recommended response on March 31, 2003.

Moreover, the Performance/Evaluation Report was revised and resubmitted to HUD on March 12, 2003. DCED feels that it has implemented its recommendations as provided in its response to the auditors on March 14, 2003.

Finding 02-6: Internal Control Weakness Over Information Reported from Integrated Disbursement and Information System (A Similar Condition Was Noted in Prior Year Finding #01-3)

No further information provided. See agency response in the body of the finding.

Finding 02-7: DCED Did Not Perform Adequate Monitoring of Community Housing Development Organization Operating Grants (A Similar Condition Was Noted in Prior Year Finding #01-4)

DCED staff has issued a corrective plan which entails the following steps:

* DCED has developed a revised set of CHDO Operating Grant Closeout Procedures which were developed in consultation with and received the approval of HUD.

* HUD reviewed these revised CHDO Operating Grant Closeout Procedures and determined that on-site monitoring is not necessary.

* The revised procedures included clarifications regarding how DCED selects invoices for review.

The revised CHDO Operating Grant Closeout Procedures will be used in closing out any CHDO Operating grant effective May 23, 2003.

DEPARTMENT OF EDUCATION (PDE)

Finding 02-17: Inadequate Controls Over PDE's VOC ED Consolidated Annual Performance, Accountability and Financial Status Report Submitted to USDE

Audit Reference: CFDA 84.048 **-** Vocational Education **-** Basic Grants to States

Description of Noncompliance or Weakness: The auditors review disclosed a weakness in PDE's internal controls over the Vocational Education Consolidated Annual Performance, Accountability, and Financial Status Report submitted to USDE.

Specific Steps to be Taken and Timetable: Monitoring procedures will be developed, implemented and documented between BCTE and its testing contractor and BCAS and its testing contractor to assure accuracy of data submitted to USDE as it relates to the CAR.

Supervisory signatory reviews will be documented to assure reasonableness and accuracy of data prior to forwarding the CAR to the USDE.

The timetable will involve those months when data is received, compiled, analyzed and synthesized for the 2002 CAR.

Description of Monitoring: BCTE and BCAS will request and receive test data from the third party contractors for comparative data reviews of that collected internally. Individuals that are engaged in the processes will be identified, expected to document the analysis and submit such documentation for supervisory review and be available for audit upon request.

Title of Official Responsible for Corrective Action: Director, Bureau of Career and Technical Education

Anticipated Completion Date for Corrective Action: December 31, 2003

DEPARTMENT OF ENVIRONMENTAL PROTECTION (DEP)

Finding 02-8: Unallowable Personnel Charges Result in Questioned Costs of $112 (A Similar Condition Was Noted in Prior Year Finding #01-5)

No further information provided. See agency response in the body of the finding.

Finding 02-15: Internal Control Weakness Over the Preparation of DEP Quarterly Billings to PENNVEST

No further information provided. See agency response in the body of the finding.

DEPARTMENT OF HEALTH (DOH)

Finding 02-3: Noncompliance and Internal Control Weaknesses in DOH Systems Result in $144,126 in Questioned Costs

No further information provided. See agency response in the body of the finding.

Finding 02-4: DOH Did Not Obtain Prior Approval from FNS for Project Costs Related to Acquisition and Implementation of a New Automated WIC Database System

No further information provided. See agency response in the body of the finding.

Finding 02-16: Noncompliance and Internal Control Weaknesses at DOH Result in $551,764 in Questioned Costs

DOH will pursue resolution of this finding with the applicable federal awarding agencies involved (HHS and USDE). No further information provided. See agency response in the body of the finding.

Finding 02-31: DOH Could Not Support Information Submitted to HHS on its Annual Statistical Report

No further information provided. See agency response in the body of the finding.

PENNSYLVANIA INFRASTRUCTURE INVESTMENT AUTHORITY (PENNVEST)

Finding 02-32: Noncompliance with OMB Circular A-133 Subrecipient Audit Requirements

CFDA #66.458 **-** Capitalization Grants for State Revolving Funds
CFDA #66.468 – Capitalization Grants for Drinking Water

<u>PENNVEST Remedial Action Plan Time Lines</u>

All federal subrecipients subject to reporting requirements will be notified at the end of respective fiscal year with general references to remedial actions for noncompliance. PENNVEST reserves the right to waive any part of the remedial action plan if warranted to bring the subrecipient into compliance.

1. 1-30 days – Notify subrecipient of compliance issue and of potential or real default of loan agreement

2. 31-60 days – Order actions to bring subrecipient into compliance or resolution and include notification that further disbursements on the subrecipient's loan are being withheld.

3. 61-90 days – Notify subrecipient of compliance issue and of potential placement on Central Contractor Responsibility File.

4. 91-120 days – Notify and place subrecipient on Central Contractor Responsibility File until under compliance or resolution of issue.
5. 121-150 days – Notify subrecipient of potential offset of other state monies being held (if applicable).

6. 151-180 days – Notify subrecipient and Commonwealth agency of offset of other state monies (if applicable).

7. 181 days – Refer matter to the PENNVEST Legal Department for notice of default of loan agreement and potential acceleration of debt.

INSURANCE DEPARTMENT (INS)

Finding 02-29: Noncompliance and Internal Control Weaknesses in Federal Reporting and State Matching Procedures Result in $31,576 in Questioned Costs

As recommended in the audit findings, Central Services has implemented supervisory review to ensure proper oversight prior to electronic submission of the CMS-21 report. In addition to the internal control recommendation, Central Services will contact Health and Human Services (HHS) to negotiate a resolution for corrective action for the $31,576 overclaim.

DEPARTMENT OF LABOR AND INDUSTRY (L&I)€

Comment 02-5: Weaknesses in Internal Controls Over State Workers' Insurance Fund (SWIF) Investments€

No further information provided. See agency response in the body of the finding.

Finding 02-9: Incomplete Reporting on the ETA 563 Report

No further information provided. See agency response in the body of the finding.

Finding 02-10: Weakness in L&I's Controls Over Preparation and Submission of the Trade Act Participant Report to USDOL (A Similar Condition Was Noted in Prior Year Finding #01-7)

No further information provided. See agency response in the body of the finding.

Finding 02-11: Overpayment of TRA Benefits Results in Questioned Costs of $3,989 (A Similar Condition Was Noted in Prior Year Finding #01-6)

No further information provided. See agency response in the body of the finding.

Finding 02-13: Incomplete Reporting On and Inadequate Controls Over the WIA Annual Performance Report

No further information provided. See agency response in the body of the finding.

Finding 02-18: A Weakness Exists in L&I's Procurement System Related to Debarment and Suspension (A Similar Condition Was Noted in Prior Year Finding #01-10)

No further information provided. See agency response in the body of the finding.

Finding 02-20: Noncompliance and Weaknesses in Internal Controls Over Charging of Personnel Costs Result in Questioned Costs of $11,969 (A Similar Condition Was Noted in Prior Year Finding #01-11)

No further information provided. See agency response in the body of the finding.

Finding 02-21: Internal Control Weaknesses Over Preparation and Submission of Vocational Rehabilitation Provider Claim Forms to SSA

No further information provided. See agency response in the body of the finding.

Finding 02-22: Weaknesses Exist in L&I's Monitoring of RSBS Subgrantees (A Similar Condition Was Noted in Prior Year Finding #01-12)

No further information provided. See agency response in the body of the finding.

Finding 02-34: Noncompliance With OMB Circular A-133 Subrecipient Audit Requirements (A Similar Condition Was Noted in Prior Year Finding #01-19)

No further information provided. See agency response in the body of the finding.

DEPARTMENT OF PUBLIC WELFARE (DPW)

Comment 02-6: Internal Control Weaknesses Result in Improper Payments in the Tobacco Settlement Fund

The Department of Public Welfare, Office of Medical Assistance Programs (OMAP), continues to follow the criteria outlined in the Tobacco Settlement Act of 2001, and will strive to consistently use the best available data. In addition, the OMAP has initiated an internal and external validation process. For fiscal year ending 2002 tobacco payments, the OMAP had an internal validation process that included computer programming cross-checks to ensure the accuracy of data outcomes, and a core team of personnel who individually analyzed the calculations for facilities. As an external validation, all data was sent to each facility for verification, and the final calculations were accepted by the hospital industry. Currently, the OMAP is pursuing a contract with an independent entity, Tucker Alan, Inc., as an additional external validator of the calculations.

Lastly, the Extraordinary Expense payments in question (Charles Cole Memorial, Titusville, and Butler County Memorial) are currently under audit by the Department of the Auditor General, Bureau of State-Aided Audits, as indicated in an August 12, 2002 engagement letter that states their intention to audit hospitals that have received tobacco settlement monies related to compensated care. The OMAP is awaiting the outcome of the audit before finalizing calculations and making payment decisions.

Finding 02-2: Internal Control Weaknesses at DPW Result in Noncompliance with Federal Regulations

The OIM will ensure that the County Assistance Office (CAO) caseworkers receive additional training, and that supervisors will conduct periodic Comprehensive Supervisory Reviews and Targeted Supervisory Reviews to make sure staff follow established DPW policies and procedures regarding determining eligibility and redeterminations. These periodic reviews are done on an ongoing basis.

The DPW has been working with the Administrative Office of Pennsylvania Courts to establish a data match that would provide information on criminal justice dispositions and clients' compliance with fines, costs, and restitution related to these dispositions.

The Automated Restitution Referral and Computation Procedures releases and all other applicable regulations pertaining to overpayments are reviewed with Income Maintenance caseworkers on a regular basis. The DPW is currently reviewing the process statewide to enhance the procedures.

Finding 02-23: Lack of Documentation to Support Compliance with Federal Welfare Reform Regulations (A Similar Condition Was Noted in Prior Year Finding #01-13)

To institute corrective action, the DPW, Office of Income Maintenance (OIM), issued an 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. The auditors are aware of the issuance of Operations Memorandum OPO020202, and will test this corrective action as part of the subsequent year single audit.

Finding 02-24: Inaccurate Reporting on the TANF ACF-199 Data Report (A Similar Condition Was Noted in Prior Year Finding #01-14)

The OIM did find an issue with the marital status of individuals not always being updated immediately by the caseworker when a spouse leaves or returns to the household. The OIM had previously made changes to the Client Information System (CIS) to address this problem; however, based on this audit finding, the OIM has identified an additional modification that must be made to ensure that marital statuses are updated as changes occur in the family composition.

An issue was also found with how the OIM process used to extract information from the CIS for the ACF-199 assigns the relationship code, Item 38, for the second parent in those families where both spouses are receiving Supplemental Security Income. The OIM is currently reviewing this process to resolve the issue.

The OIM concurs that subsidized childcare payment information for 51/2455737 for the month of September 2001 was not accurately presented in the ACF-199 report. Corrected ACF-199 files have been prepared and submitted back to October 2001.

The OIM agrees with most of the conditions and recommendations as stated in the finding. However, it must be noted that the current Single Audit finding lists similar conditions contained within Prior Year Finding #00-13. The federal Administration for Children and Families (ACF), by correspondence dated April 29, 2003 (copy enclosed), advised the DPW of its concurrence with all of the auditors' recommendations. Additionally, the ACF performed a review on a sample of Temporary Assistance to Needy Families (TANF) data transmitted quarterly by the DPW for the ACF-199, and confirmed that the data was inaccurate and did not agree with the information contained on the automated tracking system identified by the DPW as the source of the data for the report.

Accordingly, the DPW is subject to a penalty, in accordance with the TANF regulation, as the DPW failed to submit accurate, complete, and timely required reports during the prior Single Audit period July 1, 2000, to June 30, 2001. The ACF will issue a separate notice to impose the penalty on the DPW. It is anticipated that further corrective action would be implemented as a result of the impending penalty.

Lastly, it is also anticipated that a similar penalty would be imposed against the DPW for similar ACF-199 deficiencies, as identified in the current single audit period.

Finding 02-25: Noncompliance and Internal Control Weakness Over the Processing of Interstate Registry Cases (A Similar Condition Was Noted in Prior Year Finding #01-15)

The OIM, Bureau of Child Support Enforcement (BCSE), review of the finding indicates that 90 percent of the audit sample of **responding interstate cases** met the 10-day established timeframe, and maintains it is in compliance with standards for determining substantial compliance with IV-D requirements. 45 CFR 305.63 specifies that the BCSE must provide interstate services required under 45 CFR 307 in at least 75 percent of the cases reviewed.

Similarly, the BCSE review of the finding indicates that 90 percent of the audit sample of **initiating interstate cases** met the 20-day established timeframe, and maintains it is in compliance with standards for determining substantial compliance with IV-D requirements as cited above, again in at least 75 percent of the cases reviewed.

The BCSE disagrees with both components of the Finding and will await federal resolution action.

Finding 02-26: Weakness in DPW Monitoring Procedures Results in Over $15 Million in Excess Subgrantee Federal Cash at June 30, 2002 (A Similar Condition Was Noted in Prior Year Finding #01-16)

On several previous occasions, the DPW attempted to engage in a dialog with the federal Department of Health and Human Services on the general cash management issue. In that regard, DPW's previously issued correspondence continues to remain unanswered. The DPW encourages federal resolution of this ongoing single audit finding.

Finding 02-27: Internal Control Weaknesses and Noncompliance With Federal Earmarking Requirements Result in Questioned Costs of $1,624,404 (A Similar Condition Was Noted in Prior Year Finding #01-17)

The DPW, Office of Children, Youth and Families, is planning a review of its procedures in order to ensure documentation, tracking, and monitoring of future infant and toddler earmarked expenditures.

It must be noted that the current Single Audit finding lists similar conditions contained in Prior Year Finding # 01-17. The ACF, by correspondence dated April 29, 2003, acknowledged that additional substantiating documentation was submitted in order to justify the validity of the grant expenditures questioned during the prior single audit period July 1, 2000, to June 30, 2001. However, the letter advises of the ACF decision to have their staff schedule a further review in order to make an accurate determination with respect to expenditures that may qualify as allowable for the infant and toddlers earmark.

The ACF may expand the review of expenditure documentation to include the current Single Audit issues.

Finding 02-28: DPW Office of Children, Youth and Families Should Renew Licensing of Foster Care Agencies in a More Timely Manner (A Similar Condition Was Noted in Prior Year Finding #01-18)

The internal control weakness cited that caused untimely Foster Care Agency licensing renewals were due to staffing vacancies, delays caused by negotiations between the agency regional office and the counties regarding regulatory citations or acceptable plans of correction, and regional office staff time used in preparation for a one-time federal review.

All staffing shortages and administrative issues have already been addressed.

Finding 02-30: Ineligible Payments to MA Beneficiaries Result in Questioned Costs of $27,552

The OIM disagrees with the need to issue this audit finding; therefore, no corrective action is warranted.

DEPARTMENT OF TRANSPORTATION (PADOT)

Comment 02-2: Internal Control Weakness Over Reporting Highway and Bridge Infrastructure and Related Depreciation in the Government-Wide Statements

No further information provided. See agency response in the body of the finding.

DEPARTMENT OF TREASURY (TREAS)

Comment 02-4: Noncompliance With Pennsylvania Laws Governing Authorized Investments for Participants in the INVEST Program (A Similar Condition Was Noted in Prior Year Comment #01-3)

No further information provided. See agency response in the body of the finding.