



Independent Auditor's Report

To the Board of Directors of the
Commonwealth Financing Authority
(Component Unit of Commonwealth of Pennsylvania)

We have audited the accompanying statement of net assets of the Commonwealth Financing Authority ("Authority") as of June 30, 2006, and the related statements of revenues, expenses, and changes in net assets and cash flows for the period April 1, 2004 (date of formation) through June 30, 2006. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in the Summary of Significant Accounting Policies the financial statements present only financial information about the Commonwealth Financing Authority and are not intended to present fairly the financial position of the Commonwealth of Pennsylvania and the results of its operations and cash flows of its proprietary and similar trust fund types in conformity with accounting principles generally accepted in the United States of America.

The Authority is a component unit of the Commonwealth of Pennsylvania ("Commonwealth"). As disclosed in the Summary of Significant Accounting Policies of the financial statements, the Authority has extensive transactions and relationships with certain Commonwealth affiliated agencies. The financial position and results of operations of the Authority may not be indicative of that which would have been obtained had the Authority operated independently.

In our opinion, the financial statements referred to above present fairly the financial position of the Authority, and the results of its operations and cash flows in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 21, 2006 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis as referenced in the table of contents is not a required part of the basic financial statements but is supplemental information required by accounting principles generally accepted in the United States of America. 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.

Clifton Henderson LLP

Harrisburg, Pennsylvania
September 21, 2006

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2006**

The Commonwealth Financing Authority, hereafter referred to as the "Authority," is pleased to present its financial statements developed in compliance with Statement of Governmental Accounting Standard No. 34, entitled "Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments" (hereafter "GASB 34"), and related standards. GASB 34 enhances information provided to the users of its financial statements. This section of the financial reporting package presents our discussion and analysis of the Authority's financial performance during the period April 1, 2004 (date of formation) through June 30, 2006. Please read it in conjunction with the Authority's financial statements that follow this section.

FINANCIAL HIGHLIGHTS

- The period ended June 30, 2006 was the initial period of the Authority's operation.
- During the period ended June 30, 2006 the Authority received bond proceeds of \$375.5 million to fund its operations and to provide grants, loans and loan guarantees under established financing programs.
- During the period ended June 30, 2006, the Authority approved \$245,817,102 in loans, \$28,500,000 in venture capital, \$6,750,000 in loan guarantees, and \$151,291,788 in grants. The Authority's programs support economic development and expansion within the Commonwealth of Pennsylvania.

OVERVIEW OF THE FINANCIAL STATEMENTS

Management's Discussion and Analysis (MD&A) serves as an introduction to, and should be read in conjunction with, the basic audited financial statements. The MD&A represents management's examination and analysis of the Authority's financial condition and performance. Summary financial statement data and other management tools were used for this analysis.

The financial statements report information about the Authority using the full accrual method of accounting, as utilized by similar business activities in the private sector. The financial statements include a statement of net assets; a statement of revenues, expenses, and changes in fund net assets; a statement of cash flows; and notes to the financial statements.

The Statement of Net Assets presents the financial position of the Authority on a full accrual historical cost basis. The Statement of Net Assets presents information on all of the Authority's assets and liabilities, with the difference reported as net assets. Over time, increases and decreases in net assets are one indicator of whether the financial position of the Authority is improving or deteriorating.

While the Statement of Net Assets provides information about the nature and amount of resources and obligations at year-end, the Statement of Revenues, Expenses, and Changes in Net Assets presents the results of the business-type activities over the course of the fiscal year and information as to how the net assets changed during the year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2006**

timing of the related cash flows. This statement also provides certain information about the Authority's recovery of its costs.

The Statement of Cash Flows presents changes in cash and cash equivalents, resulting from operational, financing, and investing activities. This statement presents cash receipts and cash disbursement information without consideration of the earnings event when an obligation arises, or depreciation of capital assets.

The Notes to the Financial Statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Authority's accounting policies, significant account balances and activities, long-term debt and subsequent events, if any.

FINANCIAL ANALYSIS

This is the first year that the Authority is presenting its financial statements; it has no prior years to provide comparative data. In future years when prior year information is available, a comparative analysis of financial data will be included. Financial statements and other selected information serve as the key financial data and indicators for management, monitoring and planning.

Condensed Statement of Net Assets

	<u>June 30, 2006</u>
Current assets	\$ 321,187,709
Long-term assets	<u>38,482,356</u>
Total assets	<u>\$ 359,670,065</u>
Current liabilities	\$ 13,551,143
Long-term liabilities	<u>369,252,955</u>
Total liabilities	<u>382,804,098</u>
Net assets	
Unrestricted (deficit)	<u>(23,134,033)</u>
Total net assets	<u>\$ (23,134,033)</u>

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2006**

Condensed Statement of Revenues, Expenses, and Changes in Fund Net Assets

	Period Ended June 30, 2006
Operating revenues	\$ 5,472,601
Operating expenses	(9,821,668)
Provision for loan losses	(808,226)
Nonoperating revenues/(expenses) - net	(17,976,740)
Increase in net assets	<u>\$ (23,134,033)</u>

As shown in the table above, operating revenues consist mostly of interest earnings. Nonoperating revenues and expenses consist mainly of a Transfer to the Commonwealth for the Machinery and Equipment Loan Fund (MELF) program (\$15 million).

Long-Term Debt

During the current audit period, the Authority issued two revenue bonds totaling \$375 million to provide funds for loan disbursements, investments in venture capital and grant expenditures. This is the first indebtedness incurred by the Authority. In addition, the Authority entered into a service agreement with the Commonwealth of Pennsylvania for the payment of the annual debt service through an annual appropriation by the Commonwealth. However, there is no assurance that there will be sufficient funds appropriated annually by the Commonwealth.

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, investors and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. If you have questions about this report or need additional information, contact the Commonwealth Financing Authority, 400 North Street, Fourth Floor, Harrisburg, PA 17120.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
STATEMENT OF NET ASSETS
June 30, 2006

ASSETS

Current assets:	
Cash and cash equivalents	\$ 315,911,068
Receivables (net):	
Loans	997,830
Accrued interest	55,680
Penalties/late fees	728
Other assets	<u>4,222,403</u>
Total current assets	321,187,709
Long-term assets:	
Long-term portion of loans receivable (net)	<u>38,482,356</u>
TOTAL ASSETS	<u><u>\$ 359,670,065</u></u>

LIABILITIES

Current liabilities:	
Current portion of long-term debt	\$ 10,280,000
Accrued interest payable	2,976,740
Accounts payable and accrued expenses	20,498
Due to primary governments - DCED	<u>273,905</u>
Total current liabilities	13,551,143
Non-current liabilities:	
Long-term debt, net of current portion and unamortized bond premium	<u>369,252,955</u>
Total liabilities	<u>382,804,098</u>
NET ASSETS	
Unrestricted (deficit)	<u>(23,134,033)</u>
TOTAL NET ASSETS	<u><u>\$ (23,134,033)</u></u>

These financial statements should be read only in connection
with the accompanying summary of significant accounting policies
and notes to financial statements.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
The Period April 1, 2004 to June 30, 2006

OPERATING INCOME	
Interest on loans	\$ 117,238
Interest on investments	5,322,967
Penalty/late fee	728
Commitment and application fee	<u>31,668</u>
Total operating income	<u>5,472,601</u>
OPERATING EXPENSE	
Administrative/operating expense	1,756,126
Grant expense - Business in Our Sites	5,217,887
Grant expense - First Industries	<u>2,847,655</u>
Total operating expenses	<u>9,821,668</u>
Net operating loss before provision for loan losses	(4,349,067)
PROVISION FOR LOAN LOSSES	<u>808,226</u>
Net operating loss after provision for loan losses	<u>(5,157,293)</u>
NON-OPERATING INCOME (EXPENSE)	
Transfers in from primary government	5,064,189
Interest on bonds	(8,040,929)
Transfers to primary government - MELF	<u>(15,000,000)</u>
Total non-operating loss	<u>(17,976,740)</u>
Net loss	(23,134,033)
NET ASSETS, BEGINNING OF PERIOD	<u>-</u>
NET ASSETS, END OF PERIOD	<u><u>\$ (23,134,033)</u></u>

These financial statements should be read only in connection
with the accompanying summary of significant accounting policies
and notes to financial statements.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
STATEMENT OF CASH FLOWS
The Period April 1, 2004 to June 30, 2006

CASH FLOWS FROM OPERATING ACTIVITIES	
Cash received from interest and fees on loans	\$ 93,226
Cash received from interest on investments	5,322,967
Cash paid for operating expenses	(1,461,723)
Cash paid for grant expenses	(8,065,542)
Net cash used in operating activities	<u>(4,111,072)</u>
CASH FLOWS FROM INVESTING ACTIVITIES	
Principal receipt on loans	122,886
Investment in loans	(32,911,298)
Investment in venture capital	(7,500,000)
Transfer to primary government	(15,000,000)
Net cash used in investing activities	<u>(55,288,412)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Proceeds from bonds payable, net	375,310,552
Commonwealth appropriation	5,064,189
Interest on bonds payable	(5,064,189)
Net cash provided by noncapital financing activities	<u>375,310,552</u>
NET INCREASE IN CASH	315,911,068
CASH, BEGINNING	<u>-</u>
CASH, END OF YEAR	<u>\$ 315,911,068</u>
RECONCILIATION OF NET OPERATING LOSS AFTER PROVISION FOR LOAN LOSSES TO CASH USED IN OPERATING ACTIVITIES	
Net operating loss after provision for loan losses	\$ (5,157,293)
Adjustments to reconcile net loss to net cash provided by operating activities:	
Provision for loan losses	808,226
Effects of changes in operating assets and liabilities:	
Interest receivables	(55,680)
Other assets	(728)
Accounts payable and accrued expenses	294,403
NET CASH USED IN OPERATING ACTIVITIES	<u>\$ (4,111,072)</u>

These financial statements should be read only in connection
with the accompanying summary of significant accounting policies
and notes to financial statements.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
June 30, 2006**

The Commonwealth Financing Authority (“Authority”) is a body corporate and politic duly organized by the Commonwealth of Pennsylvania (“Commonwealth”) incorporated under the Public Authorities and Quasi-Public Corporations Act of 2004 (“Act”), being the Act of April 1, 2004, P.L. 163, as amended by the Commonwealth of Pennsylvania. The Authority, by virtue of the Act and its articles of incorporation, has all powers as set forth in the Act including those for creation and retention of jobs. The purpose of the Authority is to engage in financial assistance in the form of loans, loan guarantees, grants and private equity participating loans to promote activities which lead to the creation and retention of jobs within the Commonwealth of Pennsylvania, the establishment of economically viable Pennsylvania communities, the development of a stable tax base within Pennsylvania Communities, the reuse of abandoned industrial, commercial and other previously utilized sites, the promotion and commercialization of Pennsylvania products and services and investment of private capital in Pennsylvania communities to promote the health, safety, employment, business opportunities, economic activity and general welfare of the people of the Commonwealth of Pennsylvania.

The legislation creating the Authority as well as program specific guidelines establish certain activities to be carried out by the Authority as follows:

- Business in Our Sites Program: provides financial assistance for preparation of sites for future development.
- First Industries Program: provides financial assistance for projects related to tourism and agriculture.
- Second Stage Loan Program: provides loan guarantees to commercial lending institutions that make loans to life sciences, advanced technology or manufacturing businesses.
- New Pennsylvania Venture Guarantee Program: provides guarantees to venture capital partnerships for investments in Pennsylvania-related companies which are in early-stage or mid-stage development.
- Building Pennsylvania Program: provides loans to fund managers for investment in real estate projects in Pennsylvania.
- TIF Guarantee Program: provides guarantees for TIF bonds or other indebtedness in accordance with the TIF Act of 1990.
- New Pennsylvania Venture Capital Investments Program: provides loans to Venture Capital partnerships for investment in Pennsylvania Companies.
- Penn Works Program: provides grants and loans for water supply and wastewater infrastructure within Pennsylvania.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
June 30, 2006**

REPORTING ENTITY

The Authority has adopted the provisions of Section 2100 of the Codification of Governmental Accounting and Financial Reporting Standards for the criteria used to evaluate organizations, activities and functions that should be included in the Authority's financial statements. The basic criteria is the exercise of oversight responsibility over such organizations, activities and functions. The Authority has not identified any entities which should be subject to evaluation for inclusion in the Authority's reporting entity.

The Commonwealth appoints the members of the Authority's governing board. The Commonwealth maintains the accounts and records of the Authority. In addition, the Commonwealth employs and supervises personnel to provide administrative services. Therefore, the Authority is considered a component unit of the Commonwealth of Pennsylvania.

MEASUREMENT FOCUS, BASIS OF ACCOUNTING AND FINANCIAL STATEMENT PRESENTATION

The Authority's financial statements are presented on the full accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under this basis of accounting, revenues are recorded when earned and expenses are recorded when the liability is incurred, regardless of the timing of the related cash flows. The Authority applies Governmental Accounting Standards Board (GASB) pronouncements as well as Financial Accounting Standards Board (FASB) statements and interpretations, and the Accounting Principles Board (APB) of the Committee of Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

All activities of the Authority are accounted for within a single proprietary (enterprise) fund. A proprietary fund is used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The accounting and financial reporting treatment applied to the Authority is determined by its measurement focus. The transactions of the Authority are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the balance sheet. Net assets represent total assets net of total liabilities.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
June 30, 2006**

CASH AND CASH EQUIVALENTS

Cash and cash equivalents, for the purposes of the Statement of Cash Flows, include cash on hand or on deposit with a maturity of three months or less.

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is a reserve account for possible future loan losses. Loan losses and recoveries of previously charged-off loans are charged or credited directly to the allowance account. The provision for loan losses is adjusted monthly at the rate of 2% of outstanding loan balances at the respective month end. The provision for loan losses was based on comparison with other Authorities of the Commonwealth with similar operations and loan portfolio.

USE OF ESTIMATES IN PREPARING FINANCIAL STATEMENTS

The preparation of financial statements requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

BOND PREMIUM AND DISCOUNT

The difference between the cash received from bondholders at issuance and the amount due to bondholders at maturity is recognized as bond premium or discount. Bond premium or discount is amortized using the straight-line method over the lives of the bonds issued. Due to the recent issuance of the bonds, no amortization was taken in the current period.

This information is an integral part of the
accompanying financial statements.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

NOTE 1 – FINANCIAL SUPPORT

The Authority has a net asset deficit of \$20,151,293 as of June 30, 2006. The Authority's business purpose will result in continued losses from operation due to the disbursement of grant awards to help promote economic growth in the Commonwealth. In addition, the Authority is committed to providing part of their bond proceeds to the Commonwealth for the Machinery and Equipment Loan Fund (MELF) program, which contributes to the deficit in net assets.

Through a service agreement with the Authority, the Commonwealth has pledged to seek annual appropriations to pay the Authority's annual debt service obligations. Therefore, these factors listed above, do not raise doubt as to the Authority's ability to meet obligations when due.

NOTE 2 – DEPOSITS**Custodial Credit Risk - Deposits**

Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. As of June 30, 2006, the Authority's bank balance was exposed to custodial credit risk as follows:

FDIC Insured	\$ 200,000
Uninsured and collateral held by pledging bank's trust department not in the Authority's name	<u>315,711,068</u>
Total	<u>\$ 315,911,068</u>

NOTE 3 – LOANS RECEIVABLE

The Authority provides loans, in accordance with its enabling legislation and statutory requirements to spur economic development activity within the Commonwealth of Pennsylvania. The loans have amortization periods not to exceed 20 years and bear interest at rates ranging from 1% to 8% depending on the nature of the loan and the Authority program from which the loan was funded.

The Authority, through the New Venture Capital Investment Program, provides loans to venture capital partnerships for investments in Pennsylvania-related companies.

At June 30, 2006 the outstanding balance of loans receivable was as follows:

	Current Portion	Long-term Portion	Total
Loans receivable	\$ 1,018,257	\$ 31,770,155	\$ 32,788,412
Venture Capital Investment loans	-	7,500,000	7,500,000
Allowance for loan losses	<u>(20,427)</u>	<u>(787,799)</u>	<u>(808,226)</u>
Loan receivable - net	<u>\$ 997,830</u>	<u>\$ 38,482,356</u>	<u>\$ 39,480,186</u>

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2006**

NOTE 4 – BONDS PAYABLE

Series 2006 Revenue Bonds, issued \$45,000,000 fixed rate, tax exempt revenue bonds, Series A and \$142,500,000 fixed rate, federacy taxable revenue bonds, Series B in April 2006 at 4.5% - 5.6% interest only payable semi-annually through June 1, 2026 and principal payable annually through June 1, 2026.	\$ 187,500,000
Series 2005 Revenue Bonds, issued \$62,500,000 fixed rate, tax exempt revenue bonds, Series A and \$125,000,000 fixed rate, federacy taxable revenue bonds, Series B in November 2005 at 4.5% - 5.3%, interest payable semi-annually and principal payable annually through June 1, 2025.	<u>187,500,000</u>
	375,000,000
Less current portion	(10,280,000)
Unamortized bond premium	<u>4,532,955</u>
Long-term debt, net of current portion and unamortized bond premium	<u>\$ 369,252,955</u>

Bond principal requirements subsequent to June 30, 2006 are as follows:

For the Year Ended June 30,	Principal Maturities	Interest
2007	\$ 10,280,000	\$ 21,105,925
2008	12,000,000	19,376,518
2009	12,635,000	18,744,076
2010	13,305,000	18,074,687
2011	14,015,000	17,364,080
2012-2016	82,230,000	74,663,407
2017-2021	107,225,000	49,669,202
2022-2026	<u>123,310,000</u>	<u>17,877,822</u>
Total	<u>\$375,000,000</u>	<u>\$236,875,717</u>

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

NOTE 4 – BONDS PAYABLE (CONTINUED)

The Authority, with the Commonwealth approval, issued the above noted revenue bonds to fund the activities of the Authority. Repayments with respect to the revenue bonds are derived solely from project revenues which are defined as annual appropriations by the Commonwealth per the Official Statement. The Revenue Bonds described above are limited obligations of the Authority and are considered non-recourse, as the Authority is not obligated to bondholders beyond amounts received by the Authority from annual appropriations to the Authority by the Commonwealth. The Commonwealth has not pledged its full faith and credit nor the taxing power of the Commonwealth or any political subdivision for the payment of the Authority's Revenue Bonds and the payments by the Commonwealth to the Authority are subject to annual appropriation of funds for such purposes by the General Assembly and there is no assurance that such funds will be appropriated in any fiscal year. Repayments of loans do not constitute project revenues.

NOTE 5 – RELATED PARTY TRANSACTIONS

The Authority entered into an agreement with the Commonwealth of Pennsylvania, through the Department of Community and Economic Development (DCED) to provide administrative and operational support services for the Authority. The Authority employs no personnel and owns no capital assets; all employees performing services for the Authority are DCED employees. As such under the memorandum of understanding, the Authority reimburses DCED for services rendered by DCED employees to the Authority. During the fiscal year ended June 30, 2006 the services provided by DCED to Authority and recorded as Administrative/Operating expenses totaled \$1,756,126.

During the fiscal year ended June 30, 2006, the Authority received \$5,064,189 in transfers from the Commonwealth to pay debt service with respect to the Revenue Bond. See Note 3 for details with respect to the Revenue Bonds.

NOTE 6 – COMMITMENTS AND CONTINGENCIES

The Authority, through various economic development programs, provided loan guarantees as follows:

First industries loan guarantees	\$ 1,375,500
Tax increment financing guarantees	5,000,000
Second stage loan guarantees	<u>375,000</u>
Total loan guarantees	<u>\$ 6,750,500</u>

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

NOTE 6 – COMMITMENTS AND CONTINGENCIES (CONTINUED)

The Authority has not been called upon, with respect to any loan guarantees, to make principal or interest payments on behalf of the ultimate borrowers. Accordingly, no liability has been reflected in the Authority's financial statements for loan guarantees.

Through the various Authority loan and grant programs to promote economic development within the Commonwealth of Pennsylvania, the Authority has approved loans, investments in venture capital and grants of \$212,905,804 and \$21,000,000 and \$143,226,246, respectively, which have not been disbursed as of June 30, 2006.

This information is an integral part of the
accompanying financial statements.



**Independent Auditor's Report on Internal Control Over Financial
Reporting and on Compliance and Other Matters Based on an
Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards***

Board of Directors
Commonwealth Financing Authority
Harrisburg, Pennsylvania

We have audited the basic financial statements of Commonwealth Financing Authority (the Authority) as of and for the period April 1, 2004 (date of formation) through June 30, 2006 and have issued our report thereon dated September 21, 2006. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority'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 an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. 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 caused by error or fraud 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management in a separate letter dated September 21, 2006.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

Clifton Henderson LLP

Harrisburg, Pennsylvania
September 21, 2006

COMMONWEALTH FINANCING AUTHORITY
(Component Unit of Commonwealth of Pennsylvania)
Harrisburg, Pennsylvania

FINANCIAL STATEMENTS
June 30, 2007 and 2006

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Independent Auditor's Report

To the Board of Directors of the
Commonwealth Financing Authority
Harrisburg, Pennsylvania

We have audited the accompanying statements of net assets of the Commonwealth Financing Authority ("Authority") as of June 30, 2007 and 2006, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years ended June 30, 2007 and 2006. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in the Notes, the financial statements present only financial information about the Commonwealth Financing Authority and are not intended to present fairly the financial position of the Commonwealth of Pennsylvania and the results of its operations and cash flows of its proprietary and similar trust fund types in conformity with accounting principles generally accepted in the United States of America.

The Authority is a component unit of the Commonwealth of Pennsylvania ("Commonwealth"). As disclosed in Note 1 of the financial statements, the Authority has extensive transactions and relationships with certain Commonwealth affiliated agencies. The financial position and results of operations of the Authority may not be indicative of that which would have been obtained had the Authority operated independently.

In our opinion, the financial statements referred to above present fairly the financial position of the Authority, and the results of its operations and cash flows in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 12, 2007 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis as referenced in the table of contents is not a required part of the basic financial statements but is supplemental information required by accounting principles generally accepted in the United States of America. 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.

Clifton Gunderson LLP

Harrisburg, Pennsylvania
September 12, 2007

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007 and 2006**

The Commonwealth Financing Authority, hereafter referred to as the "Authority," is pleased to present its financial statements developed in compliance with Statement of Governmental Accounting Standard No. 34, entitled "Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments" (hereafter "GASB 34"), and related standards. GASB 34 enhances information provided to the users of its financial statements. This section of the financial reporting package presents our discussion and analysis of the Authority's financial performance during the years ended June 30, 2007 and 2006. Please read it in conjunction with the Authority's financial statements that follow this section.

FINANCIAL HIGHLIGHTS

- During the fiscal year ending June 30, 2007, the Authority executed its third \$187.5 million bond issue to fund projects approved for grants, loans, and venture capital investments under established financing programs. Since inception, the Authority has awarded \$891 million to assist 598 economic development projects across the Commonwealth. This investment will leverage more than \$2.7 billion in private investment.
- The Authority board approved an investment strategy to guide the investment of bond proceeds and payments received from approved loan and venture capital investment projects.
- The Authority opened for business the final two of eight programs under its jurisdiction, the Building PA Program and the Venture Guarantee Program and approved investments and guarantees for fund managers.

OVERVIEW OF THE FINANCIAL STATEMENTS

Management's Discussion and Analysis (MD&A) serves as an introduction to, and should be read in conjunction with, the basic audited financial statements. The MD&A represents management's examination and analysis of the Authority's financial condition and performance. Summary financial statement data and other management tools were used for this analysis.

The financial statements report information about the Authority using the full accrual method of accounting, as utilized by similar business activities in the private sector. The financial statements include a statement of net assets; a statement of revenues, expenses, and changes in net assets; a statement of cash flows; and notes to the financial statements.

The Statement of Net Assets presents the financial position of the Authority on a full accrual historical cost basis. The Statement of Net Assets also presents information on all of the Authority's assets and liabilities, with the difference reported as net assets. Over time, increases and decreases in net assets are one indicator of whether the financial position of the Authority is improving or deteriorating.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007 and 2006**

While the Statement of Net Assets provides information about the nature and amount of resources and obligations at year-end, the Statement of Revenues, Expenses, and Changes in Net Assets presents the results of the business-type activities over the course of the fiscal year and information as to how the net assets changed during the year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the Authority's recovery of its costs.

The Statement of Cash Flows presents changes in cash and cash equivalents, resulting from operational, financing, and investing activities. This statement presents cash receipts and cash disbursement information without consideration of the earnings event when an obligation arises, or depreciation of capital assets.

The Notes to the Financial Statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Authority's accounting policies, significant account balances and activities, long-term debt and subsequent events, if any.

FINANCIAL ANALYSIS

Condensed Statements of Net Assets		
	2007	2006
Current assets	\$ 343,892,109	\$ 321,187,709
Long-term assets	<u>122,545,599</u>	<u>38,482,356</u>
Total assets	<u>466,437,708</u>	<u>359,670,065</u>
Current liabilities	20,890,603	13,551,143
Long-term liabilities	<u>538,315,943</u>	<u>369,252,955</u>
Total liabilities	<u>559,206,546</u>	<u>382,804,098</u>
Net assets		
Unrestricted (deficit)	<u>(92,768,838)</u>	<u>(23,134,033)</u>
Total net assets (deficit)	<u>\$ (92,768,838)</u>	<u>\$ (23,134,033)</u>

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007 and 2006**

Condensed Statements of Revenues, Expenses, and Changes in Fund Net Assets

	<u>2007</u>	<u>2006</u>
Operating revenues	\$ 18,048,722	\$ 5,472,601
Operating expenses	(35,956,634)	(9,821,668)
Provision for loan losses	(1,774,253)	(808,226)
Nonoperating expenses - net	<u>(49,952,640)</u>	<u>(17,976,740)</u>
Decrease in net assets	<u>\$ (69,634,805)</u>	<u>\$ (23,134,033)</u>

As shown in the table above, operating revenues consist mostly of interest earnings. Nonoperating revenues and expenses consist mainly of a Transfer to the Commonwealth for the Machinery and Equipment Loan Fund (MELF) program in the amount of \$60 million and \$15 million for 2007 and 2006, respectively.

Long-Term Debt

During the current audit period, the Authority issued one revenue bond totaling \$187,500,000 to provide funds for loan disbursements, investments in venture capital and grant expenditures. In the prior year, the Authority issued two revenue bonds totaling \$375 million. In addition, the Authority entered into a service agreement with the Commonwealth of Pennsylvania for the payment of the annual debt service through an annual appropriation by the Commonwealth. However, there is no assurance that there will be sufficient funds appropriated annually by the Commonwealth.

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, investors and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. If you have questions about this report or need additional information, contact the Commonwealth Financing Authority, 400 North Street, Fourth Floor, Harrisburg, PA 17120.

FINANCIAL STATEMENTS

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF NET ASSETS
June 30, 2007 and 2006**

	<u>2007</u>	<u>2006</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 335,333,775	\$ 315,911,068
Receivables (net):		
Loans	2,367,072	997,830
Accrued interest	326,279	55,680
Penalties/late fees	8,343	728
Other assets	<u>5,856,640</u>	<u>4,222,403</u>
Total current assets	343,892,109	321,187,709
Long-term assets:		
Long-term portion of loans receivable (net)	<u>122,545,599</u>	<u>38,482,356</u>
Total assets	<u>466,437,708</u>	<u>359,670,065</u>
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	\$ 18,115,000	\$ 10,280,000
Accrued interest payable	2,410,245	2,976,740
Accounts payable and accrued expenses	6,046	20,498
Due to primary governments - DCED	<u>359,312</u>	<u>273,905</u>
Total current liabilities	20,890,603	13,551,143
Non-current liabilities:		
Long-term debt, net of current portion and unamortized bond premium	<u>538,315,943</u>	<u>369,252,955</u>
Total liabilities	<u>559,206,546</u>	<u>382,804,098</u>
NET ASSETS		
Unrestricted (deficit)	<u>(92,768,838)</u>	<u>(23,134,033)</u>
TOTAL NET ASSETS (DEFICIT)	<u>\$ (92,768,838)</u>	<u>\$ (23,134,033)</u>

The accompanying notes are an integral part of the financial statements.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Years Ended June 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
OPERATING INCOME		
Interest on loans	\$ 1,258,197	\$ 117,238
Interest on investments	15,809,023	5,322,967
Penalties/late fees	7,615	728
Commitment and application fee	<u>973,887</u>	<u>31,668</u>
Total operating income	<u>18,048,722</u>	<u>5,472,601</u>
OPERATING EXPENSE		
Administrative/operating expense	2,426,663	1,756,126
Grant expense - Business in Our Sites	30,175,469	5,217,887
Grant expense - First Industries	<u>3,354,502</u>	<u>2,847,655</u>
Total operating expenses	<u>35,956,634</u>	<u>9,821,668</u>
Net operating loss before provision for loan losses	(17,907,912)	(4,349,067)
PROVISION FOR LOAN LOSSES	<u>1,774,253</u>	<u>808,226</u>
Net operating loss after provision for loan losses	<u>(19,682,165)</u>	<u>(5,157,293)</u>
NON-OPERATING INCOME (EXPENSE)		
Transfers in from primary government	35,468,689	5,064,189
Interest on bonds	(24,623,173)	(8,040,929)
Amortization of bond premium	322,012	-
Amortization of bond issuance costs	(346,144)	-
Transfers to primary government - MELF	(60,000,000)	(15,000,000)
Other	<u>(774,024)</u>	<u>-</u>
Total non-operating loss	<u>(49,952,640)</u>	<u>(17,976,740)</u>
Net loss	(69,634,805)	(23,134,033)
NET ASSETS, BEGINNING OF PERIOD	<u>(23,134,033)</u>	<u>-</u>
NET ASSETS, END OF PERIOD	<u>\$ (92,768,838)</u>	<u>\$ (23,134,033)</u>

The accompanying notes are an integral part of the financial statements.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2007 and 2006**

	<u>2007</u>	<u>2006</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from interest and fees on loans	\$ 1,961,485	\$ 93,226
Cash received from interest on investments	15,809,023	5,322,967
Cash paid for operating expenses	(2,355,708)	(1,461,723)
Cash paid for grant expenses	<u>(33,529,971)</u>	<u>(8,065,542)</u>
Net cash used in operating activities	<u>(18,115,171)</u>	<u>(4,111,072)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Principal receipt on loans	2,314,166	122,886
Investment in loans	(78,294,928)	(32,911,298)
Investment in venture capital	(12,000,000)	(7,500,000)
Transfer to primary government	<u>(60,000,000)</u>	<u>(15,000,000)</u>
Net cash used in investing activities	<u>(147,980,762)</u>	<u>(55,288,412)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from bonds payable, net	185,519,619	375,310,552
Commonwealth appropriation	35,468,689	5,064,189
Principal payments on bonds	(10,280,000)	-
Interest on bonds payable	<u>(25,189,668)</u>	<u>(5,064,189)</u>
Net cash provided by noncapital financing activities	<u>185,518,640</u>	<u>375,310,552</u>
NET INCREASE IN CASH	19,422,707	315,911,068
CASH, BEGINNING	<u>315,911,068</u>	<u>-</u>
CASH, END OF YEAR	<u>\$ 335,333,775</u>	<u>\$ 315,911,068</u>
RECONCILIATION OF NET OPERATING LOSS AFTER PROVISION FOR LOAN LOSSES TO CASH USED IN OPERATING ACTIVITIES		
Net operating loss after provision for loan losses	\$ (19,682,165)	\$ (5,157,293)
Adjustments to reconcile net operating loss to net cash used in operating activities:		
Provision for loan losses	1,774,253	808,226
Effects of changes in operating assets and liabilities:		
Interest receivables	(270,599)	(55,680)
Penalties/late fees	(7,615)	(728)
Accounts payable and accrued expenses	<u>70,955</u>	<u>294,403</u>
NET CASH USED IN OPERATING ACTIVITIES	<u>\$ (18,115,171)</u>	<u>\$ (4,111,072)</u>

The accompanying notes are an integral part of the financial statements.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2007 and 2006**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Commonwealth Financing Authority (“Authority”) is a body corporate and politic duly organized by the Commonwealth of Pennsylvania (“Commonwealth”) incorporated under the Public Authorities and Quasi-Public Corporations Act of 2004 (“Act”), being the Act of April 1, 2004, P.L. 163, as amended by the Commonwealth of Pennsylvania. The Authority, by virtue of the Act and its articles of incorporation, has all powers as set forth in the Act including those for creation and retention of jobs. The purpose of the Authority is to engage in financial assistance in the form of loans, loan guarantees, grants and private equity participating loans to promote activities which lead to the creation and retention of jobs within the Commonwealth of Pennsylvania, the establishment of economically viable Pennsylvania Communities, the development of a stable tax base within Pennsylvania Communities, the reuse of abandoned industrial, commercial and other previously utilized sites, the promotion and commercialization of Pennsylvania products and services and investment of private capital in Pennsylvania communities to promote the health, safety, employment, business opportunities, economic activity and general welfare of the people of the Commonwealth of Pennsylvania.

The legislation creating the Authority as well as program specific guidelines establish certain activities to be carried out by the Authority as follows:

- Business in Our Sites Program: provides financial assistance for preparation of sites for future development.
- First Industries Program: provides financial assistance for projects related to tourism and agriculture.
- Second Stage Loan Program: provides loan guarantees to commercial lending institutions that make loans to life sciences, advanced technology or manufacturing businesses.
- New Pennsylvania Venture Guarantee Program: provides guarantees to venture capital partnerships for investments in Pennsylvania-related companies which are in early-stage or mid-stage development.
- Building Pennsylvania Program: provides loans to fund managers for investment in real estate projects in Pennsylvania.
- TIF Guarantee Program: provides guarantees for TIF bonds or other indebtedness in accordance with the TIF Act of 1990.
- New Pennsylvania Venture Capital Investments Program: provides loans to Venture Capital partnerships for investment in Pennsylvania Companies.
- Penn Works Program: provides grants and loans for water supply and wastewater infrastructure within Pennsylvania.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2007 and 2006**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Reporting Entity

The Authority has adopted the provisions of Section 2100 of the Codification of Governmental Accounting and Financial Reporting Standards for the criteria used to evaluate organizations, activities and functions that should be included in the Authority's financial statements. The basic criteria is the exercise of oversight responsibility over such organizations, activities and functions. The Authority has not identified any entities which should be subject to evaluation for inclusion in the Authority's reporting entity.

The Commonwealth appoints the members of the Authority's governing board. The Commonwealth maintains the accounts and records of the Authority. In addition, the Commonwealth employs and supervises personnel to provide administrative services. Therefore, the Authority is considered a component unit of the Commonwealth of Pennsylvania.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The Authority's financial statements are presented on the full accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under this basis of accounting, revenues are recorded when earned and expenses are recorded when the liability is incurred, regardless of the timing of the related cash flows. The Authority applies Governmental Accounting Standards Board (GASB) pronouncements as well as Financial Accounting Standards Board (FASB) statements and interpretations, and the Accounting Principles Board (APB) of the Committee of Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

All activities of the Authority are accounted for within a single proprietary (enterprise) fund. A proprietary fund is used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The accounting and financial reporting treatment applied to the Authority is determined by its measurement focus. The transactions of the Authority are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the balance sheet. Net assets represent total assets net of total liabilities.

Cash and Cash Equivalents

Cash and cash equivalents, for the purposes of the Statement of Cash Flows, include cash on hand or on deposit with a maturity of three months or less at the date of purchase.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2007 and 2006

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses

The allowance for loan losses is a reserve account for possible future loan losses. Loan losses and recoveries of previously charged-off loans are charged or credited directly to the allowance account. The provision for loan losses is adjusted monthly at the rate of 2% of outstanding loan balances at the respective month-end. The provision for loan losses was based on comparison with other Authorities of the Commonwealth with similar operations and loan portfolio.

Loan Origination Fees and Costs

The Authority recognizes loan origination fees and costs in accordance with Statement of Financial Accounting Standards No. 91 ("SFAS No. 91"), *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*. For the years ended June 30, 2007 and 2006, \$774,024 and \$0, respectively, of net deferred fees are included in loans receivable.

Use of Estimates in Preparing Financial Statements

The preparation of financial statements requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Bond Premium and Discount

The difference between the cash received from bondholders at issuance and the amount due to bondholders at maturity is recognized as bond premium or discount. Bond premium or discount is amortized using the straight-line method over the lives of the bonds issued.

NOTE 2 – FINANCIAL SUPPORT

The Authority has a net asset deficit of \$91,966,254 and \$23,134,033 as of June 30, 2007 and 2006, respectively. The Authority's business purpose will result in continued losses from operation due to the disbursement of grant awards to help promote economic growth in the Commonwealth. In addition, the Authority transferred part of their bond proceeds to the Commonwealth for the Machinery and Equipment Loan Fund (MELF) program, which contributes to the deficit in net assets.

Through a service agreement with the Authority, the Commonwealth has pledged to seek annual appropriations to pay the Authority's annual debt service obligations. Therefore, these factors listed above, do not raise doubt as to the Authority's ability to meet obligations when due.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2007 and 2006

NOTE 3 – DEPOSITS**Custodial Credit Risk**

Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. As of June 30, 2007 and 2006, the Authority's bank balance was exposed to custodial credit risk as follows:

	<u>2007</u>	<u>2006</u>
FDIC Insured	\$ 100,000	\$ 200,000
Uninsured and collateral held by pledging bank's trust department not in the Authority's name	<u>335,233,775</u>	<u>315,711,068</u>
Total	<u>\$ 335,333,775</u>	<u>\$ 315,911,068</u>

NOTE 4 – LOANS RECEIVABLE

The Authority provides loans, in accordance with its enabling legislation and statutory requirements to spur economic development activity within the Commonwealth of Pennsylvania. The loans have amortization periods not to exceed 20 years and bear interest at rates ranging from 1% to 8% depending on the nature of the loan and the Authority program from which the loan was funded.

The Authority, through the New Venture Capital Investment Program, provides loans to venture capital partnerships for investments in Pennsylvania-related companies.

At June 30, 2007 and 2006, the outstanding balance of loans receivable was as follows:

	<u>2007</u>		
	<u>Current Portion</u>	<u>Long-term Portion</u>	<u>Total</u>
Loans receivable	\$ 2,469,848	\$ 111,299,326	\$ 113,769,174
Venture Capital Investment loans	-	14,500,000	14,500,000
Deferred loan origination fees - net	(53,379)	(720,645)	(774,024)
Allowance for loan losses	<u>(49,397)</u>	<u>(2,533,082)</u>	<u>(2,582,479)</u>
Loan receivable - net	<u>\$ 2,367,072</u>	<u>\$ 122,545,599</u>	<u>\$ 124,912,671</u>
	<u>2006</u>		
Loans receivable	\$ 1,018,257	\$ 31,770,155	\$ 32,788,412
Venture Capital Investment loans	-	7,500,000	7,500,000
Allowance for loan losses	<u>(20,427)</u>	<u>(787,799)</u>	<u>(808,226)</u>
Loan receivable - net	<u>\$ 997,830</u>	<u>\$ 38,482,356</u>	<u>\$ 39,480,186</u>

An analysis of the allowance for loan losses for the years ended June 30, 2007 and 2006 is as follows:

	<u>2007</u>	<u>2006</u>
Balance, beginning of year	\$ 808,226	\$ -
Provision for potential losses	<u>1,774,253</u>	<u>808,226</u>
Balance, end of year	<u>\$ 2,582,479</u>	<u>\$ 808,226</u>

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2007 and 2006

NOTE 5 – BONDS PAYABLE

	<u>2007</u>	<u>2006</u>
Series 2006 Revenue Bonds, issued \$187,500,000 fixed rate, federally taxable revenue bonds, Series C in November 2006 at 4.9% - 5.2%, interest payable semi-annually and principal payable annually through June 1, 2026.	\$ 187,500,000	\$ -
Series 2006 Revenue Bonds, issued \$45,000,000 fixed rate, tax exempt revenue bonds, Series A and \$142,500,000 fixed rate, federally taxable revenue bonds, Series B in April 2006 at 4.5% - 5.6%, interest only payable semi-annually through June 1, 2026 and principal payable annually through June 1, 2026.	183,285,000	187,500,000
Series 2005 Revenue Bonds, issued \$62,500,000 fixed rate, tax exempt revenue bonds, Series A and \$125,000,000 fixed rate, federally taxable revenue bonds, Series B in November 2005 at 4.5% - 5.3%, interest payable semi-annually and principal payable annually through June 1, 2025.	<u>181,435,000</u>	<u>187,500,000</u>
	552,220,000	375,000,000
Less current portion	(18,115,000)	(10,280,000)
Unamortized bond premium	<u>4,210,943</u>	<u>4,532,955</u>
Long-term debt, net of current portion and unamortized bond premium	<u>\$ 538,315,943</u>	<u>\$ 369,252,955</u>

Bond principal requirements subsequent to June 30, 2007 are as follows:

	<u>Principal Maturities</u>	<u>Interest</u>
For the Year Ended June 30,		
2008	\$ 18,115,000	\$ 28,922,940
2009	19,055,000	27,986,705
2010	20,045,000	26,998,370
2011	21,095,000	25,952,920
2012	22,195,000	24,850,346
2013-2017	129,785,000	105,477,256
2018-2022	168,275,000	67,037,578
2023-2027	<u>153,655,000</u>	<u>18,927,322</u>
Total	<u>\$ 552,220,000</u>	<u>\$ 326,153,437</u>

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2007 and 2006**

NOTE 5 – BONDS PAYABLE (CONTINUED)

The Authority, with the Commonwealth approval, issued the above noted revenue bonds to fund the activities of the Authority. Repayments with respect to the revenue bonds are derived solely from project revenues which are defined as annual appropriations by the Commonwealth per the Official Statement. The Revenue Bonds described above are limited obligations of the Authority and are considered non-recourse, as the Authority is not obligated to bondholders beyond amounts received by the Authority from annual appropriations to the Authority by the Commonwealth. The Commonwealth has not pledged its full faith and credit nor the taxing power of the Commonwealth or any political subdivision for the payment of the Authority's Revenue Bonds and the payments by the Commonwealth to the Authority are subject to annual appropriation of funds for such purposes by the General Assembly and there is no assurance that such funds will be appropriated in any fiscal year. Repayments of loans do not constitute project revenues.

NOTE 6 – RELATED PARTY TRANSACTIONS

The Authority entered into an agreement with the Commonwealth of Pennsylvania, through the Department of Community and Economic Development (DCED) to provide administrative and operational support services for the Authority. The Authority employs one personnel and owns no capital assets; the remaining employees performing services for the Authority are DCED employees. As such under the memorandum of understanding, the Authority reimburses DCED for services rendered by DCED employees to the Authority. During the fiscal year ended June 30, 2007 and 2006, the services provided by DCED to the Authority and recorded as Administrative/Operating expenses totaled \$2,426,663 and \$1,756,126, respectively.

During the fiscal year ended June 30, 2007 and 2006, the Authority received \$35,468,689 and \$5,064,189, respectively, in transfers from the Commonwealth to pay debt service with respect to Revenue Bonds. See Note 5 for details with respect to the Revenue Bonds.

NOTE 7 – COMMITMENTS AND CONTINGENCIES

The Authority, through various economic development programs, provided loan guarantees as follows:

	2007	2006
First industries loan guarantees	\$ 9,220,250	\$ 1,375,500
Tax increment financing guarantees	15,000,000	5,000,000
Second stage loan guarantees	2,660,000	375,000
Venture capital guarantees	172,500,000	-
Total loan guarantees	\$ 199,380,250	\$ 6,750,500

The Authority has not been called upon, with respect to any loan guarantees, to make principal or interest payments on behalf of the ultimate borrowers. Accordingly, no liability has been reflected in the Authority's financial statements for loan guarantees.

Through the various Authority loan and grant programs to promote economic development within the Commonwealth of Pennsylvania, the Authority has approved loans, investments in venture capital and grants of \$300,107,152, \$27,750,000 and \$176,374,715, respectively, which have not been disbursed as of June 30, 2007.



Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Directors
Commonwealth Financing Authority
Harrisburg, Pennsylvania

We have audited the basic financial statements of the Commonwealth Financing Authority ("Authority") as of and for the years ended June 30, 2007 and 2006, and have issued our report thereon dated September 12, 2007. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

Clifton Gunderson LLP

Harrisburg, Pennsylvania
September 12, 2007

COMMONWEALTH FINANCING AUTHORITY
(Component Unit of Commonwealth of Pennsylvania)
Harrisburg, Pennsylvania

FINANCIAL STATEMENTS
June 30, 2008 and 2007

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Independent Auditor's Report

To the Board of Directors of the
Commonwealth Financing Authority
Harrisburg, Pennsylvania

We have audited the accompanying statements of net assets of the Commonwealth Financing Authority ("Authority") as of June 30, 2008 and 2007, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years ended June 30, 2008 and 2007. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in the Notes, the financial statements present only financial information about the Commonwealth Financing Authority and are not intended to present fairly the financial position of the Commonwealth of Pennsylvania and the results of its operations and cash flows of its proprietary and similar trust fund types in conformity with accounting principles generally accepted in the United States of America.

The Authority is a component unit of the Commonwealth of Pennsylvania ("Commonwealth"). As disclosed in Note 1 of the financial statements, the Authority has extensive transactions and relationships with certain Commonwealth affiliated agencies. The financial position and results of operations of the Authority may not be indicative of that which would have been obtained had the Authority operated independently.

In our opinion, the financial statements referred to above present fairly the financial position of the Authority, and the results of its operations and cash flows in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 29, 2008 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis as referenced in the Table of Contents is not a required part of the basic financial statements but is supplemental information required by accounting principles generally accepted in the United States of America. 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.

Clifton Henderson LLP

Harrisburg, Pennsylvania
August 29, 2008

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2008 and 2007**

The Commonwealth Financing Authority, hereafter referred to as the "Authority," is pleased to present its financial statements developed in compliance with Statement of Governmental Accounting Standard No. 34, entitled "Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments" (hereafter "GASB 34"), and related standards. GASB 34 enhances information provided to the users of its financial statements. This section of the financial reporting package presents our discussion and analysis of the Authority's financial performance during the years ended June 30, 2008 and 2007. Please read it in conjunction with the Authority's financial statements that follow this section.

FINANCIAL HIGHLIGHTS

- During the fiscal year ending June 30, 2008, the Authority executed its fourth bond issue in the amount of \$187.5 million to fund projects approved for grants, loans, and venture capital investments under established financing programs. Since inception, the Authority has awarded over \$1 billion to assist 729 economic development projects across the Commonwealth. This investment will leverage more than \$3.2 billion in private investment.
- The economic impact of these economic development projects, many of which are still in planning and early construction phases, already has created more than 7,200 new jobs and almost \$1 billion in private investment.
- The Authority entered into a \$50 million revolving credit agreement with Dexia Bank to ensure sufficient funds are available for demands made on the loan guarantee programs.

OVERVIEW OF THE FINANCIAL STATEMENTS

Management's Discussion and Analysis (MD&A) serves as an introduction to, and should be read in conjunction with, the basic audited financial statements. The MD&A represents management's examination and analysis of the Authority's financial condition and performance. Summary financial statement data and other management tools were used for this analysis.

The financial statements report information about the Authority using the full accrual method of accounting, as utilized by similar business activities in the private sector. The financial statements include a Statement of Net Assets; a Statement of Revenues, Expenses, and Changes in Net Assets; a Statement of Cash Flows; and notes to the Financial Statements.

The Statement of Net Assets presents the financial position of the Authority on a full accrual historical cost basis. The Statements of Net Assets also presents information on all of the Authority's assets and liabilities, with the difference reported as net assets. Over time, increases and decreases in net assets are one indicator of whether the financial position of the Authority is improving or deteriorating.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2008 and 2007**

While the Statement of Net Assets provides information about the nature and amount of resources and obligations at year-end, the Statement of Revenues, Expenses, and Changes in Net Assets presents the results of the business-type activities over the course of the fiscal year and information as to how the net assets changed during the year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the Authority's recovery of its costs.

The Statement of Cash Flows presents changes in cash and cash equivalents, resulting from operational, financing, and investing activities. This statement presents cash receipts and cash disbursement information without consideration of the earnings event when an obligation arises, or depreciation of capital assets.

The Notes to the Financial Statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Authority's accounting policies, significant account balances and activities, long-term debt and subsequent events, if any.

FINANCIAL ANALYSIS

Condensed Statements of Net Assets

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Current assets	\$ 448,882,160	\$ 343,892,109	\$ 321,187,709
Long-term assets	<u>184,532,028</u>	<u>122,545,599</u>	<u>38,482,356</u>
Total assets	<u>633,414,188</u>	<u>466,437,708</u>	<u>359,670,065</u>
Current liabilities	29,135,723	20,890,603	13,551,143
Long-term liabilities	<u>702,026,980</u>	<u>538,315,943</u>	<u>369,252,955</u>
Total liabilities	<u>731,162,703</u>	<u>559,206,546</u>	<u>382,804,098</u>
Net assets			
Unrestricted (deficit)	<u>(97,748,515)</u>	<u>(92,768,838)</u>	<u>(23,134,033)</u>
Total net assets (deficit)	<u>\$ (97,748,515)</u>	<u>\$ (92,768,838)</u>	<u>\$ (23,134,033)</u>

The Authority issued bonds totaling \$187.5 million for both 2008 and 2007, which caused an increase in total liabilities of \$172.0 and \$176.4 at June 30, 2008 and 2007, respectively. Due to the issuance of bonds, the Authority has been able to increase the amount of loan originations over the past two years, causing an increase in total assets of \$167.0 and \$106.8 as of June 30, 2008 and 2007, respectively. Due to the nature of the loans, some of which require drawdowns, funding not immediately disbursed upon Board approval is held as cash and cash equivalents.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2008 and 2007**

Condensed Statements of Revenues, Expenses, and Changes in Fund Net Assets

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Operating income	\$ 16,398,583	\$ 18,048,722	\$ 5,472,601
Operating expenses	(35,525,735)	(35,956,634)	(9,821,668)
Provision for loan losses	(1,307,417)	(1,774,253)	(808,226)
Nonoperating expenses - net	<u>15,454,892</u>	<u>(49,952,640)</u>	<u>(17,976,740)</u>
Decrease in net assets	<u>\$ (4,979,677)</u>	<u>\$ (69,634,805)</u>	<u>\$ (23,134,033)</u>

The Authority continues to operate with a net asset deficit, partly due to its economic development mission, which includes granting money to applicants for planning and construction projects. In the prior year, the Authority incurred significant non-operating expenses due to the transfer to the Commonwealth for the Machinery and Equipment Loan Fund (MELF) program in the amount of \$60 million for 2007. There were no transfers to the Commonwealth under this program for 2008.

Long-Term Debt

During the current audit period, the Authority issued one revenue bond totaling \$187.5 million to provide funds for loan disbursements, investments in venture capital and grant expenditures. Since inception, the Authority has issued four revenue bonds totaling \$750 million. The Authority has a service agreement with the Commonwealth of Pennsylvania for the payment of the annual debt service through an annual appropriation by the Commonwealth. However, there is no assurance that there will be sufficient funds appropriated annually by the Commonwealth.

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, investors and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. If you have questions about this report or need additional information, contact the Commonwealth Financing Authority, 400 North Street, Fourth Floor, Harrisburg, PA 17120.

FINANCIAL STATEMENTS

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF NET ASSETS
June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 435,076,058	\$ 335,333,775
Receivables (net):		
Loans	5,653,990	2,367,072
Accrued interest	280,723	326,279
Penalties/late fees	1,989	8,343
Other assets	<u>7,869,400</u>	<u>5,856,640</u>
 Total current assets	 448,882,160	 343,892,109
Long-term assets:		
Long-term portion of loans receivable (net)	<u>184,532,028</u>	<u>122,545,599</u>
 Total assets	 <u>633,414,188</u>	 <u>466,437,708</u>
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	23,505,000	18,115,000
Accrued interest payable	5,124,764	2,410,245
Accounts payable and accrued expenses	41,413	6,046
Due to primary governments - DCED	<u>464,546</u>	<u>359,312</u>
 Total current liabilities	 29,135,723	 20,890,603
Non-current liabilities:		
Long-term debt, net of current portion and unamortized bond premium	<u>702,026,980</u>	<u>538,315,943</u>
 Total liabilities	 <u>731,162,703</u>	 <u>559,206,546</u>
NET ASSETS		
Unrestricted (deficit)	<u>(97,748,515)</u>	<u>(92,768,838)</u>
 TOTAL NET ASSETS (DEFICIT)	 <u>\$ (97,748,515)</u>	 <u>\$ (92,768,838)</u>

The accompanying notes are an integral part of the financial statements.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
OPERATING INCOME		
Interest on loans	\$ 2,369,357	\$ 1,258,197
Interest on investments	13,910,201	15,809,023
Fee income	<u>119,025</u>	<u>981,502</u>
Total operating income	<u>16,398,583</u>	<u>18,048,722</u>
OPERATING EXPENSES		
Administrative/operating expense	2,178,895	2,426,663
Grant expense - Business in Our Sites	31,961,556	30,175,469
Grant expense - First Industries	<u>1,385,284</u>	<u>3,354,502</u>
Total operating expenses	<u>35,525,735</u>	<u>35,956,634</u>
Net operating loss before provision for loan losses	(19,127,152)	(17,907,912)
PROVISION FOR LOAN LOSSES	<u>1,307,417</u>	<u>1,774,253</u>
Net operating loss after provision for loan losses	<u>(20,434,569)</u>	<u>(19,682,165)</u>
NON-OPERATING INCOME (EXPENSE)		
Transfers in from primary government	47,037,935	35,468,689
Interest on bonds	(31,637,458)	(24,623,173)
Amortization of bond premium	226,360	322,012
Amortization of bond issuance costs	(408,978)	(346,144)
Transfers to primary government - MELF	-	(60,000,000)
Other	<u>237,033</u>	<u>(774,024)</u>
Total non-operating income (expense)	<u>15,454,892</u>	<u>(49,952,640)</u>
Net loss	(4,979,677)	(69,634,805)
NET ASSETS, BEGINNING OF PERIOD	<u>(92,768,838)</u>	<u>(23,134,033)</u>
NET ASSETS, END OF PERIOD	<u>\$ (97,748,515)</u>	<u>\$ (92,768,838)</u>

The accompanying notes are an integral part of the financial statements.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from interest and fees on loans	\$ 2,540,292	\$ 1,961,485
Cash received from interest on investments	13,910,201	15,809,023
Cash paid for operating expenses	(2,038,294)	(2,355,708)
Cash paid for grant expenses	<u>(33,346,840)</u>	<u>(33,529,971)</u>
Net cash and cash equivalents used in operating activities	<u>(18,934,641)</u>	<u>(18,115,171)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Principal receipt on loans	5,119,169	2,314,166
Investment in loans	(63,812,898)	(78,294,928)
Investment in venture capital	(7,650,000)	(12,000,000)
Transfer to primary government	<u>-</u>	<u>(60,000,000)</u>
Net cash and cash equivalents used in investing activities	<u>(66,343,729)</u>	<u>(147,980,762)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from bonds payable, net	185,020,657	185,519,619
Commonwealth appropriation	47,037,935	35,468,689
Principal payments on bonds	(18,115,000)	(10,280,000)
Interest on bonds payable	<u>(28,922,939)</u>	<u>(25,189,668)</u>
Net cash and cash equivalents provided by noncapital financing activities	<u>185,020,653</u>	<u>185,518,640</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	99,742,283	19,422,707
CASH AND CASH EQUIVALENTS, BEGINNING	<u>335,333,775</u>	<u>315,911,068</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 435,076,058</u>	<u>\$ 335,333,775</u>
RECONCILIATION OF NET OPERATING LOSS AFTER PROVISION FOR LOAN LOSSES TO CASH USED IN OPERATING ACTIVITIES		
Net operating loss after provision for loan losses	\$ (20,434,569)	\$ (19,682,165)
Adjustments to reconcile net operating loss to net cash used in operating activities:		
Provision for loan losses	1,307,417	1,774,253
Effects of changes in operating assets and liabilities:		
Interest receivables	45,556	(270,599)
Penalties/late fees	6,354	(7,615)
Accounts payable and accrued expenses and due to primary governments - DCED	<u>140,601</u>	<u>70,955</u>
NET CASH AND CASH EQUIVALENTS USED IN OPERATING ACTIVITIES	<u>\$ (18,934,641)</u>	<u>\$ (18,115,171)</u>

The accompanying notes are an integral part of the financial statements.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Commonwealth Financing Authority (“Authority”) is a body corporate and politic duly organized by the Commonwealth of Pennsylvania (“Commonwealth”) incorporated under the Public Authorities and Quasi-Public Corporations Act of 2004 (“Act”), being the Act of April 1, 2004, P.L. 163, as amended by the Commonwealth of Pennsylvania. The Authority, by virtue of the Act and its articles of incorporation, has all powers as set forth in the Act including those for creation and retention of jobs. The purpose of the Authority is to engage in financial assistance in the form of loans, loan guarantees, grants and private equity participating loans to promote activities which lead to the creation and retention of jobs within the Commonwealth of Pennsylvania, the establishment of economically viable Pennsylvania Communities, the development of a stable tax base within Pennsylvania Communities, the reuse of abandoned industrial, commercial and other previously utilized sites, the promotion and commercialization of Pennsylvania products and services and investment of private capital in Pennsylvania communities to promote the health, safety, employment, business opportunities, economic activity and general welfare of the people of the Commonwealth of Pennsylvania.

The legislation creating the Authority as well as program specific guidelines establish certain activities to be carried out by the Authority as follows:

- Business in Our Sites Program: provides financial assistance for preparation of sites for future development.
- First Industries Program: provides financial assistance for projects related to tourism and agriculture.
- Second Stage Loan Program: provides loan guarantees to commercial lending institutions that make loans to life sciences, advanced technology or manufacturing businesses.
- New Pennsylvania Venture Guarantee Program: provides guarantees to venture capital partnerships for investments in Pennsylvania-related companies which are in early-stage or mid-stage development.
- Building Pennsylvania Program: provides loans to fund managers for investment in real estate projects in Pennsylvania.
- TIF Guarantee Program: provides guarantees for TIF bonds or other indebtedness in accordance with the TIF Act of 1990.
- New Pennsylvania Venture Capital Investments Program: provides loans to Venture Capital partnerships for investment in Pennsylvania Companies.
- Penn Works Program: provides grants and loans for water supply and wastewater infrastructure within Pennsylvania.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Reporting Entity

The Authority has adopted the provisions of Section 2100 of the Codification of Governmental Accounting and Financial Reporting Standards for the criteria used to evaluate organizations, activities and functions that should be included in the Authority's financial statements. The basic criteria is the exercise of oversight responsibility over such organizations, activities and functions. The Authority has not identified any entities which should be subject to evaluation for inclusion in the Authority's reporting entity.

The Commonwealth appoints the members of the Authority's governing board. The Commonwealth maintains the accounts and records of the Authority. In addition, the Commonwealth employs and supervises personnel to provide administrative services. Therefore, the Authority is considered a component unit of the Commonwealth of Pennsylvania.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The Authority's financial statements are presented on the full accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under this basis of accounting, revenues are recorded when earned and expenses are recorded when the liability is incurred, regardless of the timing of the related cash flows. The Authority applies Governmental Accounting Standards Board (GASB) pronouncements as well as Financial Accounting Standards Board (FASB) statements and interpretations, and the Accounting Principles Board (APB) of the Committee of Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

All activities of the Authority are accounted for within a single proprietary (enterprise) fund. A proprietary fund is used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The accounting and financial reporting treatment applied to the Authority is determined by its measurement focus. The transactions of the Authority are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the balance sheet. Net assets represent total assets net of total liabilities.

Cash and Cash Equivalents

Cash and cash equivalents, for the purposes of the Statement of Cash Flows, include cash on hand or on deposit with a maturity of three months or less at the date of purchase.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses

The allowance for loan losses is a reserve account for possible future loan losses. Loan losses and recoveries of previously charged-off loans are charged or credited directly to the allowance account. The provision for loan losses is adjusted monthly at the rate of 2% of outstanding loan balances at the respective month-end. The provision for loan losses was based on comparison with other Authorities of the Commonwealth with similar operations and loan portfolio.

Loan Origination Fees and Costs

The Authority recognizes loan origination fees and costs in accordance with Statement of Financial Accounting Standards No. 91 ("SFAS No. 91"), *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*. For the years ended June 30, 2008 and 2007, \$536,991 and \$774,024, respectively, of net deferred fees are included in loans receivable.

Use of Estimates in Preparing Financial Statements

The preparation of financial statements requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Reclassifications

For comparative purposes, prior year's financial statements have been reclassified to conform to report classifications of the current year. The reclassifications had no effect on net assets.

Bond Premium and Discount

The difference between the cash received from bondholders at issuance and the amount due to bondholders at maturity is recognized as bond premium or discount. Bond premium or discount is amortized using the straight-line method over the lives of the bonds issued.

NOTE 2 – FINANCIAL SUPPORT

The Authority has a net asset deficit of \$97,748,515 and \$92,768,838 as of June 30, 2008 and 2007, respectively. The Authority's business purpose will result in continued losses from operation due to the disbursement of grant awards to help promote economic growth in the Commonwealth. In addition, the Authority transferred part of their bond proceeds in prior years to the Commonwealth for the Machinery and Equipment Loan Fund (MELF) program, which contributes to the deficit in net assets.

Through a service agreement with the Authority, the Commonwealth has pledged to seek annual appropriations to pay the Authority's annual debt service obligations. Therefore, these factors listed above, do not raise doubt as to the Authority's ability to meet obligations when due.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007

NOTE 3 – DEPOSITS**Custodial Credit Risk**

Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. As of June 30, 2008 and 2007, the Authority's bank balance was exposed to custodial credit risk as follows:

	<u>2008</u>	<u>2007</u>
FDIC Insured	\$ 100,000	\$ 100,000
Uninsured and collateral held by pledging bank's trust department not in the Authority's name	<u>434,976,058</u>	<u>335,233,775</u>
Total	<u>\$ 435,076,058</u>	<u>\$ 335,333,775</u>

Additionally, due to the short-term maturity and types of investments, there is limited interest rate risk.

NOTE 4 – LOANS RECEIVABLE

The Authority provides loans, in accordance with its enabling legislation and statutory requirements to spur economic development activity within the Commonwealth of Pennsylvania. The loans have amortization periods not to exceed 20 years and bear interest at rates ranging from 1% to 8% depending on the nature of the loan and the Authority program from which the loan was funded.

The Authority, through the New Venture Capital Investment Program, provides loans to venture capital partnerships for investments in Pennsylvania-related companies.

At June 30, 2008 and 2007, the outstanding balance of loans receivable was as follows:

	<u>2008</u>		
	<u>Current Portion</u>	<u>Long-term Portion</u>	<u>Total</u>
Loans receivable	\$ 5,810,920	\$166,651,985	\$172,462,905
Venture Capital Investment loans	-	22,150,000	22,150,000
Deferred loan origination fees - net	(40,712)	(496,279)	(536,991)
Allowance for loan losses	<u>(116,218)</u>	<u>(3,773,678)</u>	<u>(3,889,896)</u>
Loan receivable - net	<u>\$ 5,653,990</u>	<u>\$184,532,028</u>	<u>\$190,186,018</u>
	<u>2007</u>		
Loans receivable	\$ 2,469,848	\$111,299,326	\$113,769,174
Venture Capital Investment loans	-	14,500,000	14,500,000
Deferred loan origination fees - net	(53,379)	(720,645)	(774,024)
Allowance for loan losses	<u>(49,397)</u>	<u>(2,533,082)</u>	<u>(2,582,479)</u>
Loan receivable - net	<u>\$ 2,367,072</u>	<u>\$122,545,599</u>	<u>\$124,912,671</u>

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007**

NOTE 4 – LOANS RECEIVABLE (CONTINUED)

An analysis of the allowance for loan losses for the years ended June 30, 2008 and 2007 is as follows:

	<u>2008</u>	<u>2007</u>
Balance, beginning of year	\$ 2,582,479	\$ 808,226
Change in provision for potential losses	<u>1,307,417</u>	<u>1,774,253</u>
Balance, end of year	<u>\$ 3,889,896</u>	<u>\$ 2,582,479</u>

NOTE 5 – BONDS PAYABLE

	<u>2008</u>	<u>2007</u>
Series 2008 Revenue Bonds, issued \$187,500,000 fixed rate, federally taxable revenue bonds, Series A at 3.1% -5.2%, interest payable semi-annually and principal payable annually through June 1, 2027.	\$187,500,000	\$ -
Series 2006 Revenue Bonds, issued \$187,500,000 fixed rate, federally taxable revenue bonds, Series C in November 2006 at 4.9% - 5.2%, interest payable semi-annually and principal payable annually through June 1, 2026.	181,385,000	187,500,000
Series 2006 Revenue Bonds, issued \$45,000,000 fixed rate, tax exempt revenue bonds, Series A and \$142,500,000 fixed rate, federally taxable revenue bonds, Series B in April 2006 at 4.5% - 5.6%, interest only payable semi-annually through June 1, 2026 and principal payable annually through June 1, 2026.	177,640,000	183,285,000
Series 2005 Revenue Bonds, issued \$62,500,000 fixed rate, tax exempt revenue bonds, Series A and \$125,000,000 fixed rate, federally taxable revenue bonds, Series B in November 2005 at 4.5% - 5.3%, interest payable semi-annually and principal payable annually through June 1, 2025.	<u>175,080,000</u>	<u>181,435,000</u>
	721,605,000	552,220,000
Less current portion	(23,505,000)	(18,115,000)
Unamortized bond premium	<u>3,926,980</u>	<u>4,210,943</u>
Long-term debt, net of current portion and unamortized bond premium	<u>\$702,026,980</u>	<u>\$538,315,943</u>

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007**

NOTE 5 – BONDS PAYABLE (CONTINUED)

Bond principal requirements subsequent to June 30, 2008 are as follows:

For the Year Ended June 30,	Principal Maturities	Interest
2008	\$ 23,505,000	\$ 39,916,755
2009	26,645,000	36,777,389
2010	27,920,000	35,508,199
2011	29,280,000	34,142,180
2012	30,740,000	32,678,571
2013-2017	179,235,000	137,908,841
2018-2022	232,780,000	84,382,611
2023-2027	171,500,000	19,458,278
Total	<u>\$ 721,605,000</u>	<u>\$ 420,772,824</u>

The Authority, with the Commonwealth approval, issued the above noted revenue bonds to fund the activities of the Authority. Repayments with respect to the revenue bonds are derived solely from project revenues which are defined as annual appropriations by the Commonwealth per the Official Statement. The Revenue Bonds described above are limited obligations of the Authority and are considered non-recourse, as the Authority is not obligated to bondholders beyond amounts received by the Authority from annual appropriations to the Authority by the Commonwealth. The Commonwealth has not pledged its full faith and credit nor the taxing power of the Commonwealth or any political subdivision for the payment of the Authority's Revenue Bonds and the payments by the Commonwealth to the Authority are subject to annual appropriation of funds for such purposes by the General Assembly and there is no assurance that such funds will be appropriated in any fiscal year. Repayments of loans do not constitute project revenues.

NOTE 6 – RELATED PARTY TRANSACTIONS

The Authority entered into an agreement with the Commonwealth of Pennsylvania, through the Department of Community and Economic Development (DCED) to provide administrative and operational support services for the Authority. The Authority employs one personnel and owns no capital assets; the remaining employees performing services for the Authority are DCED employees. As such under the Memorandum of Understanding, the Authority reimburses DCED for services rendered by DCED employees to the Authority. During the fiscal year ended June 30, 2008 and 2007, the services provided by DCED to the Authority and recorded as Administrative/Operating expenses totaled \$2,178,895 and \$2,426,663, respectively.

During the fiscal year ended June 30, 2008 and 2007, the Authority received \$47,037,935 and \$35,468,689, respectively, in transfers from the Commonwealth to pay debt service with respect to Revenue Bonds. See Note 5 for details with respect to the Revenue Bonds.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007**

NOTE 7 – LINE OF CREDIT

The Authority has available a secured line of credit with a bank, which, under a revolving credit agreement, is limited to borrowings of \$50,000,000. Under the revolving credit agreement, interest shall accrue on the aggregate unpaid principal amount outstanding on the draws. As of June 30, 2008 and 2007, no funds were drawn under the revolving credit agreement.

NOTE 8 – COMMITMENTS AND CONTINGENCIES

The Authority, through various economic development programs, provided loan guarantees as follows:

	<u>2008</u>	<u>2007</u>
First Industries loan guarantees	\$ 18,140,750	\$ 9,220,250
Tax increment financing guarantees	30,000,000	15,000,000
Second stage loan guarantees	2,785,000	2,660,000
Venture capital guarantees	<u>197,500,000</u>	<u>172,500,000</u>
Total loan guarantees	<u>\$248,425,750</u>	<u>\$199,380,250</u>

The Authority has not been called upon, with respect to any loan guarantees, to make principal or interest payments on behalf of the ultimate borrowers. Accordingly, no liability has been reflected in the Authority's financial statements for loan guarantees.

Through the various Authority loan and grant programs to promote economic development within the Commonwealth of Pennsylvania, the Authority has approved loans, investments in venture capital and grants of \$181,973,899, \$27,500,000 and \$39,398,626, respectively, which have not been disbursed as of June 30, 2008.

This information is an integral part of the accompanying financial statements.



**Independent Auditor's Report on Internal Control Over Financial Reporting
and on Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

Board of Directors
Commonwealth Financing Authority
Harrisburg, Pennsylvania

We have audited the basic financial statements of the Commonwealth Financing Authority ("Authority") as of and for the years ended June 30, 2008, and have issued our report thereon dated August 29, 2008. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency described below to be a significant deficiency in internal control over financial reporting.

During the course of the audit, we discovered several misstatements, that combined had a material effect on the Authority's financial statements. Specifically, adjustments were made to properly record issuance costs and bond premium for the 2008 bond issuance and to correct errors made in recording the accrued interest income for loans and accrued interest expense for bonds payable at year-end. We recommend that management establish procedures for review and approval of journal entries for accuracy and completeness in the recording of month-end accruals and all components of a bond issuance.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

Clifton Henderson LLP

Harrisburg, Pennsylvania
August 29, 2008

COMMONWEALTH FINANCING AUTHORITY
 (Component Unit of the Commonwealth of Pennsylvania)
 Harrisburg, Pennsylvania

FINANCIAL STATEMENTS
 June 30, 2009 and 2008

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS	18



Independent Auditor's Report

Board of Directors
Commonwealth Financing Authority
Harrisburg, Pennsylvania

We have audited the accompanying statements of net assets of the Commonwealth Financing Authority (Authority), a component unit of the Commonwealth of Pennsylvania, as of June 30, 2009 and 2008, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended, which collectively comprise the Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in the Notes, the financial statements present only financial information about the Commonwealth Financing Authority and are not intended to present fairly the financial position of the Commonwealth of Pennsylvania and the results of its operations and cash flows of its proprietary and similar trust fund types in conformity with accounting principles generally accepted in the United States of America.

The Authority is a component unit of the Commonwealth of Pennsylvania (Commonwealth). As disclosed in Note 1 of the financial statements, the Authority has extensive transactions and relationships with certain Commonwealth affiliated agencies. The financial position and results of operations of the Authority may not be indicative of that which would have been obtained had the Authority operated independently.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority, and the results of its operations and cash flows in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 8, 2009 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis as referenced in the Table of Contents is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. 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.

Clifton Gunderson LLP

Harrisburg, Pennsylvania
September 8, 2009

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2009 and 2008**

The Commonwealth Financing Authority, hereafter referred to as the "Authority," is pleased to present its financial statements developed in compliance with Statement of Governmental Accounting Standard No. 34, entitled "Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments" (hereafter GASB 34), and related standards. GASB 34 enhances information provided to the users of its financial statements. This section of the financial reporting package presents our discussion and analysis of the Authority's financial performance during the years ended June 30, 2009 and 2008. Please read it in conjunction with the Authority's financial statements that follow this section.

OPERATIONAL HIGHLIGHTS

The Authority implemented two major legislative initiatives approved by the General Assembly in July 2008. Three new grant programs to repair high hazard unsafe dams, construct flood control projects, and repair water and sewer systems began accepting applications in December 2008. 774 applications requesting over \$3 billion were received for consideration under the \$800 million H2O PA programs. The Authority also began accepting applications under four new programs to promote alternative energy production, energy conservation, and manufacturing of alternative energy equipment in the Commonwealth. The Authority will raise \$500 million through bond sales to fund the new energy programs.

OVERVIEW OF THE FINANCIAL STATEMENTS

Management's Discussion and Analysis (MD&A) serves as an introduction to, and should be read in conjunction with, the basic audited financial statements. The MD&A represents management's examination and analysis of the Authority's financial condition and performance. Summary financial statement data and other management tools were used for this analysis.

The financial statements report information about the Authority using the full accrual method of accounting, as utilized by similar business activities in the private sector. The financial statements include a Statement of Net Assets; a Statement of Revenues, Expenses, and Changes in Net Assets; a Statement of Cash Flows; and Notes to the Financial Statements.

The Statement of Net Assets presents the financial position of the Authority on a full accrual historical cost basis. The Statement of Net Assets also presents information on all of the Authority's assets and liabilities, with the difference reported as net assets. Over time, increases and decreases in net assets are one indicator of whether the financial position of the Authority is improving or deteriorating.

While the Statement of Net Assets provides information about the nature and amount of resources and obligations at year-end, the Statement of Revenues, Expenses, and Changes in Net Assets presents the results of the business-type activities over the course of the fiscal year and information as to how the net assets changed during the year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the Authority's recovery of its costs.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2009 and 2008**

The Statement of Cash Flows presents changes in cash and cash equivalents, resulting from operational, financing, and investing activities. This statement presents cash receipt and cash disbursement information without consideration of the earnings event when an obligation arises, or depreciation of capital assets.

The Notes to the Financial Statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Authority's accounting policies, significant account balances and activities, long-term debt and subsequent events, if any.

FINANCIAL ANALYSIS

Condensed Statements of Net Assets

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Assets:			
Current assets	\$ 483,900,761	\$ 448,882,160	\$ 343,892,109
Long-term assets	<u>239,787,756</u>	<u>184,532,028</u>	<u>122,545,599</u>
Total assets	<u>723,688,517</u>	<u>633,414,188</u>	<u>466,437,708</u>
Liabilities:			
Current liabilities	30,501,487	29,135,723	20,890,603
Long-term liabilities	<u>773,952,402</u>	<u>702,026,980</u>	<u>538,315,943</u>
Total liabilities	<u>804,453,889</u>	<u>731,162,703</u>	<u>559,206,546</u>
Total net deficit – unrestricted	<u>\$ (80,765,372)</u>	<u>\$ (97,748,515)</u>	<u>\$ (92,768,838)</u>

The Authority issued bonds totaling \$100 million and \$187.5 million in 2009 and 2008, respectively, which caused an increase in total liabilities of \$73 million and \$172 million at June 30, 2009 and 2008, respectively. Due to the issuance of bonds, the Authority has been able to increase the amount of loan originations over the past two years, causing an increase in total assets of \$90 million and \$167 million as of June 30, 2009 and 2008, respectively. Due to the nature of the loans, some of which require drawdowns, funding not immediately disbursed upon Board approval is held as cash and cash equivalents.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2009 and 2008**

Condensed Statements of Revenues, Expenses, and Changes in Net Assets

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Operating income	\$ 11,614,029	\$ 16,398,583	\$ 18,048,722
Operating expenses	(18,734,695)	(35,525,735)	(35,956,634)
Provision for loan losses	(1,177,504)	(1,307,417)	(1,774,253)
Nonoperating income (expense) - net	<u>25,281,313</u>	<u>15,454,892</u>	<u>(49,952,640)</u>
Increase (decrease) in net assets	<u>\$ 16,983,143</u>	<u>\$ (4,979,677)</u>	<u>\$ (69,634,805)</u>

Long-Term Debt

During 2009, the Authority issued one revenue bond totaling \$100 million to provide funds for loan disbursements and grant expenditures under Alternative Energy programs. Since inception, the Authority has issued five revenue bonds totaling \$850 million. The Authority has a service agreement with the Commonwealth of Pennsylvania for the payment of the annual debt service through an annual appropriation by the Commonwealth. However, there is no assurance that there will be sufficient funds appropriated annually by the Commonwealth.

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, investors and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. If you have questions about this report or need additional information, contact the Commonwealth Financing Authority, 400 North Street, Fourth Floor, Harrisburg, PA 17120.

FINANCIAL STATEMENTS

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF NET ASSETS
June 30, 2009 and 2008

	2009	2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 466,995,050	\$ 435,076,058
Receivables (net):		
Loans	8,092,104	5,653,990
Accrued interest	530,832	280,723
Penalties/late fees	4,053	1,989
Other assets	8,278,722	7,869,400
Total current assets	483,900,761	448,882,160
Long-term assets:		
Long-term portion of loans receivable (net)	239,787,756	184,532,028
Total assets	723,688,517	633,414,188
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	26,645,000	23,505,000
Accrued interest payable	3,414,469	5,124,764
Accounts payable and accrued expenses	-	41,413
Due to primary governments - DCED	442,018	464,546
Total current liabilities	30,501,487	29,135,723
Non-current liabilities:		
Long-term debt, net of current portion and unamortized bond premium and discount	773,952,402	702,026,980
Total liabilities	804,453,889	731,162,703
TOTAL NET DEFICIT - UNRESTRICTED	\$ (80,765,372)	\$ (97,748,515)

The accompanying notes are an integral part of the financial statements.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Years Ended June 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
OPERATING INCOME		
Interest on loans	\$ 3,979,784	\$ 2,369,357
Interest on investments	7,104,622	13,910,201
Fee income	279,623	119,025
Interest from venture capital loan	<u>250,000</u>	<u>-</u>
Total operating income	<u>11,614,029</u>	<u>16,398,583</u>
OPERATING EXPENSES		
Administrative/operating expense	2,145,097	2,178,895
Grant expense - Business in Our Sites	15,601,132	31,961,556
Grant expense - First Industries	<u>988,466</u>	<u>1,385,284</u>
Total operating expenses	<u>18,734,695</u>	<u>35,525,735</u>
Net operating loss before provision for loan losses	(7,120,666)	(19,127,152)
PROVISION FOR LOAN LOSSES	<u>1,177,504</u>	<u>1,307,417</u>
Net operating loss	<u>(8,298,170)</u>	<u>(20,434,569)</u>
NONOPERATING INCOME (EXPENSE)		
Transfers in from primary government	63,421,755	47,037,935
Interest on bonds	(38,206,461)	(31,637,458)
Amortization of bond premium	221,031	226,360
Amortization of bond issuance costs	(443,797)	(408,978)
Other	<u>288,785</u>	<u>237,033</u>
Total nonoperating income	<u>25,281,313</u>	<u>15,454,892</u>
Change in net assets	16,983,143	(4,979,677)
NET ASSETS, BEGINNING OF PERIOD	<u>(97,748,515)</u>	<u>(92,768,838)</u>
NET ASSETS, END OF PERIOD	<u>\$ (80,765,372)</u>	<u>\$ (97,748,515)</u>

The accompanying notes are an integral part of the financial statements.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from interest and fees on loans	\$ 4,257,234	\$ 2,540,292
Cash received from interest on investments	7,104,622	13,910,201
Cash paid for operating expenses	(2,209,038)	(2,038,294)
Cash paid for grant expenses	<u>(16,589,598)</u>	<u>(33,346,840)</u>
Net cash and cash equivalents used in operating activities	<u>(7,436,780)</u>	<u>(18,934,641)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Principal receipt on loans	6,197,927	5,119,169
Investment in loans	(54,005,487)	(63,812,898)
Investment in venture capital	<u>(10,775,000)</u>	<u>(7,650,000)</u>
Net cash and cash equivalents used in investing activities	<u>(58,582,560)</u>	<u>(66,343,729)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from bonds payable	97,938,333	185,020,657
Commonwealth appropriation	63,421,755	47,037,935
Principal payments on bonds	(23,505,000)	(18,115,000)
Interest on bonds payable	<u>(39,916,756)</u>	<u>(28,922,939)</u>
Net cash and cash equivalents provided by noncapital financing activities	<u>97,938,332</u>	<u>185,020,653</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	31,918,992	99,742,283
CASH AND CASH EQUIVALENTS, BEGINNING	<u>435,076,058</u>	<u>335,333,775</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 466,995,050</u>	<u>\$ 435,076,058</u>
RECONCILIATION OF NET OPERATING LOSS AFTER PROVISION FOR LOAN LOSSES TO CASH AND CASH EQUIVALENTS USED IN OPERATING ACTIVITIES		
Net operating loss	\$ (8,298,170)	\$ (20,434,569)
Adjustments to reconcile net operating loss to net cash and cash equivalents used in operating activities:		
Provision for loan losses	1,177,504	1,307,417
Effects of changes in operating assets and liabilities:		
Interest receivables	(250,109)	45,556
Penalties/late fees	(2,064)	6,354
Accounts payable and accrued expenses and due to primary governments - DCED	<u>(63,941)</u>	<u>140,601</u>
NET CASH AND CASH EQUIVALENTS USED IN OPERATING ACTIVITIES	<u>\$ (7,436,780)</u>	<u>\$ (18,934,641)</u>

The accompanying notes are an integral part of the financial statements.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2009 and 2008**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Commonwealth Financing Authority (Authority) is a body corporate and politic duly organized by the Commonwealth of Pennsylvania (Commonwealth) incorporated under the Public Authorities and Quasi-Public Corporations Act of 2004 (Act), being the Act of April 1, 2004, P.L. 163, as amended by the Commonwealth of Pennsylvania. The Authority, by virtue of the Act and its articles of incorporation, has all powers as set forth in the Act including those for creation and retention of jobs. The purpose of the Authority is to engage in financial assistance in the form of loans, loan guarantees, grants and private equity participating loans to promote activities which lead to the use of alternative and clean energy, the creation and retention of jobs within the Commonwealth of Pennsylvania, the establishment of economically viable Pennsylvania communities, the development of a stable tax base within Pennsylvania communities, the reuse of abandoned industrial, commercial and other previously utilized sites, the promotion and commercialization of Pennsylvania products and services and investment of private capital in Pennsylvania communities to promote the health, safety, employment, business opportunities, economic activity and general welfare of the people of the Commonwealth.

The legislation creating the Authority as well as program specific guidelines establishes certain activities to be carried out by the Authority as follows:

- Business in Our Sites Program: provides financial assistance for preparation of sites for future development.
- First Industries Program: provides financial assistance for projects related to tourism and agriculture.
- Second Stage Loan Program: provides loan guarantees to commercial lending institutions that make loans to life sciences, advanced technology or manufacturing businesses.
- New Pennsylvania Venture Guarantee Program: provides guarantees to venture capital partnerships for investments in Pennsylvania-related companies which are in early-stage or mid-stage development.
- Building Pennsylvania Program: provides loans to fund managers for investment in real estate projects in Pennsylvania.
- TIF Guarantee Program: provides guarantees for TIF bonds or other indebtedness in accordance with the TIF Act of 1990.
- New Pennsylvania Venture Capital Investments Program: provides loans to Venture Capital partnerships for investment in Pennsylvania companies.
- Penn Works Program: provides grants and loans for water supply and wastewater infrastructure within Pennsylvania.
- H₂O PA Program: provides for single-year or multi-year grants to municipalities or municipal authorities to assist with the construction of flood control projects, drinking water, sanitary sewer and storm sewer projects, and the repair of high hazard unsafe dams.
- Solar Energy Program: provides financial assistance in the form of grant and loan funds to promote the generation and use of solar energy and the manufacture or assembly of solar equipment.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- Renewable Energy Program: provides financial assistance in the form of grant and loan funds to promote the use of wind and geothermal energy.
- Alternative and Clean Energy Program: provides grant and loan funds to encourage the implementation of alternative energy production projects and clean energy projects.
- High performance Buildings: provides grants and loans for the construction of energy efficient buildings.

Reporting Entity

The Authority has adopted the provisions of Section 2100 of the Codification of Governmental Accounting and Financial Reporting Standards for the criteria used to evaluate organizations, activities and functions that should be included in the Authority's financial statements. The basic criteria are the exercise of oversight responsibility over such organizations, activities and functions. The Authority has not identified any entities which should be subject to evaluation for inclusion in the Authority's reporting entity.

The Commonwealth appoints the members of the Authority's governing board. The Commonwealth maintains the accounts and records of the Authority. In addition, the Commonwealth employs and supervises personnel to provide administrative services. Therefore, the Authority is considered a component unit of the Commonwealth of Pennsylvania.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The Authority's financial statements are presented on the full accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under this basis of accounting, revenues are recorded when earned and expenses are recorded when the liability is incurred, regardless of the timing of the related cash flows. The Authority applies Governmental Accounting Standards Board (GASB) pronouncements as well as Financial Accounting Standards Board (FASB) statements and interpretations, and the Accounting Principles Board (APB) of the Committee of Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

All activities of the Authority are accounted for within a single proprietary (enterprise) fund. A proprietary fund is used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Measurement Focus, Basis of Accounting and Financial Statement Presentation
(Continued)

The accounting and financial reporting treatment applied to the Authority is determined by its measurement focus. The transactions of the Authority are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the balance sheet. Net assets represent total assets net of total liabilities.

Cash and Cash Equivalents

Cash and cash equivalents, for the purposes of the Statement of Cash Flows, include cash on hand or on deposit with a maturity of three months or less at the date of purchase.

Allowance for Loan Losses

The allowance for loan losses is a reserve account for possible future loan losses. Loan losses and recoveries of previously charged-off loans are charged or credited directly to the allowance account. The provision for loan losses is adjusted monthly at the rate of 2% of outstanding loan balances at the respective month-end. The provision for loan losses was based on comparison with other Authorities of the Commonwealth with similar operations and loan portfolio.

Interest Income

Interest income on investment securities and loans are recorded when earned.

Uncollectible interest on loans that are contractually past due is charged off, or an allowance is established based on management's periodic evaluations. The allowance is established by a charge-to-interest income equal to all previously accrued, and income is subsequently recognized only to the extent that cash payments are received until, in management's judgment, the borrower's ability to make period interest and principal payments is back to normal.

In addition to fixed interest arrangements, some loans contain provisions which provide lump sum interest payments based upon certain conditions being met. This additional income is recognized when earned.

Loan Origination Fees and Costs

The Authority recognizes loan origination fees and costs in accordance with Statement of Financial Accounting Standards No. 91 (SFAS No. 91), *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*. For the years ended June 30, 2009 and 2008, \$248,320 and \$536,991, respectively, of net deferred fees are included in loans receivable.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2009 and 2008**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Use of Estimates in Preparing Financial Statements

The preparation of financial statements requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Reclassifications

For comparative purposes, the prior year's financial statements have been reclassified to conform to report classifications of the current year. The reclassifications had no effect on net assets.

Bond Premium and Discount

The difference between the cash received from bondholders at issuance and the amount due to bondholders at maturity is recognized as bond premium or discount. Bond premium or discount is amortized using the straight-line method over the lives of the bonds issued.

NOTE 2 – FINANCIAL SUPPORT

The Authority has a net asset deficit of \$80,765,372 and \$97,748,515 as of June 30, 2009 and 2008, respectively. The Authority's business purpose will result in continued losses from operation due to the disbursement of grant awards to help promote economic growth in the Commonwealth. In addition, the Authority transferred part of their bond proceeds in prior years to the Commonwealth for the Machinery and Equipment Loan Fund (MELF) program, which contributed to the deficit in net assets.

Through a service agreement with the Authority, the Commonwealth has pledged to seek annual appropriations to pay the Authority's annual debt service obligations. Therefore, these factors listed above do not raise doubt as to the Authority's ability to meet obligations when due.

NOTE 3 – DEPOSITS

Custodial Credit Risk

Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. As of June 30, 2009 and 2008, the Authority's bank balance was exposed to custodial credit risk as follows:

	<u>2009</u>	<u>2008</u>
FDIC Insured	\$ 250,000	\$ 100,000
Uninsured and collateral held by pledging bank's trust department not in the Authority's name	<u>466,063,768</u>	<u>433,784,201</u>
Total	<u>\$ 466,313,768</u>	<u>\$ 433,884,201</u>

Additionally, due to the short-term maturity and types of investments, there is limited interest rate risk.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 4 – LOANS RECEIVABLE

The Authority provides loans, in accordance with its enabling legislation and statutory requirements to spur economic development activity within the Commonwealth of Pennsylvania. The loans have amortization periods not to exceed 20 years and bear interest at rates ranging from 1% to 8% depending on the nature of the loan and the Authority program from which the loan was funded.

The Authority, through the New Venture Capital Investment Program, provides loans to venture capital partnerships for investments in Pennsylvania-related companies.

At June 30, 2009 and 2008, the outstanding balance of loans receivable was as follows:

	2009		
	Current Portion	Long-term Portion	Total
Loans receivable	\$ 8,285,866	\$ 211,984,714	\$ 220,270,580
Venture Capital Investment loans	-	32,925,000	32,925,000
Deferred loan origination fees - net	(28,045)	(220,275)	(248,320)
Allowance for loan losses	<u>(165,717)</u>	<u>(4,901,683)</u>	<u>(5,067,400)</u>
Loan receivable - net	<u>\$ 8,092,104</u>	<u>\$ 239,787,756</u>	<u>\$ 247,879,860</u>
	2008		
Loans receivable	\$ 5,810,920	\$ 166,651,985	\$ 172,462,905
Venture Capital Investment loans	-	22,150,000	22,150,000
Deferred loan origination fees - net	(40,712)	(496,279)	(536,991)
Allowance for loan losses	<u>(116,218)</u>	<u>(3,773,678)</u>	<u>(3,889,896)</u>
Loan receivable - net	<u>\$ 5,653,990</u>	<u>\$ 184,532,028</u>	<u>\$ 190,186,018</u>

An analysis of the allowance for loan losses for the years ended June 30, 2009 and 2008 is as follows:

	2009	2008
Balance, beginning of year	\$ 3,889,896	\$ 2,582,479
Change in provision for potential losses	<u>1,177,504</u>	<u>1,307,417</u>
Balance, end of year	<u>\$ 5,067,400</u>	<u>\$ 3,889,896</u>

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 5 – BONDS PAYABLE

	<u>2009</u>	<u>2008</u>
Series 2009 Revenue Bonds, issued \$50,000,000 fixed rate, federal taxable revenue bonds, Series A and \$50,000,000 fixed rate, tax-exempt revenue bonds, Series B at 3.0% - 6.4%, interest payable semi-annually and principal payable annually through June 1, 2031.	\$ 100,000,000	\$ -
Series 2008 Revenue Bonds, issued \$187,500,000 fixed rate, federally taxable revenue bonds, Series A at 3.1% -5.2%, interest payable semi-annually and principal payable annually through June 1, 2027.	183,050,000	187,500,000
Series 2006 Revenue Bonds, issued \$187,500,000 fixed rate, federally taxable revenue bonds, Series C at 4.9% - 5.2%, interest payable semi-annually and principal payable annually through June 1, 2026.	174,965,000	181,385,000
Series 2006 Revenue Bonds, issued \$45,000,000 fixed rate, tax exempt revenue bonds, Series A and \$142,500,000 fixed rate, federally taxable revenue bonds, Series B at 4.5% - 5.6%, interest only payable semi-annually through June 1, 2026 and principal payable annually through June 1, 2026.	171,675,000	177,640,000
Series 2005 Revenue Bonds, issued \$62,500,000 fixed rate, tax exempt revenue bonds, Series A and \$125,000,000 fixed rate, federally taxable revenue bonds, Series B at 4.5% - 5.3%, interest payable semi-annually and principal payable annually through June 1, 2025.	<u>168,410,000</u>	<u>175,080,000</u>
	798,100,000	721,605,000
Less current portion	(26,645,000)	(23,505,000)
Unamortized bond premium	3,701,371	3,926,980
Unamortized bond discount	<u>(1,203,969)</u>	<u>-</u>
Long-term debt, net of current portion and unamortized bond premium	<u>\$ 773,952,402</u>	<u>\$ 702,026,980</u>

Changes in long-term liabilities

<u>Governmental Activities</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Economic revenue bonds	\$ 721,605,000	\$ 100,000,000	\$ 23,505,000	\$ 798,100,000	\$ 26,645,000
Bond premium	3,926,980	-	225,609	3,701,371	-
Bond discount	<u>-</u>	<u>(1,208,547)</u>	<u>(4,578)</u>	<u>(1,203,969)</u>	<u>-</u>
Total	<u>\$ 725,531,980</u>	<u>\$ 98,791,453</u>	<u>\$ 23,726,031</u>	<u>\$ 800,597,402</u>	<u>\$ 26,645,000</u>

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2009 and 2008**

NOTE 5 – BONDS PAYABLE (CONTINUED)

Bond principal requirements subsequent to June 30, 2009 are as follows:

For the Year Ended June 30,	Principal Maturities	Interest
2010	\$ 26,645,000	\$ 42,144,501
2011	30,715,000	40,633,292
2012	32,155,000	39,184,122
2013	33,725,000	37,610,229
2014	35,410,000	35,930,029
2015-2019	206,840,000	149,904,095
2020-2024	269,485,000	87,268,610
2025-2029	148,400,000	18,714,318
2030-2031	<u>14,725,000</u>	<u>1,113,250</u>
Total	<u>\$ 798,100,000</u>	<u>\$ 452,502,446</u>

The Authority, with the Commonwealth approval, issued the above noted revenue bonds to fund the activities of the Authority. Repayments with respect to the revenue bonds are derived solely from project revenues which are defined as annual appropriations by the Commonwealth per the Official Statement. The Revenue Bonds described above are limited obligations of the Authority and are considered non-recourse, as the Authority is not obligated to bondholders beyond amounts received by the Authority from annual appropriations to the Authority by the Commonwealth. The Commonwealth has not pledged its full faith and credit nor the taxing power of the Commonwealth or any political subdivision for the payment of the Authority's Revenue Bonds and the payments by the Commonwealth to the Authority are subject to annual appropriation of funds for such purposes by the General Assembly and there is no assurance that such funds will be appropriated in any fiscal year. Repayments of loans do not constitute project revenues.

NOTE 6 – RELATED PARTY TRANSACTIONS

The Authority entered into an agreement with the Commonwealth of Pennsylvania, through the Department of Community and Economic Development (DCED) to provide administrative and operational support services for the Authority. The Authority owns no capital assets; the employees performing services for the Authority are DCED employees. As such, under the Memorandum of Understanding, the Authority reimburses DCED for services rendered by DCED employees to the Authority. During the fiscal years ended June 30, 2009 and 2008, the services provided by DCED to the Authority and recorded as Administrative/Operating expenses totaled \$2,145,097 and \$2,178,895, respectively.

During the fiscal years ended June 30, 2009 and 2008, the Authority received \$63,421,755 and \$47,037,935, respectively, in transfers from the Commonwealth to pay debt service with respect to Revenue Bonds. See Note 5 for details with respect to the Revenue Bonds.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2009 and 2008**

NOTE 7 – LINE OF CREDIT

The Authority has available a secured line of credit with a bank, which, under a revolving credit agreement, is limited to borrowings of \$50,000,000. Under the revolving credit agreement, interest shall accrue on the aggregate unpaid principal amount outstanding on the draws. As of June 30, 2009 and 2008, no funds were drawn under the revolving credit agreement. As of June 30, 2009, the line of credit was terminated.

NOTE 8 – COMMITMENTS AND CONTINGENCIES

The Authority, through various economic development programs, provided loan guarantees as follows:

	<u>2009</u>	<u>2008</u>
First Industries loan guarantees	\$ 18,340,250	\$ 18,140,750
Tax increment financing guarantees	44,911,970	30,000,000
Second stage loan guarantees	2,035,000	2,785,000
Venture capital guarantees	<u>190,000,000</u>	<u>197,500,000</u>
Total loan guarantees	<u>\$ 255,287,220</u>	<u>\$248,425,750</u>

The Authority has not been called upon, with respect to any loan guarantees, to make principal or interest payments on behalf of the ultimate borrowers. Accordingly, no liability has been reflected in the Authority's financial statements for loan guarantees.

Through the various Authority loan and grant programs to promote economic development within the Commonwealth of Pennsylvania, the Authority has approved loans, investments in venture capital and grants of \$223,206,530, \$2,725,000 and \$83,541,697, respectively, which have not been disbursed as of June 30, 2009.

This information is an integral part of the accompanying financial statements.



**Independent Auditor's Report on Internal Control Over Financial Reporting
and on Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

Board of Directors
Commonwealth Financing Authority
Harrisburg, Pennsylvania

We have audited the basic financial statements of the Commonwealth Financing Authority (Authority) as of and for the year ended June 30, 2009, and have issued our report thereon dated September 8, 2009. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Authority in a separate letter dated September 8, 2009.

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

Clifton Gunderson LLP

Harrisburg, Pennsylvania
September 8, 2009

COMMONWEALTH FINANCING AUTHORITY
 (Component Unit of the Commonwealth of Pennsylvania)
 Harrisburg, Pennsylvania

FINANCIAL STATEMENTS
 June 30, 2010 and 2009

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Independent Auditor's Report

Board of Directors
Commonwealth Financing Authority
Harrisburg, Pennsylvania

We have audited the accompanying statements of net assets of the Commonwealth Financing Authority (the Authority), a component unit of the Commonwealth of Pennsylvania, as of June 30, 2010 and 2009, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended, which collectively comprise the Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only financial information about the Commonwealth Financing Authority and are not intended to present fairly the financial position of the Commonwealth of Pennsylvania and the results of its operations and cash flows of its proprietary and similar trust fund types in conformity with accounting principles generally accepted in the United States of America.

The Authority is a component unit of the Commonwealth of Pennsylvania (the Commonwealth). As disclosed in Note 1 of the financial statements, the Authority has extensive transactions and relationships with certain Commonwealth affiliated agencies. The financial position and results of operations of the Authority may not be indicative of that which would have been obtained had the Authority operated independently.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority, and the results of its operations and cash flows in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 8, 2010 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis as referenced in the Table of Contents is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. 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.

Clifton Gunderson LLP

Lancaster, Pennsylvania
September 15, 2010

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2010 and 2009**

The Commonwealth Financing Authority, hereafter referred to as the "Authority," is pleased to present its financial statements developed in compliance with Statement of Governmental Accounting Standard No. 34, entitled "Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments" (hereafter GASB 34), and related standards. GASB 34 enhances information provided to the users of its financial statements. This section of the financial reporting package presents our discussion and analysis of the Authority's financial performance during the years ended June 30, 2010 and 2009. Please read it in conjunction with the Authority's financial statements that follow this section.

OPERATIONAL HIGHLIGHTS

The Authority deployed investments into two major legislative initiatives this Fiscal Year. By approving a combined \$95.7 million in grant, loan and loan guarantee funding assistance into alternative energy projects, the Authority accelerated the use of alternative and clean energy in the Commonwealth. Applicants received assistance under four energy programs, which include the Solar Energy Program, Renewable Energy Program, Alternative & Clean Energy Program and the High Performance Building Program.

The Authority provided \$551 million in funding, which consists of grants for the construction and upgrading of drinking water, sanitary sewer and storm sewer systems. In raising capital for this H₂O initiative, the Authority issued Build America Bonds which will save over \$46 million in debt service over the life of the bonds.

OVERVIEW OF THE FINANCIAL STATEMENTS

Management's Discussion and Analysis (MD&A) serves as an introduction to, and should be read in conjunction with, the basic audited financial statements. The MD&A represents management's examination and analysis of the Authority's financial condition and performance. Summary financial statement data and other management tools were used for this analysis.

The financial statements report information about the Authority using the full accrual method of accounting, as utilized by similar business activities in the private sector. The financial statements include a Statement of Net Assets; a Statement of Revenues, Expenses, and Changes in Net Assets; a Statement of Cash Flows; and Notes to the Financial Statements.

The Statement of Net Assets presents the financial position of the Authority on a full accrual historical cost basis. The Statement of Net Assets also presents information on all of the Authority's assets and liabilities, with the difference reported as net assets. Over time, increases and decreases in net assets are one indicator of whether the financial position of the Authority is improving or deteriorating.

While the Statement of Net Assets provides information about the nature and amount of resources and obligations at year-end, the Statement of Revenues, Expenses, and Changes in Net Assets presents the results of the business-type activities over the course of the fiscal year and information as to how the net assets changed during the year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the Authority's recovery of its costs.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2010 and 2009**

The Statement of Cash Flows presents changes in cash and cash equivalents, resulting from operational, financing, and investing activities. This statement presents cash receipt and cash disbursement information without consideration of the earnings event when an obligation arises, or depreciation of capital assets.

The Notes to the Financial Statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Authority's accounting policies, significant account balances and activities, long-term debt and subsequent events, if any.

FINANCIAL ANALYSIS

Condensed Statements of Net Assets

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Assets:			
Current assets	\$ 750,222,910	\$ 483,900,761	\$ 448,882,160
Long-term assets	<u>287,632,709</u>	<u>239,787,756</u>	<u>184,532,028</u>
Total assets	<u>1,037,855,619</u>	<u>723,688,517</u>	<u>633,414,188</u>
Liabilities:			
Current liabilities	42,198,516	30,501,487	29,135,723
Long-term liabilities	<u>1,282,704,529</u>	<u>773,952,402</u>	<u>702,026,980</u>
Total liabilities	<u>1,324,903,045</u>	<u>804,453,889</u>	<u>731,162,703</u>
Total net deficit - unrestricted	<u>\$ (287,047,426)</u>	<u>\$ (80,765,372)</u>	<u>\$ (97,748,515)</u>

The Authority issued bonds totaling \$542 million and \$100 million in 2010 and 2009, respectively, which caused an increase in total liabilities of \$520 million and \$73 million at June 30, 2010 and 2009, respectively. Due to the issuance of bonds, the Authority has been able to increase the amount of loan originations over the past two years, causing an increase in total assets of \$314 million and \$90 million as of June 30, 2010 and 2009, respectively. Due to the nature of the loans, some of which require drawdowns, funding not immediately disbursed upon Board approval is held as cash and cash equivalents.

The significant increase in the total net deficit is attributable to \$123 million in Authority assets disbursed as grant proceeds under the H₂O initiative, \$85 million in assets that were transferred to the Department of Environmental Protection and \$13 million in assets transferred to the Ben Franklin Technology Development Partners. The transfer of bond proceeds to these Governmental entities was prescribed by legislation. Management acknowledges but is not concerned with the annual net asset deficit. As an authority under which economic stimulus programs are established, grants and transfers to other governmental entities are essential to achieve its mission. The Authority has a service agreement with the Commonwealth of Pennsylvania in which the Commonwealth has pledged to seek annual appropriations to pay the Authority's annual debt service obligations to assist the Authority in funding the deficit.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2010 and 2009**

Condensed Statements of Revenues, Expenses, and Changes in Net Assets

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Operating income	\$ 8,091,436	\$ 11,614,029	\$ 16,398,583
Operating expenses	(138,624,287)	(18,734,695)	(35,525,735)
Provision for loan losses	(1,093,798)	(1,177,504)	(1,307,417)
Nonoperating income (expense), net	<u>(74,655,405)</u>	<u>25,281,313</u>	<u>15,454,892</u>
Increase (decrease) in net asset	<u>\$ (206,282,054)</u>	<u>\$ 16,983,143</u>	<u>\$ (4,979,677)</u>

Operating expenses increased by approximately \$120 million in FY 2010 and decreased by approximately \$17 million in FY 2009 due to the timing of grant payments. The Authority established 7 new programs related to H₂O and Alternative Energy initiatives at the end of FY 2009 that provided grants that were disbursed in FY 2010. Under the H₂O program, the Authority received and reviewed over 800 applications for funding assistance.

For the year ended June 30, 2010, nonoperating income decreased by approximately \$100 million over FY 2009 due to the transfer of \$98 million in bond proceeds to other governmental entities within the Commonwealth and a \$20 million increase in bond interest payments. This was offset by an increase in the Commonwealth appropriation of \$18 million for debt service payments.

Long-Term Debt

During 2010, the Authority issued revenue bonds for \$142 million to provide funds for loan disbursements and grant expenditures under Alternative Energy programs. In addition, the Authority issued \$400 million in Build America Bonds to provide for grant funding for flood control, repairs to dams and water and sewer projects. Since inception, the Authority has issued seven revenue bonds totaling \$1.392 billion. The Authority has a service agreement with the Commonwealth of Pennsylvania for the payment of the annual debt service through an annual appropriation by the Commonwealth. However, there is no assurance that there will be sufficient funds appropriated annually by the Commonwealth.

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, investors and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. If you have questions about this report or need additional information, contact the Commonwealth Financing Authority, 400 North Street, Fourth Floor, Harrisburg, PA 17120.

FINANCIAL STATEMENTS

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF NET ASSETS
June 30, 2010 and 2009**

	<u>2010</u>	<u>2009</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 722,767,227	\$ 466,995,050
Receivables (net):		
Loans	14,553,346	8,092,104
Accrued interest	994,617	530,832
Penalties/late fees	7,881	4,053
Unamortized bond costs, net	<u>11,899,839</u>	<u>8,278,722</u>
Total current assets	750,222,910	483,900,761
Long-term assets:		
Long-term portion of loans receivable (net)	<u>287,632,709</u>	<u>239,787,756</u>
Total assets	<u>1,037,855,619</u>	<u>723,688,517</u>
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	34,210,000	26,645,000
Accrued interest payable	6,842,177	3,414,469
Loan escrow deposit	388,080	-
Accounts payable and accrued expenses	159,508	-
Due to primary governments - DCED	<u>598,751</u>	<u>442,018</u>
Total current liabilities	42,198,516	30,501,487
Non-current liabilities:		
Long-term debt, net of current portion and unamortized bond premium and discount	<u>1,282,704,529</u>	<u>773,952,402</u>
Total liabilities	<u>1,324,903,045</u>	<u>804,453,889</u>
TOTAL NET DEFICIT - UNRESTRICTED	<u>\$ (287,047,426)</u>	<u>\$ (80,765,372)</u>

The accompanying notes are an integral part of the financial statements.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
OPERATING INCOME		
Interest on loans	\$ 5,138,479	\$ 3,979,784
Interest on investments	2,286,686	7,104,622
Fee income	621,182	279,623
Interest from venture capital loan	<u>45,089</u>	<u>250,000</u>
Total operating income	<u>8,091,436</u>	<u>11,614,029</u>
OPERATING EXPENSES		
Administrative/operating expense	2,650,469	2,145,097
Grant expense - Business in Our Sites	11,295,858	15,601,132
Grant expense - First Industries	495,964	988,466
Grant expense - Solar Energy	937,826	-
Grant expense - Water and Sewer	122,963,532	-
Grant expense - Alternative and Clean Energy	168,564	-
Loan guarantee expense	<u>112,074</u>	<u>-</u>
Total operating expenses	<u>138,624,287</u>	<u>18,734,695</u>
Net operating loss before provision for loan losses	(130,532,851)	(7,120,666)
PROVISION FOR LOAN LOSSES	<u>1,093,798</u>	<u>1,177,504</u>
Net operating loss	<u>(131,626,649)</u>	<u>(8,298,170)</u>
NONOPERATING INCOME (EXPENSE)		
Transfers in from primary government	81,654,535	63,421,755
Interest on bonds	(58,447,233)	(38,206,461)
Amortization of bond premium	174,982	221,031
Amortization of bond issuance costs	(545,267)	(443,797)
Transfers to primary government	(98,000,000)	-
Other	<u>507,578</u>	<u>288,785</u>
Total nonoperating income (expense)	<u>(74,655,405)</u>	<u>25,281,313</u>
Change in net assets	(206,282,054)	16,983,143
NET DEFICIT, BEGINNING OF PERIOD	<u>(80,765,372)</u>	<u>(97,748,515)</u>
NET DEFICIT, END OF PERIOD	<u>\$ (287,047,426)</u>	<u>\$ (80,765,372)</u>

The accompanying notes are an integral part of the financial statements.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2010 and 2009**

	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from interest and fees on loans	\$ 5,337,137	\$ 4,257,234
Cash received from interest on investments	2,286,686	7,104,622
Cash paid for operating expenses	(2,334,228)	(2,209,038)
Cash paid for grant expenses	(135,861,744)	(16,589,598)
Cash paid for loan guarantees	(112,074)	-
Net cash used in operating activities	<u>(130,684,223)</u>	<u>(7,436,780)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Principal receipt on loans	18,330,460	6,197,927
Investment in loans	(69,834,794)	(54,005,487)
Investment in venture capital	<u>(3,000,000)</u>	<u>(10,775,000)</u>
Net cash and cash equivalents used in investing activities	<u>(54,504,334)</u>	<u>(58,582,560)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from bonds payable	538,970,724	97,938,333
Transfer to primary government from bond proceeds	(98,000,000)	-
Commonwealth appropriation	81,654,535	63,421,755
Principal payments on bonds	(26,645,000)	(23,505,000)
Interest on bonds payable	<u>(55,019,525)</u>	<u>(39,916,756)</u>
Net cash provided by noncapital financing activities	<u>440,960,734</u>	<u>97,938,332</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	255,772,177	31,918,992
CASH AND CASH EQUIVALENTS, BEGINNING	<u>466,995,050</u>	<u>435,076,058</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 722,767,227</u>	<u>\$ 466,995,050</u>
RECONCILIATION OF NET OPERATING LOSS TO CASH AND CASH EQUIVALENTS USED IN OPERATING ACTIVITIES		
Net operating loss	\$ (131,626,649)	\$ (8,298,170)
Adjustments to reconcile net operating loss to net cash and cash equivalents used in operating activities:		
Provision for loan losses	1,093,798	1,177,504
Effects of changes in operating assets and liabilities:		
Accrued interest receivable	(463,785)	(250,109)
Penalties/late fees	(3,828)	(2,064)
Accounts payable and accrued expenses and due to primary governments - DCED	<u>316,241</u>	<u>(63,941)</u>
NET CASH AND CASH EQUIVALENTS USED IN OPERATING ACTIVITIES	<u>\$ (130,684,223)</u>	<u>\$ (7,436,780)</u>

The accompanying notes are an integral part of the financial statements.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Commonwealth Financing Authority (the Authority) is a body corporate and politic duly organized by the Commonwealth of Pennsylvania (the Commonwealth) incorporated under the Public Authorities and Quasi-Public Corporations Act of 2004 (Act), being the Act of April 1, 2004, P.L. 163, as amended by the Commonwealth of Pennsylvania. The Authority, by virtue of the Act and its articles of incorporation, has all powers as set forth in the Act including those for creation and retention of jobs. The purpose of the Authority is to engage in financial assistance in the form of loans, loan guarantees, grants and private equity participating loans to promote activities which lead to the use of alternative and clean energy, the creation and retention of jobs within the Commonwealth of Pennsylvania, the establishment of economically viable Pennsylvania communities, the development of a stable tax base within Pennsylvania communities, the reuse of abandoned industrial, commercial and other previously utilized sites, the promotion and commercialization of Pennsylvania products and services and investment of private capital in Pennsylvania communities to promote the health, safety, employment, business opportunities, economic activity and general welfare of the people of the Commonwealth.

The legislation creating the Authority as well as program specific guidelines establishes certain activities to be carried out by the Authority as follows:

- Business in Our Sites Program: provides financial assistance for preparation of sites for future development.
- First Industries Program: provides financial assistance for projects related to tourism and agriculture.
- Second Stage Loan Program: provides loan guarantees to commercial lending institutions that make loans to life sciences, advanced technology or manufacturing businesses.
- New Pennsylvania Venture Guarantee Program: provides guarantees to venture capital partnerships for investments in Pennsylvania-related companies which are in early-stage or mid-stage development.
- Building Pennsylvania Program: provides loans to fund managers for investment in real estate projects in Pennsylvania.
- TIF Guarantee Program: provides guarantees for TIF bonds or other indebtedness in accordance with the TIF Act of 1990.
- New Pennsylvania Venture Capital Investments Program: provides loans to Venture Capital partnerships for investment in Pennsylvania companies.
- Penn Works Program: provides grants and loans for water supply and wastewater infrastructure within Pennsylvania.
- H₂O PA Program (Water and Sewer): provides for single-year or multi-year grants to municipalities or municipal authorities to assist with the construction of flood control projects, drinking water, sanitary sewer and storm sewer projects, and the repair of high hazard unsafe dams.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- Solar Energy Program: provides financial assistance in the form of grant and loan funds to promote the generation and use of solar energy and the manufacture or assembly of solar equipment.
- Renewable Energy Program: provides financial assistance in the form of grant and loan funds to promote the use of wind and geothermal energy.
- Alternative and Clean Energy Program: provides grant and loan funds to encourage the implementation of alternative energy production projects and clean energy projects.
- High performance Buildings: provides grants and loans for the construction of energy efficient buildings.

Reporting Entity

The Authority has adopted the provisions of Section 2100 of the Codification of Governmental Accounting and Financial Reporting Standards for the criteria used to evaluate organizations, activities and functions that should be included in the Authority's financial statements. The basic criteria are the exercise of oversight responsibility over such organizations, activities and functions. The Authority has not identified any entities which should be subject to evaluation for inclusion in the Authority's reporting entity.

The Commonwealth appoints the members of the Authority's governing board. The Commonwealth maintains the accounts and records of the Authority. In addition, the Commonwealth employs and supervises personnel to provide administrative services. Therefore, the Authority is considered a component unit of the Commonwealth of Pennsylvania.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The Authority's financial statements are presented on the full accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under this basis of accounting, revenues are recorded when earned and expenses are recorded when the liability is incurred, regardless of the timing of the related cash flows. The Authority applies Governmental Accounting Standards Board (GASB) pronouncements as well as

Financial Accounting Standards Board (FASB) statements and interpretations, and the Accounting Principles Board (APB) of the Committee of Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

All activities of the Authority are accounted for within a single proprietary (enterprise) fund. A proprietary fund is used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Measurement Focus, Basis of Accounting and Financial Statement Presentation
(Continued)

The accounting and financial reporting treatment applied to the Authority is determined by its measurement focus. The transactions of the Authority are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the balance sheet. Net assets represent total assets net of total liabilities.

Cash and Cash Equivalents

Cash and cash equivalents, for the purposes of the Statement of Cash Flows, include cash on hand or on deposit in highly liquid financial debt instruments with a maturity of three months or less at the date of purchase.

Allowance for Loan Losses

The allowance for loan losses is a reserve account for possible future loan losses. Loan losses and recoveries of previously charged-off loans are charged or credited directly to the allowance account. The provision for loan losses is adjusted monthly at the rate of 2% of outstanding loan balances at the respective month-end. The provision for loan losses was based on comparison with other Authorities of the Commonwealth with similar operations and loan portfolio.

Interest Income

Interest income on investment securities and loans are recorded when earned.

Uncollectible interest on loans that are contractually past due is charged off, or an allowance is established based on management's periodic evaluations. The allowance is established by a charge-to-interest income equal to all previously accrued, and income is subsequently recognized only to the extent that cash payments are received until, in management's judgment, the borrower's ability to make periodic interest and principal payments is back to normal.

In addition to fixed interest arrangements, some loans contain provisions which provide lump sum interest payments based upon certain conditions being met. This additional income is recognized when earned.

Loan Origination Fees and Costs

The Authority recognizes loan origination fees and costs in accordance with Statement of Financial Accounting Standards No. 91 (SFAS No. 91), *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*.

For the years ended June 30, 2010 and 2009, \$259,258 and \$248,320, respectively, of net deferred fees are included in loans receivable.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Use of Estimates in Preparing Financial Statements

The preparation of financial statements requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Reclassifications

For comparative purposes, the prior year's financial statements have been reclassified to conform to report classifications of the current year. The reclassifications had no effect on net assets.

Bond Premium and Discount

The difference between the cash received from bondholders at issuance and the amount due to bondholders at maturity is recognized as bond premium or discount. Bond premium or discount is amortized using the straight-line method over the lives of the bonds issued, which approximates the interest method.

Bond Issuance Costs

Bond issuance costs consist of legal, underwriting and other fees charged in connection with the issuance of bond debt. The costs are amortized over the lives of the bonds, which range from 20 to 30 years. The bonds mature serially through 2039. Amortization was \$545,267 and \$443,797 for the years ended June 30, 2010 and 2009, respectively.

NOTE 2 – FINANCIAL SUPPORT

The Authority has a net asset deficit of \$287,047,426 and \$80,765,372 as of June 30, 2010 and 2009, respectively. The Authority's business purpose will result in continued losses from operation due to the disbursement of grant awards to help promote economic growth in the Commonwealth. In addition, the Authority transferred part of their bond proceeds to the Commonwealth Department of Environmental Protection and the Ben Franklin Technology Development Authority in the current year and in prior years to the Commonwealth for the Machinery and Equipment Loan Fund (MELF) program, which contributed to the deficit in net assets.

Through a service agreement with the Authority, the Commonwealth has pledged to seek annual appropriations to pay the Authority's annual debt service obligations. Therefore, these factors listed above do not raise doubt as to the Authority's ability to meet obligations when due.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009**

NOTE 3 – DEPOSITS**Custodial Credit Risk**

Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. As of June 30, 2010 and 2009, the Authority's bank balance was exposed to custodial credit risk as follows:

	<u>2010</u>	<u>2009</u>
FDIC Insured	\$ 250,000	\$ 250,000
Uninsured and collateral held by pledging bank's trust department not in the Authority's name	<u>721,721,132</u>	<u>466,063,768</u>
Total	<u>\$ 721,971,132</u>	<u>\$ 466,313,768</u>

Additionally, due to the short-term maturity and types of investments, there is limited interest rate risk.

NOTE 4 – LOANS RECEIVABLE

The Authority provides loans, in accordance with its enabling legislation and statutory requirements to spur economic development activity within the Commonwealth of Pennsylvania. The loans have amortization periods not to exceed 20 years and bear interest at rates ranging from 1% to 8% depending on the nature of the loan and the Authority program from which the loan was funded.

The Authority, through the New Venture Capital Investment Program, provides loans to venture capital partnerships for investments in Pennsylvania-related companies.

At June 30, 2010 and 2009, the outstanding balance of loans receivable was as follows:

	<u>2010</u>		
	<u>Current Portion</u>	<u>Long-term Portion</u>	<u>Total</u>
Loans receivable	\$ 14,772,342	\$ 256,165,653	\$ 270,937,995
Venture Capital Investment loans	-	37,150,000	37,150,000
Deferred loan origination fees - net	9,841	249,417	259,258
Allowance for loan losses	<u>(228,837)</u>	<u>(5,932,361)</u>	<u>(6,161,198)</u>
Loan receivable - net	<u>\$ 14,553,346</u>	<u>\$ 287,632,709</u>	<u>\$ 302,186,055</u>
	<u>2009</u>		
Loans receivable	\$ 8,285,866	\$ 211,984,714	\$ 220,270,580
Venture Capital Investment loans	-	32,925,000	32,925,000
Deferred loan origination fees - net	(28,045)	(220,275)	(248,320)
Allowance for loan losses	<u>(165,717)</u>	<u>(4,901,683)</u>	<u>(5,067,400)</u>
Loan receivable - net	<u>\$ 8,092,104</u>	<u>\$ 239,787,756</u>	<u>\$ 247,879,860</u>

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009**

NOTE 4 – LOANS RECEIVABLE (CONTINUED)

An analysis of the allowance for loan losses for the years ended June 30, 2010 and 2009 is as follows:

	<u>2010</u>	<u>2009</u>
Balance, beginning of year	\$ 5,067,400	\$ 3,889,896
Change in provision for potential losses	<u>1,093,798</u>	<u>1,177,504</u>
Balance, end of year	<u><u>\$ 6,161,198</u></u>	<u><u>\$ 5,067,400</u></u>

There were no loans charged off in FY 2010 or FY 2009.

NOTE 5 – BONDS PAYABLE

	<u>2010</u>	<u>2009</u>
Series 2010 Revenue Bonds, issued \$62,000,000 fixed rate, federal taxable revenue bonds, Series A and \$80,000,000 fixed rate, tax-exempt revenue bonds, Series B at .93% - 5.5%, interest payable semi-annually and principal payable annually through May 1, 2031.	\$ 142,000,000	\$ -
Series 2009 Revenue Bonds, issued \$400,000,000 fixed rate, federally taxable revenue bonds, Series D at 3.4% - 5.1%, interest payable semi-annually and principal payable annually through May 1, 2039.	400,000,000	-
Series 2009 Revenue Bonds, issued \$50,000,000 fixed rate, federal taxable revenue bonds, Series A and \$50,000,000 fixed rate, tax-exempt revenue bonds, Series B at 3.0% - 6.4%, interest payable semi-annually and principal payable annually through June 1, 2031.	100,000,000	100,000,000
Series 2008 Revenue Bonds, issued \$187,500,000 fixed rate, federally taxable revenue bonds, Series A at 3.1% - 5.2%, interest payable semi-annually and principal payable annually through June 1, 2027.	176,450,000	183,050,000
Series 2006 Revenue Bonds, issued \$187,500,000 fixed rate, federally taxable revenue bonds, Series C at 4.9% - 5.2%, interest payable semi-annually and principal payable annually through June 1, 2026.	168,225,000	174,965,000
Series 2006 Revenue Bonds, issued \$45,000,000 fixed rate, tax exempt revenue bonds, Series A and \$142,500,000 fixed rate, federally taxable revenue bonds, Series B at 4.5% - 5.6%, interest only payable semi-annually through June 1, 2026 and principal payable annually through June 1, 2026.	165,375,000	171,675,000

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009**

NOTE 5 – BONDS PAYABLE (CONTINUED)

	2010	2009
Series 2005 Revenue Bonds, issued \$62,500,000 fixed rate, tax exempt revenue bonds, Series A and \$125,000,000 fixed rate, federally taxable revenue bonds, Series B at 4.5% - 5.3%, interest payable semi-annually and principal payable annually through June 1, 2025.	\$ 161,405,000	\$ 168,410,000
	1,313,455,000	798,100,000
Less current portion	(34,210,000)	(26,645,000)
Unamortized bond premium	4,657,904	3,701,371
Unamortized bond discount	(1,198,375)	(1,203,969)
Long-term debt, net of current portion and unamortized bond premium	\$ 1,282,704,529	\$ 773,952,402

Changes in long-term liabilities as of June 30, 2010:

Governmental Activities	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Economic revenue bonds	\$ 798,100,000	\$542,000,000	\$ 26,645,000	\$ 1,313,455,000	\$ 34,210,000
Bond premium	3,701,371	1,137,110	180,577	4,657,904	-
Bond discount	(1,203,969)	-	(5,594)	(1,198,375)	-
Total	\$ 800,597,402	\$543,137,110	\$ 26,819,983	\$ 1,316,914,529	\$ 34,210,000

Changes in long-term liabilities as of June 30, 2009:

Governmental Activities	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Economic revenue bonds	\$ 721,605,000	\$100,000,000	\$ 23,505,000	\$ 798,100,000	\$ 26,645,000
Bond premium	3,926,980	-	225,609	3,701,371	-
Bond discount	-	(1,208,547)	(4,578)	(1,203,969)	-
Total	\$ 725,531,980	\$ 98,791,453	\$ 23,726,031	\$ 800,597,402	\$ 26,645,000

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009**

NOTE 5 – BONDS PAYABLE (CONTINUED)

Bond principal requirements subsequent to June 30, 2010 are as follows:

For the Year Ended June 30,	Principal Maturities	Interest
2011	\$ 34,210,000	\$ 71,111,088
2012	36,400,000	68,910,785
2013	47,265,000	67,263,029
2014	49,255,000	65,167,236
2015	51,445,000	62,850,475
2016-2020	296,520,000	272,595,273
2021-2025	379,845,000	183,893,119
2026-2030	210,560,000	92,966,026
2031-2035	119,750,000	92,966,026
2036-2039	<u>88,205,000</u>	<u>13,982,417</u>
Total	<u>\$1,313,455,000</u>	<u>\$ 945,721,766</u>

The Authority, with the Commonwealth approval, issued the above noted revenue bonds to fund the activities of the Authority. Repayments with respect to the revenue bonds are derived solely from project revenues which are defined as annual appropriations by the Commonwealth per the Official Statement. The Revenue Bonds described above are limited obligations of the Authority and are considered non-recourse, as the Authority is not obligated to bondholders beyond amounts received by the Authority from annual appropriations to the Authority by the Commonwealth. The Commonwealth has not pledged its full faith and credit nor the taxing power of the Commonwealth or any political subdivision for the payment of the Authority's Revenue Bonds and the payments by the Commonwealth to the Authority are subject to annual appropriation of funds for such purposes by the General Assembly and there is no assurance that such funds will be appropriated in any fiscal year. Repayments of loans do not constitute project revenues.

NOTE 6 – RELATED PARTY TRANSACTIONS

The Authority entered into an agreement with the Commonwealth of Pennsylvania, through the Department of Community and Economic Development (DCED) and the Department of Environmental Protection (DEP) to provide administrative and operational support services for the Authority. The Authority owns no capital assets; the employees performing services for the Authority are DCED employees. As such, under the Memorandum of Understanding, the Authority reimburses DCED for services rendered by DCED employees to the Authority. During the fiscal years ended June 30, 2010 and 2009, the services provided by DCED to the Authority and recorded as Administrative/Operating expenses totaled \$2,650,469 and \$2,145,097, respectively.

During the fiscal years ended June 30, 2010 and 2009, the Authority received \$81,654,535 and \$63,421,755, respectively, in transfers from the Commonwealth to pay debt service with respect to Revenue Bonds. See Note 5 for details with respect to the Revenue Bonds.

**COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009**

NOTE 6 – RELATED PARTY TRANSACTIONS (CONTINUED)

The Authority transferred part of their bond proceeds to the Commonwealth Department of Environment Protection and the Ben Franklin Technology Development Authority totaling \$98,000,000 and \$0 for the fiscal years ending June 30, 2010 and 2009 respectively.

NOTE 7 – LINE OF CREDIT

In December 2009, the Authority entered into a secured line of credit with the Commonwealth of Pennsylvania Treasury Department, which, under a revolving credit agreement, is limited to borrowings of \$50,000,000. Under the revolving credit agreement, interest shall accrue on the aggregate unpaid principal amount outstanding on the draws. The interest rate is the greater of the rate of the United States Federal Funds Target Rate plus 75 basis points or the rate set by the British Bankers Association for London Interbank Offered Rate (LIBOR) for a six month term in United States dollars plus 45 basis points. The interest rate is reset as of the 20th of each month. As of June 30, 2010, the interest rate was 1.20%; however, no funds were drawn under the revolving credit agreement.

NOTE 8 – COMMITMENTS AND CONTINGENCIES

The Authority, through various economic development programs, provided loan guarantees as follows:

	<u>2010</u>	<u>2009</u>
First Industries loan guarantees	\$ 37,797,428	\$ 18,340,250
Tax increment financing guarantees	44,911,970	44,911,970
Second stage loan guarantees	2,910,000	2,035,000
Venture capital guarantees	<u>197,500,000</u>	<u>190,000,000</u>
Total loan guarantees	<u>\$ 283,119,398</u>	<u>\$ 255,287,220</u>

The Authority has been called upon, with respect to one loan guarantee, to make principal or interest payments on behalf of the ultimate borrowers. Accordingly, a liability totaling \$112,074 has been reflected in the Authority’s financial statements for loan guarantees as of June 30, 2010. There were no liabilities recorded for loan guarantees as of June 30, 2009.

Through the various Authority loan and grant programs to promote economic development within the Commonwealth of Pennsylvania, the Authority has approved loans, investments in venture capital and grants of \$35,632,203, \$2,725,000 and \$168,573,323, respectively, which have not been disbursed as of June 30, 2010.



**Independent Auditor's Report on Internal Control Over Financial Reporting
and on Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

Board of Directors
Commonwealth Financing Authority
Harrisburg, Pennsylvania

We have audited the basic financial statements of the Commonwealth Financing Authority (the Authority) as of and for the year ended June 30, 2010, and have issued our report thereon dated September 15, 2010. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Authority in a separate letter dated September 15, 2010.

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

Clifton Gunderson LLP

Lancaster, Pennsylvania
September 15, 2010

**COMMONWEALTH FINANCING AUTHORITY
(Component Unit of the
Commonwealth of Pennsylvania)
Harrisburg, Pennsylvania**

FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2011 AND 2010

COMMONWEALTH FINANCING AUTHORITY
(Component Unit of the Commonwealth of Pennsylvania)
YEARS ENDED JUNE 30, 2011 AND 2010

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Zelenkofske Axelrod LLC

INDEPENDENT AUDITORS' REPORT

Board of Directors
Commonwealth Financing Authority
Harrisburg, Pennsylvania

We have audited the accompanying Statement of Net Deficits of the business-type activities of the COMMONWEALTH FINANCING AUTHORITY ("the AUTHORITY"), a component unit of the Commonwealth of Pennsylvania, as of June 30, 2011, and the related statement of Revenues, Expenses, and Changes in Net Deficits and Statement of Cash Flows for the year then ended, which collectively comprise the Authority's 2011 basic financial statements as listed in the table of contents. These financial statements are the responsibility of the AUTHORITY's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Authority as of June 30, 2010, were audited by other auditors whose report dated September 15, 2010, expressed an unqualified opinion on those statements.

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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the AUTHORITY as of June 30, 2011, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 30, 2011, on our consideration of the AUTHORITY's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters as of and for the year ended June 30, 2011. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

As discussed in Note 1 to the financial statements, during the fiscal year ended June 30, 2011 the AUTHORITY adopted the provisions of Governmental Accounting Standards Board's Statement No. 59, "*Financial Instruments Omnibus*".

Accounting principles generally accepted in the United States of America require that the managements discussion and analysis on pages 2 through 3 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquires of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquires, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Zelenkofske Axelrod LLC

ZELENKOFKSKE AXELROD LLC

Harrisburg, Pennsylvania
September 30, 2011

<i>Harrisburg</i>	<i>Lehigh Valley</i>	<i>Philadelphia</i>	<i>Pittsburgh</i>
830 Sir Thomas Court, Suite 100 Harrisburg, PA 17109 717.561.9200 Fax 717.561.9202	1101 West Hamilton Street Allentown, PA 18101-1043 610.871.5077 Fax 717.561.9202	2370 York Road, Suite A-5 Jamison, PA 18929 215.918.2277 Fax 215.918.2302	3800 McKnight E. Drive, Suite 3805 Pittsburgh, PA 15237 412.367.7102 Fax 412.367.7103

**Commonwealth Financing Authority
MANAGEMENT'S DISCUSSION AND ANALYSIS
Financial Statements for the Year Ended June 30, 2011**

Page 2

The Commonwealth Financing Authority, hereafter referred to as the "Authority," is pleased to present its financial statements developed in compliance with Statement of Governmental Accounting Standard No. 34, entitled "Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments" (hereafter GASB 34), and related standards. GASB 34 enhances information provided to the users of its financial statements. This section of the financial reporting package presents our discussion and analysis of the Authority's financial performance during the years ended June 30, 2011 and 2010. Please read it in conjunction with the Authority's financial statements that follow this section.

OPERATIONAL HIGHLIGHTS

Over the past two fiscal years, the Authority has approved 463 projects totaling \$728 million in funding under the H2O initiative. This program provides funding for the construction and upgrading of drinking water, sanitary sewer and storm sewer systems. In raising capital for this H2O initiative, the Authority issued Build America Bonds which will save over \$61 million in debt service over the life of the bonds.

The Authority deployed investments into another major legislative initiative this Fiscal Year. By approving 97 projects totaling \$44 million in grant funding assistance, the Authority helped to support and enhance community and economic well-being and mitigate the impact of gaming and related activity. The program is capitalized by revenue generated from gaming operations in Luzerne and Monroe Counties. Projects are located in Carbon, Lackawanna, Luzerne, Monroe, Northampton, Pike, and Wayne Counties.

OVERVIEW OF THE FINANCIAL STATEMENTS

Management's Discussion and Analysis (MD&A) serves as an introduction to, and should be read in conjunction with, the basic audited financial statements. The MD&A represents management's examination and analysis of the Authority's financial condition and performance. Summary financial statement data and other management tools were used for this analysis.

The financial statements report information about the Authority using the full accrual method of accounting, as utilized by similar business activities in the private sector. The financial statements include a Statement of Net Assets; a Statement of Revenues, Expenses, and Changes in Net Assets; a Statement of Cash Flows; and Notes to the Financial Statements.

The Statement of Net Assets presents the financial position of the Authority on a full accrual historical cost basis. The Statement of Net Assets also presents information on all of the Authority's assets and liabilities, with the difference reported as net assets. Over time, increases and decreases in net assets are one indicator of whether the financial position of the Authority is improving or deteriorating.

While the Statement of Net Assets provides information about the nature and amount of resources and obligations at year-end, the Statement of Revenues, Expenses, and Changes in Net Assets presents the results of the business-type activities over the course of the fiscal year and information as to how the net assets changed during the year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the Authority's recovery of its costs.

The Statement of Cash Flows presents changes in cash and cash equivalents, resulting from operational, financing, and investing activities. This statement presents cash receipt and cash disbursement information without consideration of the earnings event when an obligation arises, or depreciation of capital assets.

The Notes to the Financial Statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Authority's accounting policies, significant account balances and activities, long-term debt and subsequent events, if any.

FINANCIAL ANALYSIS**Condensed Statements of Net Assets**

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Assets:			
Current assets	\$ 678,584,533	\$ 750,222,910	\$ 483,900,761
Long-term assets	<u>307,484,704</u>	<u>287,632,709</u>	<u>239,787,756</u>
Total assets	<u>986,069,237</u>	<u>1,037,855,619</u>	<u>723,688,517</u>
Liabilities:			
Current liabilities	46,714,982	42,198,516	30,501,487
Long-term liabilities	<u>1,395,049,687</u>	<u>1,282,704,529</u>	<u>773,952,402</u>
Total liabilities	<u>1,441,764,669</u>	<u>1,324,903,045</u>	<u>804,453,889</u>
Total net deficit - unrestricted	<u>\$ (455,695,432)</u>	<u>\$ (287,047,426)</u>	<u>\$ (80,765,372)</u>

The Authority issued bonds totaling \$150 million and \$542 million in 2011 and 2010, respectively, which were the primary causes of the increase in total liabilities of \$117 million and \$520 million at June 30, 2011 and 2010, respectively. In 2011, the Authority's total assets declined by \$52 million due to the transfer of \$38 million to other Commonwealth agencies for initiatives prescribed under legislation and also due to grant disbursements, particularly H2O program grants. As a result of the issuance of bonds in 2010, the Authority was able to increase the amount of loan originations during the year, causing an increase in total assets of \$314 million as of June 30, 2010. Due to the nature of the loans, some of which require drawdowns, funding not immediately disbursed upon Board approval is held as cash and cash equivalents. Operating expenses declined as compared to the previous year by \$0.4 million. The reduction corresponds to the reduced staff time necessary to review and process application for funding during 2011. In 2010, staffing requirements associated with the H2O and Alternative Energy initiatives resulted in higher administrative expenses. In 2010, the Authority received and reviewed over 800 applications for funding assistance under the H2O program.

The significant increase in the total net deficit is attributable to the \$217 million in Authority assets disbursed as grant proceeds, the \$25 million in assets that were transferred to the Department of Environmental Protection and the \$13 million in assets transferred to the Ben Franklin Technology Development Partners. The transfer of bond proceeds to these Governmental entities was prescribed by legislation. Management acknowledges but is not concerned with the annual net asset deficit. As an authority under which economic stimulus programs are established, grants and transfers to other governmental entities are essential to achieve its mission.

Condensed Statements of Revenues, Expenses, and Changes in Net Assets

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating income	\$ 8,449,239	\$ 8,091,436	\$ 11,614,029
Operating expenses	(219,224,694)	(138,624,287)	(18,734,695)
Provision for loan losses	(423,549)	(1,093,798)	(1,177,504)
Nonoperating income (expense),net	<u>42,550,998</u>	<u>(74,655,405)</u>	<u>25,281,313</u>
Increase (decrease) in net asset	<u>\$ (168,648,006)</u>	<u>\$ (206,282,054)</u>	<u>\$ 16,983,143</u>

During 2011, the Authority issued revenue bonds for \$150 million to provide funds for grant expenditures under the H2O program. This bond issuance consisted of a \$97 million Build America Bond component. Since inception, the Authority has issued eight revenue bonds totaling \$1.542 billion. The Authority has a service agreement with the Commonwealth of Pennsylvania for the payment of the annual debt service through an annual appropriation by the Commonwealth, and transfers from the Gaming Economic Development Tourism Fund. However, there is no assurance that there will be sufficient funds appropriated annually by the Commonwealth.

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, investors and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. If you have questions about this report or need additional information, contact the Commonwealth Financing Authority, 400 North Street, Fourth Floor, Harrisburg, PA 17120.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF NET DEFICITS
JUNE 30, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 649,214,245	\$ 722,767,227
Receivables:		
Loans (net)	15,319,437	14,553,346
Accrued interest	1,195,651	994,617
Penalties/late fees	18,288	7,881
Due from primary government	1,230,082	-
Unamortized bond issuance costs, net	11,606,830	11,899,839
Total Current Assets	<u>678,584,533</u>	<u>750,222,910</u>
Non-current assets:		
Long-term portion of loans receivable (net)	307,484,704	287,632,709
Total Non-current Assets	<u>307,484,704</u>	<u>287,632,709</u>
Total Assets	<u>\$ 986,069,237</u>	<u>\$ 1,037,855,619</u>
LIABILITIES		
Current Liabilities:		
Current portion of long-term debt	\$ 39,285,000	\$ 34,210,000
Accrued interest payable	6,377,642	6,842,177
Loan escrow deposit	388,080	388,080
Accounts payable and accrued expenses	52,006	159,508
Due to primary governments - DCED	612,254	598,751
Total Current Liabilities	<u>46,714,982</u>	<u>42,198,516</u>
Non-current Liabilities:		
Long-term debt, net of current portion and unamortized bond premium and discount	1,395,049,687	1,282,704,529
Total Noncurrent Liabilities	<u>1,395,049,687</u>	<u>1,282,704,529</u>
Total Liabilities	<u>1,441,764,669</u>	<u>1,324,903,045</u>
TOTAL NET DEFICITS - UNRESTRICTED	<u>\$ (455,695,432)</u>	<u>\$ (287,047,426)</u>

See accompanying notes to the financial statements

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET DEFICITS
YEARS ENDED JUNE 30, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
Operating Income		
Interest on loans	\$ 5,898,154	\$ 5,138,479
Interest on investments	2,036,680	2,286,686
Fee income	227,914	621,182
Interest from venture capital loan	286,491	45,089
	<u>8,449,239</u>	<u>8,091,436</u>
Operating Revenues before Provision for Loan Losses		
Provision for loan losses	423,549	1,093,798
	<u>8,025,690</u>	<u>6,997,638</u>
Net Operating Revenues		
Operating Expenses		
Administrative/operating expense	2,211,971	2,650,469
Grant expense	216,530,388	135,861,744
Loan guarantee expense	482,335	112,074
	<u>219,224,694</u>	<u>138,624,287</u>
Total Operating Expenses		
Operating Loss	<u>(211,199,004)</u>	<u>(131,626,649)</u>
Nonoperating Income (Expenses)		
Transfers in from primary government	156,944,512	81,654,535
Interest on bonds	(75,944,943)	(58,447,233)
Amortization of bond premium/discount	310,473	174,982
Amortization of bond issuance costs	(609,045)	(545,267)
Transfer to other Commonwealth component units	(13,000,000)	(13,000,000)
Transfers to primary government	(25,000,000)	(85,000,000)
Other	(149,999)	507,578
Total Nonoperating Revenues (Expenses)	<u>42,550,998</u>	<u>(74,655,405)</u>
Decrease in net assets	(168,648,006)	(206,282,054)
Net Deficits - Beginning of Year	<u>(287,047,426)</u>	<u>(80,765,372)</u>
Net Deficits - End of Year	<u>\$ (455,695,432)</u>	<u>\$ (287,047,426)</u>

See accompanying notes to the financial statements

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
Cash Flows from Operating Activities:		
Loan and fee receipts from customers	\$ 25,673,428	\$ 23,667,597
Loan disbursements made to customers	(40,663,944)	(72,834,794)
Interest on investments	2,036,680	2,286,686
Cash paid for operating expenses	(2,305,970)	(2,334,228)
Cash paid for grant expenses	(216,530,388)	(135,861,744)
Cash paid for loan guarantees	(482,335)	(112,074)
	<u>(232,272,529)</u>	<u>(185,188,557)</u>
Net Cash Used In Operating Activities		
Cash Flows from Noncapital Financing Activities:		
Proceeds from bonds payable	153,594,595	538,970,724
Transfer to primary government and other Commonwealth component units	(38,000,000)	(98,000,000)
Transfer from primary government	155,714,430	81,654,535
Principal payments on bonds payable	(36,180,000)	(26,645,000)
Interest on bonds payable	(76,409,478)	(55,019,525)
	<u>158,719,547</u>	<u>440,960,734</u>
Net Cash Provided By Noncapital Financing Activities		
	<u>(73,552,982)</u>	<u>255,772,177</u>
Increase (Decrease) In Cash And Cash Equivalents		
	<u>722,767,227</u>	<u>466,995,050</u>
Cash and Cash Equivalents, Beginning of Year		
	<u>\$ 649,214,245</u>	<u>\$ 722,767,227</u>
Cash and Cash Equivalents, End of Year		
	<u>\$ 649,214,245</u>	<u>\$ 722,767,227</u>
Reconciliation of Operating Income to Net Cash Provided By (Used In)		
Operating Activities:		
Operating Loss	\$ (211,199,004)	\$ (131,626,649)
Adjustments to reconcile operating income to net cash used in operating activities:		
Effect of changes in operating assets and liabilities:		
Loan disbursements	(40,663,944)	(72,834,794)
Loan repayments	19,523,622	18,330,460
Accrued interest receivable	(201,034)	(463,785)
Loan origination costs	(51,312)	-
Allowance for loan losses	423,549	1,093,798
Penalties/late fees	(10,407)	(3,828)
Accounts payable, accrued expenses, and due to primary government	(93,999)	316,241
	<u>(232,272,529)</u>	<u>(185,188,557)</u>
Net Cash Used In Operating Activities		

See accompanying notes to the financial statements

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2011 AND 2010

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization

The Commonwealth Financing Authority ("the Authority") is a body corporate and politic duly organized by the Commonwealth of Pennsylvania ("the Commonwealth") incorporated under the Public Authorities and Quasi-Public Corporations Act of 2004 (Act), being the Act of April 1, 2004, P.L. 163, as amended by the Commonwealth of Pennsylvania. The Authority, by virtue of the Act and its articles of incorporation, has all powers as set forth in the Act including those for creation and retention of jobs. The purpose of the Authority is to engage in financial assistance in the form of loans, loan guarantees, grants and private equity participating loans to promote activities which lead to the use of alternative and clean energy, the creation and retention of jobs within the Commonwealth of Pennsylvania, the establishment of economically viable Pennsylvania communities, the development of a stable tax base within Pennsylvania communities, the reuse of abandoned industrial, commercial and other previously utilized sites, the promotion and commercialization of Pennsylvania products and services and investment of private capital in Pennsylvania communities to promote the health, safety, employment, business opportunities, economic activity and general welfare of the people of the Commonwealth.

The Commonwealth appoints the members of the Authority's governing board. The Commonwealth maintains the accounts and records of the Authority. In addition the Commonwealth employs and supervises personnel to provide administrative services. Therefore, the Authority is considered a component unit of the Commonwealth of Pennsylvania.

The legislation creating the Authority as well as program specific guidelines establishes certain activities to be carried out by the Authority as follows:

- Business in Our Sites Program: provides financial assistance for preparation of sites for future development.
- First Industries Program: provides financial assistance for projects related to tourism and agriculture.
- Second Stage Loan Program: provides loan guarantees to commercial lending institutions that make loans to life sciences, advanced technology or manufacturing businesses.
- New Pennsylvania Venture Guarantee Program: provides guarantees to venture capital partnerships for investments in Pennsylvania-related companies which are in early-stage or mid-stage development.
- Building Pennsylvania Program: provides loans to fund managers for investment in real estate projects in Pennsylvania.
- Tax Increment Financing "TIF" Guarantee Program: provides guarantees for TIF bonds or other indebtedness in accordance with the TIF Act of 1990.
- New Pennsylvania Venture Capital Investments Program: provides loans to Venture Capital partnerships for investment in Pennsylvania companies.
- Penn Works Program: provides grants and loans for water supply and wastewater infrastructure within Pennsylvania.
- H₂O PA Program (Water and Sewer): provides for single-year or multi-year grants to municipalities or municipal authorities to assist with the construction of flood control projects, drinking water, sanitary sewer and storm sewer projects, and the repair of high hazard unsafe dams.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2011 AND 2010

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

A. Organization (Continued)

- Solar Energy Program: provides financial assistance in the form of grant and loan funds to promote the generation and use of solar energy and the manufacture or assembly of solar equipment.
- Renewable Energy Program: provides financial assistance in the form of grant and loan funds to promote the use of wind and geothermal energy.
- Alternative and Clean Energy Program: provides grant and loan funds to encourage the implementation of alternative energy production projects and clean energy projects.
- High Performance Buildings: provides grants and loans for the construction of energy efficient buildings.
- Local Share Account: provides grants to support and enhance community and economic well-being and mitigate the impact of gaming and related activities..

B. Measurement Focus and Basis of Accounting

The Authority follows Generally Accepted Accounting Principles (GAAP). GAAP allows specialized accounting for government entities, which is governed by pronouncements set by the Governmental Accounting Standards Board (GASB). Pronouncements set by the GASB may differ from pronouncements set by the Financial Accounting Standards Board (FASB).

The Authority is considered a special-purpose government since it is engaged solely in business-type activities under GASB Statement No. 34. The Authority's financial statements are prepared using the economic resources measurement focus and accrual basis of accounting. Under the accrual basis of accounting revenues are recorded when earned and expenses are recorded when they have been incurred. The statements are intended to report the Authority as an economic unit that includes all measurable assets and liabilities, financial and capital, of the Authority.

All activities of the Authority are accounted for within a single proprietary (enterprise) fund. A proprietary fund is used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination or revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The Authority follows the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis*. Within the Statements of Revenues, Expenses and Changes in Net Assets, Statement No. 34 requires operating income and expenses to be separated from non-operating income in order to report net operating income. Operating income and expenses are defined as those activities directly related to the Authority's primary business of providing employment through economic development lending. Non-operating revenues and expenses consist of those revenues and expenses that are related to financing and investing types of activities and result from non-exchange transactions, such as investment income/loss.

The Authority follows Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting* for reporting and disclosure purposes. As permitted by Statement No. 20, the Authority has elected not to apply Financial Accounting Standards Board pronouncements issued after November 30, 1989 unless GASB specifically adopts the FASB Statement or Interpretation.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2011 AND 2010

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Cash and Cash Equivalents

Cash and cash equivalents, for the purposes of the Statement of Cash Flows, include cash on hand or on deposit in highly liquid financial debt instruments with a maturity of three months or less at the date of purchase.

D. Allowance for Loan Losses

The allowance for loan losses is a reserve account for possible future loan losses. Provision for loan losses is credited to the allowance account. Loan losses which are charged-off and recoveries of previously charged-off loans are charged or credited directly to the allowance account. The provision for loan losses is adjusted monthly at the rate of 2% of outstanding loan balances at the respective month-end.

E. Interest Income

Interest income on cash equivalents and loans are recorded when earned.

Uncollectible interest on loans that are contractually past due is charged off, or an allowance established based on management's periodic evaluations. The allowance is established by a charge-to-interest income equal to all previously accrued, and income is subsequently recognized only to the extent that cash payments are received until, in management's judgment, the borrower's ability to make periodic interest and principal payments is back to normal.

In addition to fixed interest arrangements, some loans contain provisions which provide lump sum interest payments based upon certain conditions being met. The additional income is recognized when earned.

F. Loan Origination Fees and Costs

The Authority recognizes loan origination fees and costs in accordance with FASB Accounting Standards Codification 310-20, *Receivables – Nonrefundable Fees and Other Costs* (formerly Statement of Financial Accounting Standards No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*).

For the years ended June 30, 2011 and 2010, \$310,570 and \$259,258, respectively, of net deferred fees are included in loans receivable.

G. Bond Issuance Costs

Bond issuance costs consist of legal, underwriting and other fees charged in connection with the issuance of bond debt. The costs are amortized over the lives of the bonds, which range from 20 to 30 years. The bonds mature through 2040. Amortization was \$609,045 and \$545,267 for the years ended June 30, 2011 and 2010, respectively.

H. Utilization of Resources

When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first, then unrestricted resources as needed.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2011 AND 2010

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

I. Bond Premium and Discount

The difference between the cash received from bondholders at issuance and the amount due to bondholders at maturity is recognized as bond premium or discount. Bond premium or discount is amortized using the straight-line method over the lives of the bonds issued, which approximates the interest method.

J. Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Accordingly, actual results could differ from those estimates.

K. Reclassifications

For comparative purposes, the prior year's financial statements have been reclassified to conform to report classifications of the current year. The reclassifications had no effect on net assets.

L. Adoption of Governmental Accounting Standards Board Statements

The Authority adopted the provisions of GASB Statement No. 59, "*Financial Instruments Omnibus*". The adoption of this statement had no effect on the financial statements.

M. Pending Changes in Accounting Principles

In December 2009, the GASB issued Statement No. 57, "*OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*". The Authority is required to adopt Statement No. 57 for its fiscal year 2012 financial statements.

In November 2010, the GASB issued Statement No. 60, "*Accounting and Financial Reporting for Service Concession Arrangements*". The Authority is required to adopt Statement No. 60 for its fiscal year 2013 financial statements.

In November 2010, the GASB issued Statement No. 61, "*The Financial Reporting Entity: Omnibus-an amendment of GASB Statements No. 14 and No. 34*". The Authority is required to adopt Statement No. 61 for its fiscal year 2013 financial statements.

In December 2010, the GASB issued Statement No. 62, "*Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*". The Authority is required to adopt Statement No. 62 for its fiscal year 2013 financial statements.

In June 2011, the GASB issued Statement No. 63 "*Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*". The Authority is required to adopt Statement No. 63 for its fiscal year 2013 financial statements.

In June 2011, the GASB issued Statement No. 64 "*Derivative Instruments: Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53*". The Authority is required to adopt Statement No. 64 for its fiscal year 2012 financial statements.

The Authority has not yet completed the various analyses required to estimate the financial statement impact of these new pronouncements.

COMMONWEALTH FINANCING AUTHORITY
 (COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 YEARS ENDED JUNE 30, 2011 AND 2010

NOTE 2: FINANCIAL SUPPORT

The Authority reported a net deficit of \$455,695,432 and \$287,047,426 as of June 30, 2011 and 2010, respectively. The Authority's business purpose will result in continued losses from operation due to the disbursement of grant awards to help promote economic growth in the Commonwealth. In addition, the Authority transferred part of its bond proceeds to the Commonwealth Department of Environmental Protection and the Ben Franklin Technology Development Authority in the current year and in prior years to the Commonwealth for the Machinery and Equipment Loan Fund (MELF) program, which contributed to the deficit in net assets.

Through a service agreement with the Authority, the Commonwealth has pledged to seek annual appropriations to pay the Authority's annual debt service obligations. Therefore, factors listed above do not raise doubt as to the Authority's ability to meet obligations when due.

NOTE 3: CASH AND CASH EQUIVALENTS

Custodial Credit Risk

Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. As of June 30, 2011, due to the nature of the cash and cash equivalents balances, there is no custodial credit risk. As of June 30, 2010, the Authority's bank balance was exposed to custodial credit risk as \$250,000 was FDIC insured and \$721,721,132 were uninsured and collateral was held by the pledging bank's trust department not in the Authority's name.

Additionally, due to the short-term maturity of the cash equivalents, there is limited interest rate risk.

NOTE 4: LOANS RECEIVABLE

The Authority provides loans, in accordance with its enabling legislation and statutory requirements to spur economic development activity within the Commonwealth of Pennsylvania. The loans have amortization periods not to exceed 20 years and bear interest at rates ranging from 1% to 8% depending on the nature of the loan and the Authority program from which the loan was funded.

The Authority, through the New Venture Capital Investment Program, provides loans to venture capital partnerships for investments in Pennsylvania-related companies.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2011 AND 2010

NOTE 4: LOANS RECEIVABLE (CONTINUED)

At June 30, 2011 and 2010, the outstanding balance of loans receivable were as follows:

	2011		
	Current Portion	Long-term Portion	Total
Loan receivable	\$ 15,617,733	\$ 313,460,585	\$ 329,078,318
Deferred loan origination fees - net	14,059	296,511	310,570
Allowance for loan losses	(312,355)	(6,272,392)	(6,584,747)
Balance, end of year	\$ 15,319,437	\$ 307,484,704	\$ 322,804,141
	2010		
	Current Portion	Long-term Portion	Total
Loan receivable	\$ 14,772,342	\$ 293,315,653	\$ 308,087,995
Deferred loan origination fees - net	9,841	249,417	259,258
Allowance for loan losses	(228,837)	(5,932,361)	(6,161,198)
Balance, end of year	\$ 14,553,346	\$ 287,632,709	\$ 302,186,055

An analysis of the allowance for loan losses for the years ended June 30, 2011 and 2010 is as follows:

	2011	2010
Balance, beginning of year	\$ 6,161,198	\$ 5,067,400
Provision for loan losses	423,549	1,093,798
Balance, end of year	\$ 6,584,747	\$ 6,161,198

NOTE 5: BONDS PAYABLE

Changes in long-term liabilities for the year ended June 30, 2011:

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Economic revenue bonds	\$ 1,313,455,000	\$ 150,000,000	\$ (36,180,000)	\$ 1,427,275,000	\$ 39,285,000
Bond premium	4,657,904	3,910,631	(368,412)	8,200,123	-
Bond discount	(1,198,375)	-	57,939	(1,140,436)	-
Total	\$ 1,316,914,529	\$ 153,910,631	\$ (36,490,473)	\$ 1,434,334,687	\$ 39,285,000

COMMONWEALTH FINANCING AUTHORITY
 (COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 YEARS ENDED JUNE 30, 2011 AND 2010

NOTE 5: BONDS PAYABLE (CONTINUED)

Changes in long-term liabilities for the year ended June 30, 2010:

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Economic revenue bonds	\$ 798,100,000	\$ 542,000,000	\$ 26,645,000	\$ 1,313,455,000	\$ 34,210,000
Bond premium	3,701,371	1,137,110	180,577	4,657,904	-
Bond discount	(1,203,969)		(5,594)	(1,198,375)	-
Total	\$ 800,597,402	\$ 543,137,110	\$ 26,819,983	\$ 1,316,914,529	\$ 34,210,000

	2011	2010
Series 2010 Revenue Bonds, issued \$53,080,000 fixed rate, tax-exempt revenue bonds, Series C-1 and \$96,920,000, fixed rate, federal taxable revenue bonds, Series C-2 at 2% - 3.4%, interest payable semi-annually and principle payable annually through June 1, 2040.	\$ 148,030,000	\$ -
Series 2010 Revenue Bonds, issued \$62,000,000 fixed rate, federal taxable revenue bonds, Series A and \$80,000,000 fixed rate, tax-exempt revenue bonds, Series B at .93% - 5.5%, interest payable semi-annually and principal payable annually through May 1, 2039.	\$ 138,505,000	\$ 142,000,000
Series 2009 Revenue Bonds, issued \$400,000,000 fixed rate, federally taxable revenue bonds, Series D at 3.4% - 5.1%, interest payable semi-annually and principal payable annually through May 1, 2039.	\$ 400,000,000	\$ 400,000,000
Series 2009 Revenue Bonds, issued \$50,000,000 fixed rate, federal taxable revenue bonds, Series A and \$50,000,000 fixed rate, tax-exempt revenue bonds, Series B at 3.0% - 6.4%, interest payable semi-annually and principal payable annually through June 1, 2031.	\$ 97,205,000	\$ 100,000,000
Series 2008 Revenue Bonds, issued \$187,500,000 fixed rate, federally taxable revenue bonds, Series A at 3.1% - 5.2%, interest payable semi-annually and principal payable annually through June 1, 2027.	\$ 169,625,000	\$ 176,450,000

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2011 AND 2010

NOTE 5: BONDS PAYABLE (CONTINUED)

	<u>2011</u>	<u>2010</u>
Series 2006 Revenue Bonds, issued \$187,500,000 fixed rate, federally taxable revenue bonds, Series C at 4.9% - 5.2%, interest payable semi-annually and principal payable annually through June 1, 2026.	\$ 161,145,000	\$ 168,225,000
Series 2006 Revenue Bonds, issued \$45,000,000 fixed rate, tax exempt revenue bonds, Series A and \$142,500,000 fixed rate, federal taxable revenue bonds, Series B at 4.5% - 5.6%, interest only payable semi-annually through June 1, 2026 and principal payable annually through June 1, 2026.	\$ 158,720,000	\$ 165,375,000
Series 2005 Revenue Bonds, issued \$62,500,000 fixed rate, tax exempt revenue bonds, Series A and \$125,000,000 fixed rate, federally taxable revenue bonds, Series B at 4.5% - 5.3%, interest payable semi-annually and principal payable annually through June 1, 2025.	<u>\$ 154,045,000</u>	<u>\$ 161,405,000</u>
Total Bonds Payable - Principle	\$ 1,427,275,000	\$ 1,313,455,000
Less current portion	(39,285,000)	(34,210,000)
Unamortized bond premium	8,200,123	4,657,904
Unamortized bond discount	<u>(1,140,436)</u>	<u>(1,198,375)</u>
	<u>\$ 1,395,049,687</u>	<u>\$ 1,282,704,529</u>

Bond payable requirements subsequent to June 30, 2011 are as follows:

	<u>Principal Maturities</u>	<u>Interest</u>
For the Years Ending June 30,		
2012	\$ 39,285,000	\$ 76,531,705
2013	50,210,000	74,826,251
2014	52,290,000	72,954,021
2015	54,570,000	70,585,946
2016	57,025,000	68,054,367
2017-2021	329,355,000	294,024,221
2022-2026	406,165,000	193,807,270
2027-2031	200,315,000	104,835,251
2032-2036	139,350,000	54,806,243
2037-2040	98,710,000	13,104,570
Total	<u>\$ 1,427,275,000</u>	<u>\$ 1,023,529,845</u>

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2011 AND 2010

NOTE 5: BONDS PAYABLE (CONTINUED)

Bond payable requirements subsequent to June 30, 2010 are as follows:

For the Years Ended June 30,	<u>Principal Maturities</u>	<u>Interest</u>
2011	\$ 34,210,000	\$ 71,111,088
2012	36,400,000	68,910,785
2013	47,265,000	67,263,029
2014	49,255,000	65,167,236
2015	51,445,000	62,850,475
2016-2020	296,520,000	272,595,273
2021-2025	379,845,000	183,893,119
2026-2030	210,560,000	92,966,026
2031-2035	119,750,000	92,966,026
2036-2039	88,205,000	13,982,417
Total	<u>\$ 1,313,455,000</u>	<u>\$ 991,705,474</u>

The Authority, with Commonwealth approval, issued the above noted revenue bonds to fund the activities of the Authority. Repayments with respect to the revenue bonds are derived solely from project revenues which are defined as annual appropriations and transfers by the Commonwealth per the Official Statement. The Revenue Bonds described above are limited obligations of the Authority and are considered non-recourse, as the Authority is not obligated to bondholders beyond amounts received by the Authority from annual appropriations and transfers to the Authority by the Commonwealth. The Commonwealth has not pledged its full faith and credit nor the taxing power of the Commonwealth or any political subdivision for the payment of the Authority's Revenue Bonds and the payments by the Commonwealth to the Authority are subject to annual appropriation and transfers of funds for such purposes by the General Assembly and there is no assurance that such funds will be appropriated in any fiscal year. Repayments of loans do not constitute project revenues.

NOTE 6: RELATED PARTY TRANSACTIONS

The Authority entered into an agreement with the Commonwealth of Pennsylvania, through the Department of Community and Economic Development (DCED) and the Department of Environmental Protection (DEP) to provide administrative and operational support services for the Authority. The Authority owns no capital assets; the employees performing services for the Authority are DCED employees. As such, under the Memorandum of Understanding, the Authority reimburses DCED for services rendered by DCED employees to the Authority. During the fiscal years ended June 30, 2011 and 2010, the services provided by DCED and DEP to the Authority and recorded as Administrative/Operating expenses totaled \$1,864,263 and \$2,650,469, respectively.

During the fiscal years ended June 30, 2011 and 2010, the Authority received \$109,039,921 and \$81,654,535, respectively, in transfers from the Commonwealth to pay debt services with respect to Revenue Bonds. See Note 5 for details with respect to the Revenue Bonds.

The Authority also received \$47,904,591 and \$0 in gaming monies from the Commonwealth to fund approved projects in select areas of the state in the fiscal years ended June 30, 2011 and 2010, respectively.

The Authority transferred part of its bond proceeds to the Commonwealth Department of Environment Protection and the Ben Franklin Technology Development Authority totaling \$38,000,000 and \$98,000,000 for the fiscal years ending June 30, 2011 and 2010, respectively.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2011 AND 2010

NOTE 7: LINE OF CREDIT

In December 2009, the Authority entered into a secured line of credit with the Commonwealth of Pennsylvania Treasury Department, which, under a revolving credit agreement, is limited to borrowings of \$50,000,000. Under the revolving credit agreement, interest accrues on the aggregate unpaid principle amount outstanding on the draws. The interest rate is the greater of the rate of the United States Federal Funds Target Rate plus 75 basis points or the rate set by the British Bankers Association for London Interbank Offered Rate (LIBOR) for a six month term in United States dollars plus 45 basis points. The interest rate is reset as of the 20th of each month. As of June 30, 2011 and 2010, no funds were drawn under the revolving credit agreement.

NOTE 8: COMMITMENTS AND CONTINGENCIES

The Authority, through various economic development programs, provided loan guarantees as follows:

	2011	2010
First Industries loan guarantees	\$ 47,994,133	\$ 37,797,428
Tax increment financing gaurantees	48,411,970	44,911,970
Second stage loan gaurantees	3,360,000	2,910,000
Venture capital gaurantees	197,500,000	197,500,000
Total Loan Gaurantees	\$ 297,266,103	\$ 283,119,398

The Authority has been called upon, from time to time with respect to loan guarantees, to make principal or interest payments on behalf of the ultimate borrowers. Accordingly, expenses totaling \$482,335 and \$112,074, have been reported in the Authority's financial statements for loan guarantees as of June 30, 2011 and 2010, respectively.

Through various Authority loan and grant programs to promote economic development within the Commonwealth of Pennsylvania, the Authority has approved loans, and grants of \$47,590,997 and \$488,098,404, respectively, which have not been disbursed as of June 30, 2011.

Zelenkofske Axelrod LLC

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

Board of Directors
Commonwealth Financing Authority
Harrisburg, Pennsylvania

We have audited the financial statements of the business-type activities of the COMMONWEALTH FINANCING AUTHORITY ("the AUTHORITY"), a component unit of the Commonwealth of Pennsylvania, as of and for the year ended June 30, 2011, which collectively comprise the AUTHORITY's 2011 basic financial statements and have issued our report thereon dated September 30, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United State of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the AUTHORITY's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the AUTHORITY's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the AUTHORITY's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the AUTHORITY's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors, management, others within the entity, federal awarding agencies and the Commonwealth of Pennsylvania, and is not intended to be and should not be used by anyone other than these specified parties.

Zelenkofske Axelrod LLC

ZELENKOFOSKE AXELROD LLC

Harrisburg, Pennsylvania
September 30, 2011

<u>Harrisburg</u>	<u>Lehigh Valley</u>	<u>Philadelphia</u>	<u>Pittsburgh</u>
830 Sir Thomas Court, Suite 100 Harrisburg, PA 17109 717.561.9200 Fax 717.561.9202	1101 West Hamilton Street Allentown, PA 18101-1043 610.871.5077 Fax 717.561.9202	2370 York Road, Suite A-5 Jamison, PA 18929 215.918.2277 Fax 215.918.2302	3800 McKnight E. Drive, Suite 3805 Pittsburgh, PA 15237 412.367.7102 Fax 412.367.7103

COMMONWEALTH FINANCING AUTHORITY
(Component Unit of the
Commonwealth of Pennsylvania)
Harrisburg, Pennsylvania

FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2012 AND 2011

COMMONWEALTH FINANCING AUTHORITY
 (COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
 YEARS ENDED JUNE 30, 2012 AND 2011

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Zelenkofske Axelrod LLC

INDEPENDENT AUDITORS' REPORT

Board of Directors
Commonwealth Financing Authority
Harrisburg, Pennsylvania

We have audited the accompanying financial statements of the business-type activities of the COMMONWEALTH FINANCING AUTHORITY ("the AUTHORITY"), a component unit of the Commonwealth of Pennsylvania, as of and for the years ended June 30, 2012 and 2011, which collectively comprise the Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the AUTHORITY's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the AUTHORITY as of June 30, 2012 and 2011 and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 13, 2012, on our consideration of the AUTHORITY's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

As discussed in Note 1 to the financial statements, during the fiscal year ended June 30, 2012 the AUTHORITY adopted the provisions of Governmental Accounting Standards Board's Statement No. 57, "*OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*" and the provisions of Governmental Accounting Standards Board's Statement No. 64, "*Derivative Instruments: Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53*".

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 2 through 3 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquires of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquires, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Zelenkofske Axelrod LLC

ZELENKOFSCHE AXELROD LLC

Harrisburg, Pennsylvania
September 13, 2012

<i>Harrisburg</i>	<i>Lehigh Valley</i>	<i>Philadelphia</i>	<i>Pittsburgh</i>
830 Sir Thomas Court, Suite 100 Harrisburg, PA 17109 717.561.9200 Fax 717.561.9202	1101 West Hamilton Street Allentown, PA 18101-1043 610.871.5077 Fax 717.561.9202	2370 York Road, Suite A-5 Jamison, PA 18929 215.918.2277 Fax 215.918.2302	3800 McKnight E. Drive, Suite 3805 Pittsburgh, PA 15237 412.367.7102 Fax 412.367.7103

**Commonwealth Financing Authority
(Component Unit of the Commonwealth of Pennsylvania)
MANAGEMENT'S DISCUSSION AND ANALYSIS
Financial Statements for the Year Ended June 30, 2012**

Page 2

The , hereafter referred to as the "Authority," is pleased to present its financial statements developed in compliance with Statement of Governmental Accounting Standard No. 34, entitled "Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments" (hereafter GASB 34), and related standards. GASB 34 enhances information provided to the users of its financial statements. This section of the financial reporting package presents our discussion and analysis of the Authority's financial performance during the years ended June 30, 2012 and 2011. Please read it in conjunction with the Authority's financial statements that follow this section.

OPERATIONAL HIGHLIGHTS

Over the past fiscal year, the Authority has approved 38 projects totaling \$38,106,862 in funding under the Alternative and Clean Energy Program, the Renewable Energy Program and the Solar Energy Program. In total, the projects will generate 699,201 megawatt hours annually and save 1,189,508 kBTU's. These programs provide funding to promote the utilization, development and construction of alternative energy projects in the Commonwealth.

Over the past fiscal year, the Authority has approved 13 projects totaling \$33,421,954 in funding under the Business in Our Sites program which funds will assist in the development of 1,260 acres, 4,116,954 sq. ft of leasable space and will create 3,672 jobs. This program provides funding to support the development of strategic economic development sites throughout the Commonwealth.

OVERVIEW OF THE FINANCIAL STATEMENTS

Management's Discussion and Analysis (MD&A) serves as an introduction to, and should be read in conjunction with, the basic audited financial statements. The MD&A represents management's examination and analysis of the Authority's financial condition and performance. Summary financial statement data and other management tools were used for this analysis.

The financial statements report information about the Authority using the full accrual method of accounting, as utilized by similar business activities in the private sector. The financial statements include a Statement of Net Deficits; a Statement of Revenues, Expenses, and Changes in Net Deficits; a Statement of Cash Flows; and Notes to the Financial Statements.

The Statement of Net Deficits presents the financial position of the Authority on a full accrual historical cost basis. The Statement of Net Deficits also presents information on all of the Authority's assets and liabilities, with the difference reported as net deficits. Over time, increases and decreases in net deficits are one indicator of whether the financial position of the Authority is improving or deteriorating.

While the Statement of Net Deficits provides information about the nature and amount of resources and obligations at year-end, the Statement of Revenues, Expenses, and Changes in Net Deficits presents the results of the business-type activities over the course of the fiscal year and information as to how the net deficits changed during the year. All changes in net deficits are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the Authority's recovery of its costs.

The Statement of Cash Flows presents changes in cash and cash equivalents, resulting from operational, financing, and investing activities. This statement presents cash receipt and cash disbursement information without consideration of the earnings event when an obligation arises, or depreciation of capital assets.

The Notes to the Financial Statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Authority's accounting policies, significant account balances and activities, long-term debt and subsequent events, if any.

Commonwealth Financing Authority
(Component Unit of the Commonwealth of Pennsylvania)
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Financial Statements for the Year Ended June 30, 2012

Page 3

FINANCIAL ANALYSIS**Condensed Statements of Net Deficits**

	2012	2011	2010
Assets:			
Current assets	\$ 450,693,586	\$ 678,584,533	\$ 750,222,910
Long-term assets	307,401,520	307,484,704	287,632,709
Total assets	<u>758,095,106</u>	<u>986,069,237</u>	<u>1,037,855,619</u>
Liabilities:			
Current liabilities	57,017,378	46,714,982	42,198,516
Long-term liabilities	1,344,464,445	1,395,049,687	1,282,704,529
Total liabilities	<u>1,401,481,823</u>	<u>1,441,764,669</u>	<u>1,324,903,045</u>
Total net deficit - unrestricted	<u>\$ (643,386,717)</u>	<u>\$ (455,695,432)</u>	<u>\$ (287,047,426)</u>

The Authority did not issue any new bonds in 2012 after issuing bonds totaling \$150 million in 2011. The bond issuance was the primary cause for the increase in total liabilities of \$117 million in 2011. In 2012, total liabilities decreased by \$40 million as a result of no new debt issuances and principal payments made on existing debt. In 2012, the Authority's total assets declined by \$228 million due to the transfer of \$9 million to other Commonwealth agencies for initiatives prescribed under legislation and also due to \$249 million in grant disbursements, particularly H2O program grants. Due to the nature of economic development grants and loans, some of which require drawdowns, funding not immediately disbursed upon Board approval is held as cash and cash equivalents. Administrative operating expenses increased as compared to the previous year by \$0.7 million. The increase corresponds to the increased staff time necessary to review and process application for funding during 2012. Loan Guarantee expense increased by \$0.7 million in 2012 as the Authority was called on to pay demand notices.

The significant increase in the total net deficit is attributable to the \$249 million in Authority assets disbursed as grant proceeds, and the \$8 million in assets transferred to the Ben Franklin Technology Development Partners. The transfer of bond proceeds to these Governmental entities was prescribed by legislation. Management acknowledges but is not concerned with the annual net asset deficit. As an authority under which economic stimulus programs are established, grants and transfers to other governmental entities are essential to achieve its mission.

Since inception, the Authority has issued eight revenue bonds totaling \$1.542 billion. The Authority has a service agreement with the Commonwealth of Pennsylvania for the payment of the annual debt service through an annual appropriation by the Commonwealth, and transfers from the Gaming Economic Development Tourism Fund. However, there is no assurance that there will be sufficient funds appropriated annually by the Commonwealth.

Condensed Statements of Revenues, Expenses, and Changes in Net Deficits

	2012	2011	2010
Operating income	\$ 10,590,538	\$ 8,449,239	\$ 8,091,436
Operating expenses	(252,807,470)	(219,374,693)	(138,624,287)
Provision for loan losses	(4,988,366)	(423,549)	(1,093,798)
Nonoperating income (expense),net	<u>59,514,013</u>	<u>42,700,997</u>	<u>(74,655,405)</u>
Increase (decrease) in net asset	<u>\$ (187,691,285)</u>	<u>\$ (168,648,006)</u>	<u>\$ (206,282,054)</u>

In 2012, operating income increased by \$2.1 million as compared to 2011. The increase is attributed to increased interest on loans and venture capital investments. The Authority adjusts the loan loss reserve to account for at-risk loans. As a result, the provision for loan losses increased by \$4.6 million.

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, investors and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. If you have questions about this report or need additional information, contact the Commonwealth Financing Authority, 400 North Street, Fourth Floor, Harrisburg, PA 17120.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF NET DEFICITS
JUNE 30, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 420,093,530	\$ 649,214,245
Receivables:		
Loans (net)	18,152,055	15,319,437
Accrued interest	1,483,188	1,195,651
Penalties/late fees	-	18,288
Due from primary government	-	1,230,082
Unamortized bond issuance costs, net	<u>10,964,813</u>	<u>11,606,830</u>
Total Current Assets	<u>450,693,586</u>	<u>678,584,533</u>
Non-current assets:		
Long-term portion of loans receivable (net)	<u>307,401,520</u>	<u>307,484,704</u>
Total Non-current Assets	<u>307,401,520</u>	<u>307,484,704</u>
Total Assets	<u>\$ 758,095,106</u>	<u>\$ 986,069,237</u>
LIABILITIES		
Current Liabilities:		
Current portion of long-term debt	\$ 50,210,000	\$ 39,285,000
Accrued interest payable	6,235,521	6,377,642
Loan escrow deposit	-	388,080
Accounts payable and accrued expenses	16,000	52,006
Due to primary governments - DCED	<u>555,857</u>	<u>612,254</u>
Total Current Liabilities	<u>57,017,378</u>	<u>46,714,982</u>
Non-current Liabilities:		
Long-term debt, net of current portion and unamortized bond premium and discount	<u>1,344,464,445</u>	<u>1,395,049,687</u>
Total Noncurrent Liabilities	<u>1,344,464,445</u>	<u>1,395,049,687</u>
Total Liabilities	<u>1,401,481,823</u>	<u>1,441,764,669</u>
TOTAL NET DEFICITS - UNRESTRICTED	<u>\$ (643,386,717)</u>	<u>\$ (455,695,432)</u>

See accompanying notes to the financial statements

COMMONWEALTH FINANCING AUTHORITY
 (COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
 STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET DEFICITS
 YEARS ENDED JUNE 30, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
Operating Income		
Interest on loans	\$ 6,870,547	\$ 5,898,154
Interest on investments	1,462,859	2,036,680
Fee income	417,953	227,914
Interest from venture capital loan	<u>1,839,179</u>	<u>286,491</u>
Operating Revenues before Provision for Loan Losses	<u>10,590,538</u>	<u>8,449,239</u>
Provision for loan losses	<u>4,988,366</u>	<u>423,549</u>
Net Operating Revenues	<u>5,602,172</u>	<u>8,025,690</u>
Operating Expenses		
Administrative/operating expense	2,902,175	2,211,971
Grant expense	248,546,667	216,530,388
Loan guarantee expense	1,191,529	482,335
Other	<u>167,099</u>	<u>149,999</u>
Total Operating Expenses	<u>252,807,470</u>	<u>219,374,693</u>
Operating Loss	<u>(247,205,298)</u>	<u>(211,349,003)</u>
Nonoperating Income (Expenses)		
Transfers in from primary government	145,170,304	156,944,512
Interest on bonds	(76,389,516)	(75,944,943)
Amortization of bond premium/discount	375,242	310,473
Amortization of bond issuance costs	(642,017)	(609,045)
Transfer to other Commonwealth component units	(8,000,000)	(13,000,000)
Transfers to primary government	<u>(1,000,000)</u>	<u>(25,000,000)</u>
Total Nonoperating Revenues	<u>59,514,013</u>	<u>42,700,997</u>
Increase in net deficits	(187,691,285)	(168,648,006)
Net Deficits - Beginning of Year	<u>(455,695,432)</u>	<u>(287,047,426)</u>
Net Deficits - End of Year	<u>\$ (643,386,717)</u>	<u>\$ (455,695,432)</u>

See accompanying notes to the financial statements

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
Cash Flows from Operating Activities:		
Loan and fee receipts from customers	\$ 38,531,154	\$ 25,673,428
Loan disbursements made to customers	(37,965,703)	(40,663,944)
Interest on investments	1,462,859	2,036,680
Cash paid for operating expenses	(2,994,578)	(2,305,970)
Cash paid for grant expenses	(248,546,667)	(216,530,388)
Cash paid for loan guarantees	(1,191,529)	(482,335)
	<u>(250,704,464)</u>	<u>(232,272,529)</u>
Net Cash Used In Operating Activities		
Cash Flows from Noncapital Financing Activities:		
Proceeds from bonds payable	-	153,594,595
Transfer to primary government and other Commonwealth component units	(9,000,000)	(38,000,000)
Transfer from primary government	146,400,386	155,714,430
Principal payments on bonds payable	(39,285,000)	(36,180,000)
Interest on bonds payable	(76,531,637)	(76,409,478)
	<u>21,583,749</u>	<u>158,719,547</u>
Net Cash Provided By Noncapital Financing Activities		
	<u>(229,120,715)</u>	<u>(73,552,982)</u>
Decrease In Cash And Cash Equivalents		
Cash and Cash Equivalents, Beginning of Year	<u>649,214,245</u>	<u>722,767,227</u>
Cash and Cash Equivalents, End of Year	<u>\$ 420,093,530</u>	<u>\$ 649,214,245</u>
Reconciliation of Operating Income to Net Cash Provided By (Used In) Operating Activities:		
Operating Loss	\$ (247,205,298)	\$ (211,349,003)
Adjustments to reconcile operating income to net cash used in operating activities:		
Effect of changes in operating assets and liabilities:		
Loan disbursements	(37,410,524)	(40,513,945)
Loan repayments	29,319,589	19,523,622
Loan escrow deposits	(388,080)	-
Accrued interest receivable	(287,537)	(201,034)
Loan origination costs	353,135	(51,312)
Allowance for loan losses	4,988,366	423,549
Penalties/late fees	18,288	(10,407)
Accounts payable, accrued expenses, and due to primary government	(92,403)	(93,999)
Net Cash Used In Operating Activities	<u>\$ (250,704,464)</u>	<u>\$ (232,272,529)</u>
Supplemental Disclosure of Cash Flow Information		
Noncash Noncapital Financing Activities:		
Amortization of bond premium/discount (net)	\$ (375,242)	\$ (310,473)
Amortization of bond issuance costs	642,017	609,045
Total Noncash Noncapital Financing Activities	<u>\$ 266,775</u>	<u>\$ 298,572</u>

See accompanying notes to the financial statements

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2012 AND 2011

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization

The Commonwealth Financing Authority ("the Authority") is a body corporate and politic duly organized by the Commonwealth of Pennsylvania ("the Commonwealth") incorporated under the Public Authorities and Quasi-Public Corporations Act of 2004 (Act), being the Act of April 1, 2004, P.L. 163, as amended by the Commonwealth of Pennsylvania. The Authority, by virtue of the Act and its articles of incorporation, has all powers as set forth in the Act including those for creation and retention of jobs. The purpose of the Authority is to engage in financial assistance in the form of loans, loan guarantees, grants and private equity participating loans to promote activities which lead to the use of alternative and clean energy, the creation and retention of jobs within the Commonwealth of Pennsylvania, the establishment of economically viable Pennsylvania communities, the development of a stable tax base within Pennsylvania communities, the reuse of abandoned industrial, commercial and other previously utilized sites, the promotion and commercialization of Pennsylvania products and services and investment of private capital in Pennsylvania communities to promote the health, safety, employment, business opportunities, economic activity and general welfare of the people of the Commonwealth.

The Commonwealth appoints the members of the Authority's governing board. The Commonwealth maintains the accounts and records of the Authority. In addition the Commonwealth employs and supervises personnel to provide administrative services. Therefore, the Authority is considered a component unit of the Commonwealth of Pennsylvania.

The legislation creating the Authority as well as program specific guidelines establishes certain activities to be carried out by the Authority as follows:

- Business in Our Sites Program: provides financial assistance for preparation of sites for future development.
- First Industries Program: provides financial assistance for projects related to tourism and agriculture.
- Second Stage Loan Program: provides loan guarantees to commercial lending institutions that make loans to life sciences, advanced technology or manufacturing businesses.
- New Pennsylvania Venture Guarantee Program: provides guarantees to venture capital partnerships for investments in Pennsylvania-related companies which are in early-stage or mid-stage development.
- Building Pennsylvania Program: provides loans to fund managers for investment in real estate projects in Pennsylvania.
- Tax Increment Financing "TIF" Guarantee Program: provides guarantees for TIF bonds or other indebtedness in accordance with the TIF Act of 1990.
- New Pennsylvania Venture Capital Investments Program: provides loans to Venture Capital partnerships for investment in Pennsylvania companies.
- Penn Works Program: provides grants and loans for water supply and wastewater infrastructure within Pennsylvania.
- H₂O PA Program (Water and Sewer): provides for single-year or multi-year grants to municipalities or municipal authorities to assist with the construction of flood control projects, drinking water, sanitary sewer and storm sewer projects, and the repair of high hazard unsafe dams.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2012 AND 2011

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

A. Organization (Continued)

- Solar Energy Program: provides financial assistance in the form of grant and loan funds to promote the generation and use of solar energy and the manufacture or assembly of solar equipment.
- Renewable Energy Program: provides financial assistance in the form of grant and loan funds to promote the use of wind and geothermal energy.
- Alternative and Clean Energy Program: provides grant and loan funds to encourage the implementation of alternative energy production projects and clean energy projects.
- High Performance Buildings: provides grants and loans for the construction of energy efficient buildings.
- Local Share Account: provides grants to support and enhance community and economic well-being and mitigate the impact of gaming and related activities.

B. Measurement Focus and Basis of Accounting

The Authority follows Generally Accepted Accounting Principles (GAAP). GAAP allows specialized accounting for government entities, which is governed by pronouncements set by the Governmental Accounting Standards Board (GASB). Pronouncements set by the GASB may differ from pronouncements set by the Financial Accounting Standards Board (FASB).

The Authority is considered a special-purpose government since it is engaged solely in business-type activities under GASB Statement No. 34. The Authority's financial statements are prepared using the economic resources measurement focus and accrual basis of accounting. Under the accrual basis of accounting revenues are recorded when earned and expenses are recorded when they have been incurred. The statements are intended to report the Authority as an economic unit that includes all measurable assets and liabilities, financial and capital, of the Authority.

All activities of the Authority are accounted for within a single proprietary (enterprise) fund. A proprietary fund is used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination or revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The Authority follows the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis*. Within the Statements of Revenues, Expenses and Changes in Net Deficits, Statement No. 34 requires operating income and expenses to be separated from non-operating income in order to report net operating income or loss. Operating income and expenses are defined as those activities directly related to the Authority's primary business of providing employment through economic development lending. Non-operating revenues and expenses consist of those revenues and expenses that are related to financing and investing types of activities and result from non-exchange transactions, such as investment income/loss.

The Authority follows Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting* for reporting and disclosure purposes. As permitted by Statement No. 20, the Authority has elected not to apply Financial Accounting Standards Board pronouncements issued after November 30, 1989 unless GASB specifically adopts the FASB Statement or Interpretation.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2012 AND 2011

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Cash and Cash Equivalents

Cash and cash equivalents, for the purposes of the Statement of Cash Flows, include cash on hand or on deposit in highly liquid financial debt instruments with a maturity of three months or less at the date of purchase.

D. Allowance for Loan Losses

The allowance for loan losses is a reserve account for possible future loan losses. Provision for loan losses is credited to the allowance account. Loan losses which are charged-off and recoveries of previously charged-off loans are charged or credited directly to the allowance account. The provision for loan losses is adjusted monthly at the rate of 2% of outstanding loan balances at the respective month-end.

E. Interest Income

Interest income on cash equivalents and loans are recorded when earned.

Uncollectible interest on loans that are contractually past due is charged off, or an allowance established based on management's periodic evaluations. The allowance is established by a charge-to-interest income equal to all previously accrued, and income is subsequently recognized only to the extent that cash payments are received until, in management's judgment, the borrower's ability to make periodic interest and principal payments is back to normal.

In addition to fixed interest arrangements, some loans contain provisions which provide lump sum interest payments based upon certain conditions being met. The additional income is recognized when earned.

F. Loan Origination Fees and Costs

The Authority recognizes loan origination fees and costs in accordance with FASB Accounting Standards Codification 310-20, *Receivables – Nonrefundable Fees and Other Costs* (formerly Statement of Financial Accounting Standards No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*).

For the years ended June 30, 2012 and 2011, (\$42,565) and \$310,570, respectively, of net deferred fees are included in loans receivable.

G. Bond Issuance Costs

Bond issuance costs consist of legal, underwriting and other fees charged in connection with the issuance of bond debt. The costs are amortized over the lives of the bonds, which range from 20 to 30 years. The bonds mature through 2040. Amortization was \$642,017 and \$609,045 for the years ended June 30, 2012 and 2011, respectively.

H. Utilization of Resources

When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first, then unrestricted resources as needed.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2012 AND 2011

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

I. Bond Premium and Discount

The difference between the cash received from bondholders at issuance and the amount due to bondholders at maturity is recognized as bond premium or discount. Bond premium or discount is amortized using the straight-line method over the lives of the bonds issued, which approximates the interest method.

J. Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Accordingly, actual results could differ from those estimates.

K. Reclassifications

For comparative purposes, the prior year's financial statements have been reclassified to conform to report classifications of the current year. The reclassifications had no effect on net assets.

L. Adoption of Governmental Accounting Standards Board Statements

The Authority adopted the requirements of GASB Statement No. 57, "*OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*". The adoption of this statement had no effect on previously reported amounts.

The Authority adopted the requirements of GASB Statement No. 64 "*Derivative Instruments: Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53*". The adoption of this statement had no effect on previously reported amounts.

M. Pending Changes in Accounting Principles

In November 2010, the GASB issued Statement No. 60, "*Accounting and Financial Reporting for Service Concession Arrangements*". The Authority is required to adopt Statement No. 60 for its fiscal year 2013 financial statements.

In November 2010, the GASB issued Statement No. 61, "*The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34*". The Authority is required to adopt Statement No. 61 for its fiscal year 2013 financial statements.

In December 2010, the GASB issued Statement No. 62, "*Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*". The Authority is required to adopt Statement No. 62 for its fiscal year 2013 financial statements.

In June 2011, the GASB issued Statement No. 63, "*Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*". The Authority is required to adopt Statement No. 63 for its fiscal year 2013 financial statements.

In March 2012, the GASB issued a Statement No. 65, "*Items Previously Reported as Assets and Liabilities*". The Authority is required to adopt statement No. 65 for its fiscal year 2014 financial statements.

In March 2012, the GASB issued a Statement No. 66, "*Technical Corrections – 2012 – An Amendment of GASB Statements No. 10 and No. 62*". The Authority is required to adopt statement No. 65 for its fiscal year 2014 financial statements.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2012 AND 2011

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

M. Pending Changes in Accounting Principles (Continued)

In June 2012, the GASB issued a Statement No. 67, *Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25*. The Authority is required to adopt statement No. 67 for its fiscal year 2014 financial statements.

In June 2012, the GASB issued a Statement No. 68, *Accounting and Financial Reporting – an amendment of GASB Statement No. 27*. The Authority is required to adopt statement No. 68 for its fiscal year 2015 financial statements.

The Authority has not yet completed the various analyses required to estimate the financial statement impact of these new pronouncements.

NOTE 2: FINANCIAL SUPPORT

The Authority reported a net deficit of \$643,386,717 and \$455,695,432 as of June 30, 2012 and 2011, respectively. The Authority's business purpose will result in continued losses from operation due to the disbursement of grant awards to help promote economic growth in the Commonwealth. In addition, the Authority transferred part of its bond proceeds to the Commonwealth Department of Environmental Protection and the Ben Franklin Technology Development Authority in the current year and in prior years to the Commonwealth for the Machinery and Equipment Loan Fund (MELF) program, which contributed to the deficit in net assets.

Through a service agreement with the Authority, the Commonwealth has pledged to seek annual appropriations to pay the Authority's annual debt service obligations. Therefore, factors listed above do not raise doubt as to the Authority's ability to meet obligations when due.

NOTE 3: CASH AND CASH EQUIVALENTS

Custodial Credit Risk

Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. As of June 30, 2012 and 2011, due to the nature of the cash and cash equivalents balances, there is no custodial credit risk.

Additionally, due to the short-term maturity of the cash equivalents, there is limited interest rate risk.

NOTE 4: LOANS RECEIVABLE

The Authority provides loans, in accordance with its enabling legislation and statutory requirements to spur economic development activity within the Commonwealth of Pennsylvania. The loans have amortization periods not to exceed 20 years and bear interest at rates ranging from 1% to 8% depending on the nature of the loan and the Authority program from which the loan was funded.

The Authority, through the New Venture Capital Investment Program, provides loans to venture capital partnerships for investments in Pennsylvania-related companies.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2012 AND 2011

NOTE 4: LOANS RECEIVABLE (CONTINUED)

At June 30, 2012 and 2011, the outstanding balance of loans receivable were as follows:

	2012		
	Current Portion	Long-term Portion	Total
Loan receivable	\$ 18,524,920	\$ 318,644,333	\$ 337,169,253
Deferred loan origination fees - net	(2,367)	(40,198)	(42,565)
Allowance for loan losses	(370,498)	(11,202,615)	(11,573,113)
Balance, end of year	\$ 18,152,055	\$ 307,401,520	\$ 325,553,575
	2011		
	Current Portion	Long-term Portion	Total
Loan receivable	\$ 15,617,733	\$ 313,460,585	\$ 329,078,318
Deferred loan origination fees - net	14,059	296,511	310,570
Allowance for loan losses	(312,355)	(6,272,392)	(6,584,747)
Balance, end of year	\$ 15,319,437	\$ 307,484,704	\$ 322,804,141

An analysis of the allowance for loan losses for the years ended June 30, 2012 and 2011 is as follows:

	2012	2011
Balance, beginning of year	\$ 6,584,747	\$ 6,161,198
Provision for loan losses	4,988,366	423,549
Balance, end of year	\$ 11,573,113	\$ 6,584,747

NOTE 5: BONDS PAYABLE

Changes in long-term liabilities for the year ended June 30, 2012:

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Economic revenue bonds	\$ 1,427,275,000	\$ -	\$ (39,285,000)	\$ 1,387,990,000	\$ 50,210,000
Bond premium	8,200,123	-	(433,182)	7,766,941	-
Bond discount	(1,140,436)	-	57,940	(1,082,496)	-
Total	\$ 1,434,334,687	\$ -	\$ (39,660,242)	\$ 1,394,674,445	\$ 50,210,000

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2012 AND 2011

NOTE 5: BONDS PAYABLE (CONTINUED)

Changes in long-term liabilities for the year ended June 30, 2011:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Economic revenue bonds	\$ 1,313,455,000	\$ 150,000,000	\$ (36,180,000)	\$ 1,427,275,000	\$ 39,285,000
Bond premium	4,657,904	3,910,631	(368,412)	8,200,123	-
Bond discount	(1,198,375)	-	57,939	(1,140,436)	-
Total	\$ 1,316,914,529	\$ 153,910,631	\$ (36,490,473)	\$ 1,434,334,687	\$ 39,285,000

	<u>2012</u>	<u>2011</u>
Series 2010 Revenue Bonds, issued \$53,080,000 fixed rate, tax-exempt revenue bonds, Series C-1 and \$96,920,000, fixed rate, federal taxable revenue bonds, Series C-2 at 2% - 3.4%, interest payable semi-annually and principle payable annually through June 1, 2040.	\$ 145,145,000	\$ 148,030,000
Series 2010 Revenue Bonds, issued \$62,000,000 fixed rate, federal taxable revenue bonds, Series A and \$80,000,000 fixed rate, tax-exempt revenue bonds, Series B at .93% - 5.5%, interest payable semi-annually and principal payable annually through May 1, 2039.	\$ 134,260,000	\$ 138,505,000
Series 2009 Revenue Bonds, issued \$400,000,000 fixed rate, federally taxable revenue bonds, Series D at 3.4% - 5.1%, interest payable semi-annually and principal payable annually through May 1, 2039.	\$ 400,000,000	\$ 400,000,000
Series 2009 Revenue Bonds, issued \$50,000,000 fixed rate, federal taxable revenue bonds, Series A and \$50,000,000 fixed rate, tax-exempt revenue bonds, Series B at 3.0% - 6.4%, interest payable semi-annually and principal payable annually through June 1, 2031.	\$ 94,330,000	\$ 97,205,000
Series 2008 Revenue Bonds, issued \$187,500,000 fixed rate, federally taxable revenue bonds, Series A at 3.1% - 5.2%, interest payable semi-annually and principal payable annually through June 1, 2027.	\$ 162,540,000	\$ 169,625,000

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2012 AND 2011

NOTE 5: BONDS PAYABLE (CONTINUED)

	<u>2012</u>	<u>2011</u>
Series 2006 Revenue Bonds, issued \$187,500,000 fixed rate, federally taxable revenue bonds, Series C at 4.9% - 5.2%, interest payable semi-annually and principal payable annually through June 1, 2026.	\$ 153,715,000	\$ 161,145,000
Series 2006 Revenue Bonds, issued \$45,000,000 fixed rate, tax exempt revenue bonds, Series A and \$142,500,000 fixed rate, federal taxable revenue bonds, Series B at 4.5% - 5.6%, interest only payable semi-annually through June 1, 2026 and principal payable annually through June 1, 2026.	\$ 151,690,000	\$ 158,720,000
Series 2005 Revenue Bonds, issued \$62,500,000 fixed rate, tax exempt revenue bonds, Series A and \$125,000,000 fixed rate, federally taxable revenue bonds, Series B at 4.5% - 5.3%, interest payable semi-annually and principal payable annually through June 1, 2025.	\$ 146,310,000	\$ 154,045,000
Total Bonds Payable - Principle	\$ 1,387,990,000	\$ 1,427,275,000
Less current portion	(50,210,000)	(39,285,000)
Unamortized bond premium	7,766,941	8,200,123
Unamortized bond discount	(1,082,496)	(1,140,436)
	<u>\$ 1,344,464,445</u>	<u>\$ 1,395,049,687</u>

Bond payable requirements subsequent to June 30, 2012 are as follows:

	<u>Principal Maturities</u>	<u>Interest</u>
For the Years Ending June 30,		
2013	\$ 50,210,000	\$ 74,826,251
2014	52,290,000	72,954,021
2015	54,570,000	70,585,946
2016	57,025,000	68,054,367
2017	59,655,000	63,509,188
2018-2022	345,920,000	267,066,553
2023-2027	379,345,000	161,328,847
2028-2032	184,950,000	88,431,574
2031-2037	134,305,000	42,306,537
2038-2040	69,720,000	4,985,390
Total	<u>\$ 1,387,990,000</u>	<u>\$ 914,048,674</u>

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2012 AND 2011

NOTE 5: BONDS PAYABLE (CONTINUED)

Bond payable requirements subsequent to June 30, 2011 are as follows:

For the Years Ended June 30,	<u>Principal Maturities</u>	<u>Interest</u>
2012	\$ 39,285,000	\$ 76,531,705
2013	50,210,000	74,826,251
2014	52,290,000	72,954,021
2015	54,570,000	70,585,946
2016	57,025,000	68,054,367
2017-2021	329,355,000	294,024,221
2022-2026	406,165,000	193,807,270
2027-2031	200,315,000	104,835,251
2032-2036	139,350,000	54,806,243
2037-2040	98,710,000	13,104,570
Total	<u>\$ 1,427,275,000</u>	<u>\$ 1,023,529,845</u>

The Authority, with Commonwealth approval, issued the above noted revenue bonds to fund the activities of the Authority. Repayments with respect to the revenue bonds are derived solely from project revenues which are defined as annual appropriations and transfers by the Commonwealth per the Official Statement. The Revenue Bonds described above are limited obligations of the Authority and are considered non-recourse, as the Authority is not obligated to bondholders beyond amounts received by the Authority from annual appropriations and transfers to the Authority by the Commonwealth. The Commonwealth has not pledged its full faith and credit nor the taxing power of the Commonwealth or any political subdivision for the payment of the Authority's Revenue Bonds and the payments by the Commonwealth to the Authority are subject to annual appropriation and transfers of funds for such purposes by the General Assembly and there is no assurance that such funds will be appropriated in any fiscal year. Repayments of loans do not constitute project revenues.

NOTE 6: RELATED PARTY TRANSACTIONS

The Authority entered into an agreement with the Commonwealth of Pennsylvania, through the Department of Community and Economic Development (DCED) and the Department of Environmental Protection (DEP) to provide administrative and operational support services for the Authority. The Authority owns no capital assets; the employees performing services for the Authority are DCED employees. As such, under the Memorandum of Understanding, the Authority reimburses DCED for services rendered by DCED employees to the Authority. During the fiscal years ended June 30, 2012 and 2011, the services provided by DCED and DEP to the Authority and recorded as Administrative/Operating expenses totaled \$2,742,647 and \$1,864,263, respectively.

During the fiscal years ended June 30, 2012 and 2011, the Authority received \$115,816,425 and \$109,039,921, respectively, in transfers from the Commonwealth to pay debt services with respect to Revenue Bonds. See Note 5 for details with respect to the Revenue Bonds.

The Authority also received \$29,353,879 and \$47,904,591 in gaming monies from the Commonwealth to fund approved projects in select areas of the state in the fiscal years ended June 30, 2012 and 2011, respectively.

The Authority transferred part of its bond proceeds to the Commonwealth Department of Environment Protection and the Ben Franklin Technology Development Authority totaling \$9,000,000 and \$38,000,000 for the fiscal years ending June 30, 2012 and 2011, respectively.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2012 AND 2011

NOTE 7: LINE OF CREDIT

In December 2009, the Authority entered into a secured line of credit with the Commonwealth of Pennsylvania Treasury Department, which, under a revolving credit agreement, is limited to borrowings of \$50,000,000. Under the revolving credit agreement, interest accrues on the aggregate unpaid principle amount outstanding on the draws. The interest rate is the greater of the rate of the United States Federal Funds Target Rate plus 75 basis points or the rate set by the British Bankers Association for London Interbank Offered Rate (LIBOR) for a six month term in United States dollars plus 45 basis points. The interest rate is reset as of the 20th of each month. The line of credit expired as of December 28, 2011, the Authority did not extend or obtain a new line of credit. As of June 30, 2012 and 2011, no funds were drawn under the revolving credit agreement.

NOTE 8: COMMITMENTS AND CONTINGENCIES

The Authority, through various economic development programs, provided loan guarantees as follows:

	2012	2011
First Industries loan guarantees	\$ 47,625,633	\$ 47,994,133
Tax increment financing gaurantees	38,500,000	48,411,970
Second stage loan gaurantees	1,485,000	3,360,000
Venture capital gaurantees	197,500,000	197,500,000
Total Loan Gaurantees	<u>\$ 285,110,633</u>	<u>\$ 297,266,103</u>

The Authority has been called upon, from time to time with respect to loan guarantees, to make principal or interest payments on behalf of the ultimate borrowers. Accordingly, expenses totaling \$1,191,529 and \$482,335, have been reported in the Authority's financial statements for loan guarantees as of June 30, 2012 and 2011, respectively.

Through various Authority loan and grant programs to promote economic development within the Commonwealth of Pennsylvania, the Authority has approved loans, and grants of \$53,855,635 and \$334,044,359, respectively, which have not been disbursed as of June 30, 2012.

Zelenkofske Axelrod LLC

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Board of Directors
Commonwealth Financing Authority
Harrisburg, Pennsylvania

We have audited the financial statements of the business-type activities of the COMMONWEALTH FINANCING AUTHORITY ("the AUTHORITY"), a component unit of the Commonwealth of Pennsylvania, as of and for the year ended June 30, 2012, which collectively comprise the AUTHORITY's basic financial statements and have issued our report thereon dated September 13, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United State of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the AUTHORITY is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the AUTHORITY's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the AUTHORITY's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the AUTHORITY's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the AUTHORITY's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors, management, others within the entity, federal awarding agencies and the Commonwealth of Pennsylvania, and is not intended to be and should not be used by anyone other than these specified parties.

Zelenkofske Axelrod LLC

ZELENKOFKSKE AXELROD LLC

Harrisburg, Pennsylvania
September 13, 2012

<u>Harrisburg</u>	<u>Lehigh Valley</u>	<u>Philadelphia</u>	<u>Pittsburgh</u>
830 Sir Thomas Court, Suite 100 Harrisburg, PA 17109 717.561.9200 Fax 717.561.9202	1101 West Hamilton Street Allentown, PA 18101-1043 610.871.5077 Fax 717.561.9202	2370 York Road, Suite A-5 Jamison, PA 18929 215.918.2277 Fax 215.918.2302	3800 McKnight E. Drive, Suite 3805 Pittsburgh, PA 15237 412.367.7102 Fax 412.367.7103

COMMONWEALTH FINANCING AUTHORITY
(Component Unit of the
Commonwealth of Pennsylvania)
Harrisburg, Pennsylvania

FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2013 AND 2012

COMMONWEALTH FINANCING AUTHORITY
 (COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
 YEARS ENDED JUNE 30, 2013 AND 2012

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Zelenkofske Axelrod LLC

INDEPENDENT AUDITORS' REPORT

Board of Directors
Commonwealth Financing Authority
Harrisburg, Pennsylvania

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the COMMONWEALTH FINANCING AUTHORITY ("the AUTHORITY"), a component unit of the Commonwealth of Pennsylvania, as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the Authority as of June 30, 2013 and 2012, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Adoption of Governmental Accounting Standards Board Statements

As discussed in Note 1 to the financial statements, during the fiscal year ending June 30, 2013, the Authority adopted the provisions of Governmental Accounting Standards Board's Statement No. 60, "*Accounting and Financial Reporting for Service Concession Arrangements*", Statement No. 61, "*The Financial Reporting Entity: Omnibus-an amendment of GASB Statement No. 14 and 34*", Statement No. 62, "*Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*", and Statement No. 63, "*Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*". Our opinion is not modified with respect to this matter.

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Zelenkofske Axelrod LLC

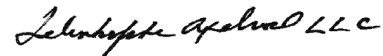
Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 5 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 2, 2013, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.



ZELENKOFSCHE AXELROD LLC

Harrisburg, Pennsylvania
October 2, 2013

Commonwealth Financing Authority
(Component Unit of the Commonwealth of Pennsylvania)
MANAGEMENT'S DISCUSSION AND ANALYSIS
Financial Statements for the Year Ended June 30, 2013

Page 3

The Commonwealth Financing Authority, hereafter referred to as the "Authority," is pleased to present its financial statements developed in compliance with Statement of Governmental Accounting Standard No. 34, entitled "Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments" (hereafter GASB 34), and related standards. GASB 34 enhances information provided to the users of its financial statements. This section of the financial reporting package presents our discussion and analysis of the Authority's financial performance during the years ended June 30, 2013 and 2012. Please read it in conjunction with the Authority's financial statements that follow this section.

OPERATIONAL HIGHLIGHTS

Over the past fiscal year, the Authority adopted guidelines for six new grant programs created through Act 13 of 2012. Over 300 applications were received requesting more than \$60 million for flood mitigation, orphaned and abandoned well plugging, greenways trails and recreation, watershed restoration and protection, abandoned mine drainage abatement and treatment, and baseline water quality projects.

The Authority also solicited applications for the PennWorks Program. The Authority received 104 applications requesting over \$262 million for water and sewer projects that directly support job creation and private investment in the Commonwealth.

OVERVIEW OF THE FINANCIAL STATEMENTS

Management's Discussion and Analysis (MD&A) serves as an introduction to, and should be read in conjunction with, the basic audited financial statements. The MD&A represents management's examination and analysis of the Authority's financial condition and performance. Summary financial statement data and other management tools were used for this analysis.

The financial statements report information about the Authority using the accrual method of accounting, as utilized by similar business activities in the private sector. The financial statements include a Statement of Net Position; a Statement of Revenues, Expenses, and Changes in Net Position; a Statement of Cash Flows; and Notes to the Financial Statements.

The Statement of Net Position presents the financial position of the Authority on an accrual cost basis. The Statement of Net Position also presents information on all of the Authority's assets and liabilities, with the difference reported as net position. Over time, increases and decreases in net position are one indicator of whether the financial position of the Authority is improving or deteriorating.

While the Statement of Net Position provides information about the nature and amount of resources and obligations at year-end, the Statement of Revenues, Expenses, and Changes in Net Position presents the results of the business-type activities over the course of the fiscal year and information as to how the net position changed during the year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the Authority's recovery of its costs.

The Statement of Cash Flows presents changes in cash and cash equivalents, resulting from operational, financing, and investing activities. This statement presents cash receipt and cash disbursement information without consideration of the earnings event when an obligation arises or depreciation of capital assets.

The Notes to the Financial Statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Authority's accounting policies, significant account balances and activities, long-term debt and subsequent events, if any.

Commonwealth Financing Authority
(Component Unit of the Commonwealth of Pennsylvania)
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Financial Statements for the Year Ended June 30, 2013

Page 4

FINANCIAL ANALYSIS**Condensed Statements of Net Position**

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Assets:			
Current assets	\$ 660,409,830	\$ 450,693,586	\$ 678,584,533
Long-term assets	305,606,245	307,401,520	307,484,704
Total assets	<u>966,016,075</u>	<u>758,095,106</u>	<u>986,069,237</u>
Liabilities:			
Current liabilities	68,452,494	57,017,378	46,714,982
Long-term liabilities	1,658,056,920	1,344,464,445	1,395,049,687
Total liabilities	<u>1,726,509,414</u>	<u>1,401,481,823</u>	<u>1,441,764,669</u>
Total net position – unrestricted	<u>\$ (760,493,339)</u>	<u>\$ (643,386,717)</u>	<u>\$ (455,695,432)</u>

The Authority issued new bonds in 2013, totaling \$330 million. The bond issuance was the primary cause for the increase in total liabilities of \$325 million in 2013, net of the principal payments made during the year on the Authority's long-term debt liabilities. The issuance of the 2013 bonds is also the primary reason for the increase of \$208 million in total assets, net of grant disbursements, and transfers to the Commonwealth, and other Commonwealth component units. Due to the nature of economic development grants and loans, some of which require drawdowns, funding not immediately disbursed upon Board approval is held as cash, cash equivalents, or authorized investments.

In 2012, total liabilities decreased by \$40 million as a result of no new debt issuances and principal payments made on existing debt. The decrease in total assets of \$228 million in 2012 can be attributed to transfers of \$9 million to other Commonwealth agencies, as well as disbursements of \$249 in the form of grants during 2012.

The significant decrease in the total net position in 2013 is attributable to the \$168 million in Authority assets disbursed in the form of grants, \$20 million in assets transferred to the Commonwealth, and other Commonwealth component units, and interest expense of \$81 million on the Authority's outstanding bonds; offset by transfers of \$27 million of gaming monies from the Commonwealth to fund approved projects, and transfers of \$120 million from the Commonwealth for debt service payments related to the Authority's outstanding bonds. The transfer of bond proceeds to these Governmental entities was prescribed by legislation. As an authority under which economic stimulus programs are established, grants and transfers to other governmental entities are essential to achieve its mission.

Since inception, the Authority has issued ten revenue bonds totaling \$1.872 billion. The Authority has a service agreement with the Commonwealth of Pennsylvania for the payment of the annual debt service through an annual appropriation by the Commonwealth, and transfers from the Gaming Economic Development Tourism Fund. However, there is no assurance that there will be sufficient funds appropriated annually by the Commonwealth.

Condensed Statements of Revenues, Expenses, and Changes in Net Position

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Operating income	\$ 10,386,165	\$ 10,590,538	\$ 8,449,239
Operating expenses	(174,089,439)	(252,807,470)	(219,374,693)
Provision for loan losses	98,046	(4,988,366)	(423,549)
Net Nonoperating revenues	<u>46,498,606</u>	<u>59,514,013</u>	<u>42,700,997</u>
Decrease in net position	<u>\$ (117,106,622)</u>	<u>\$ (187,691,285)</u>	<u>\$ (168,648,006)</u>

In 2013, operating expenses decreased by \$79 million due to a decrease of \$81 million in grant disbursements and offset slightly by \$2 million increase in loan guarantee expense. The decrease in net nonoperating revenues can be attributed to additional interest expense of \$4 million related to the 2013 bond issuances, as well as an increase of \$9 million in net transfers to the Commonwealth and related component units.

Commonwealth Financing Authority
(Component Unit of the Commonwealth of Pennsylvania)
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Financial Statements for the Year Ended June 30, 2013

Page 5

In 2012, operating income increased by \$2 million as compared to 2011. The increase is attributed to increased interest on loans and venture capital investments.

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, investors and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. If you have questions about this report or need additional information, contact the Commonwealth Financing Authority, 400 North Street, Fourth Floor, Harrisburg, PA 17120.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF NET POSITION
JUNE 30, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 629,209,439	\$ 420,093,530
Receivables:		
Loans (net)	17,041,572	18,152,055
Accrued interest	1,815,165	1,483,188
Unamortized bond issuance costs, net	<u>12,343,654</u>	<u>10,964,813</u>
Total Current Assets	<u>660,409,830</u>	<u>450,693,586</u>
Non-current assets:		
Long-term portion of loans receivable (net)	<u>305,606,245</u>	<u>307,401,520</u>
Total Non-current Assets	<u>305,606,245</u>	<u>307,401,520</u>
Total Assets	<u>966,016,075</u>	<u>758,095,106</u>
LIABILITIES		
Current Liabilities:		
Accrued interest payable	12,167,546	6,235,521
Accounts payable and accrued expenses	-	16,000
Due to primary governments - DCED	414,948	555,857
Current portion of long-term debt	<u>55,870,000</u>	<u>50,210,000</u>
Total Current Liabilities	<u>68,452,494</u>	<u>57,017,378</u>
Non-current Liabilities:		
Long-term debt, net of current portion and unamortized bond premium and discount	<u>1,658,056,920</u>	<u>1,344,464,445</u>
Total Noncurrent Liabilities	<u>1,658,056,920</u>	<u>1,344,464,445</u>
Total Liabilities	<u>1,726,509,414</u>	<u>1,401,481,823</u>
TOTAL NET POSITION - UNRESTRICTED	<u>\$ (760,493,339)</u>	<u>\$ (643,386,717)</u>

See accompanying notes to the financial statements

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
YEARS ENDED JUNE 30, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
Operating Income		
Interest on loans	\$ 7,531,547	\$ 6,870,547
Interest on investments	1,127,996	1,462,859
Fee income	145,309	417,953
Interest from venture capital loan	1,553,580	1,839,179
Other Income	<u>27,733</u>	<u>-</u>
Operating Revenues before Provision for Loan Losses	<u>10,386,165</u>	<u>10,590,538</u>
Provision for loan losses	<u>(98,046)</u>	<u>4,988,366</u>
Net Operating Revenues	<u>10,484,211</u>	<u>5,602,172</u>
Operating Expenses		
Administrative/operating expense	2,915,586	2,902,175
Grant expense	167,900,238	248,546,667
Loan guarantee expense	2,734,748	1,191,529
Other	<u>538,867</u>	<u>167,099</u>
Total Operating Expenses	<u>174,089,439</u>	<u>252,807,470</u>
Operating Loss	<u>(163,605,228)</u>	<u>(247,205,298)</u>
Nonoperating Income (Expenses)		
Transfers in from primary government	147,021,780	145,170,304
Interest on bonds	(80,758,277)	(76,389,516)
Amortization of bond premium/discount	913,803	375,242
Amortization of bond issuance costs	(678,700)	(642,017)
Transfer to other Commonwealth component units	(6,000,000)	(8,000,000)
Transfers to primary government	<u>(14,000,000)</u>	<u>(1,000,000)</u>
Total Nonoperating Revenues	<u>46,498,606</u>	<u>59,514,013</u>
Decrease in net position	(117,106,622)	(187,691,285)
Net Position - Beginning of Year	<u>(643,386,717)</u>	<u>(455,695,432)</u>
Net Position - End of Year	<u>\$ (760,493,339)</u>	<u>\$ (643,386,717)</u>

See accompanying notes to the financial statements

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
Cash Flows from Operating Activities:		
Loan and fee receipts from customers	\$ 39,826,679	\$ 38,531,154
Loan disbursements made to customers	(28,463,283)	(37,965,703)
Interest on investments	1,127,996	1,462,859
Cash paid for operating expenses	(3,072,495)	(2,994,578)
Cash paid for grant expenses	(167,900,238)	(248,546,667)
Cash paid for loan guarantees	(2,734,748)	(1,191,529)
Other cash receipts	27,733	-
	<u>(161,188,356)</u>	<u>(250,704,464)</u>
Net Cash Used In Operating Activities		
Cash Flows from Noncapital Financing Activities:		
Proceeds from bonds payable	330,000,000	-
Transfer to primary government and other Commonwealth component units	(20,000,000)	(9,000,000)
Transfer from primary government	147,021,780	146,400,386
Bond Premium	40,376,278	-
Bond Issue Costs	(2,057,541)	-
Principal payments on bonds payable	(50,210,000)	(39,285,000)
Interest on bonds payable	(74,826,252)	(76,531,637)
	<u>370,304,265</u>	<u>21,583,749</u>
Net Cash Provided By Noncapital Financing Activities		
Increase (Decrease) In Cash And Cash Equivalents	<u>209,115,909</u>	<u>(229,120,715)</u>
Cash and Cash Equivalents, Beginning of Year	<u>420,093,530</u>	<u>649,214,245</u>
Cash and Cash Equivalents, End of Year	<u>\$ 629,209,439</u>	<u>\$ 420,093,530</u>
Reconciliation of Operating Income to Net Cash Used In Operating Activities:		
Operating Loss	\$ (163,605,228)	\$ (247,205,298)
Adjustments to reconcile operating income to net cash used in operating activities:		
Effect of changes in operating assets and liabilities:		
Loan disbursements	(27,924,416)	(37,410,524)
Loan repayments	30,810,079	29,319,589
Loan escrow deposits	-	(388,080)
Accrued interest receivable	(331,977)	(287,537)
Loan origination costs	118,141	353,135
Allowance for loan losses	(98,046)	4,988,366
Penalties/late fees	-	18,288
Accounts payable, accrued expenses, and due to primary government	(156,909)	(92,403)
Net Cash Used In Operating Activities	<u>\$ (161,188,356)</u>	<u>\$ (250,704,464)</u>
Supplemental Disclosure of Cash Flow Information		
Noncash Noncapital Financing Activities:		
Amortization of bond premium/discount (net)	\$ (913,803)	\$ (375,242)
Amortization of bond issuance costs	678,700	642,017
Total Noncash Noncapital Financing Activities	<u>\$ (235,103)</u>	<u>\$ 266,775</u>

See accompanying notes to the financial statements

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2013 AND 2012

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization

The Commonwealth Financing Authority ("the Authority") is a body corporate and politic duly organized by the Commonwealth of Pennsylvania ("the Commonwealth") incorporated under the Public Authorities and Quasi-Public Corporations Act of 2004 (Act), being the Act of April 1, 2004, P.L. 163, as amended by the Commonwealth of Pennsylvania. The Authority, by virtue of the Act and its articles of incorporation, has all powers as set forth in the Act including those for creation and retention of jobs. The purpose of the Authority is to engage in financial assistance in the form of loans, loan guarantees, grants and private equity participating loans to promote activities which lead to the use of alternative and clean energy, the creation and retention of jobs within the Commonwealth of Pennsylvania, the establishment of economically viable Pennsylvania communities, the development of a stable tax base within Pennsylvania communities, the reuse of abandoned industrial, commercial and other previously utilized sites, the promotion and commercialization of Pennsylvania products and services and investment of private capital in Pennsylvania communities to promote the health, safety, employment, business opportunities, economic activity and general welfare of the people of the Commonwealth.

The Commonwealth appoints the members of the Authority's governing board. The Commonwealth maintains the accounts and records of the Authority. In addition the Commonwealth employs and supervises personnel to provide administrative services. Therefore, the Authority is considered a component unit of the Commonwealth of Pennsylvania.

The legislation creating the Authority as well as program specific guidelines establishes certain activities to be carried out by the Authority as follows:

- Business in Our Sites Program: provides financial assistance for preparation of sites for future development.
- First Industries Program: provides financial assistance for projects related to tourism and agriculture.
- Second Stage Loan Program: provides loan guarantees to commercial lending institutions that make loans to life sciences, advanced technology or manufacturing businesses.
- New Pennsylvania Venture Guarantee Program: provides guarantees to venture capital partnerships for investments in Pennsylvania-related companies which are in early-stage or mid-stage development.
- Building Pennsylvania Program: provides loans to fund managers for investment in real estate projects in Pennsylvania.
- Tax Increment Financing "TIF" Guarantee Program: provides guarantees for TIF bonds or other indebtedness in accordance with the TIF Act of 1990.
- New Pennsylvania Venture Capital Investments Program: provides loans to Venture Capital partnerships for investment in Pennsylvania companies.
- Penn Works Program: provides grants and loans for water supply and wastewater infrastructure within Pennsylvania.
- H₂O PA Program (Water and Sewer): provides for single-year or multi-year grants to municipalities or municipal authorities to assist with the construction of flood control projects, drinking water, sanitary sewer and storm sewer projects, and the repair of high hazard unsafe dams.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2013 AND 2012

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

A. Organization (Continued)

- Solar Energy Program: provides financial assistance in the form of grant and loan funds to promote the generation and use of solar energy and the manufacture or assembly of solar equipment.
- Renewable Energy Program: provides financial assistance in the form of grant and loan funds to promote the use of wind and geothermal energy.
- Alternative and Clean Energy Program: provides grant and loan funds to encourage the implementation of alternative energy production projects and clean energy projects.
- High Performance Buildings: provides grants and loans for the construction of energy efficient buildings.
- Local Share Account: provides grants to support and enhance community and economic well-being and mitigate the impact of gaming and related activities.
- Act 13 Program: provides grants for flood mitigation, orphaned and abandoned well plugging, greenways trails and recreation, watershed restoration and protection, abandoned mine drainage abatement and treatment, and baseline water quality projects.

B. Measurement Focus and Basis of Accounting

The Authority follows Generally Accepted Accounting Principles (GAAP). GAAP allows specialized accounting for government entities, which is governed by pronouncements set by the Governmental Accounting Standards Board (GASB). Pronouncements set by the GASB may differ from pronouncements set by the Financial Accounting Standards Board (FASB).

The Authority is considered a special-purpose government since it is engaged solely in business-type activities under GASB Statement No. 34. The Authority's financial statements are prepared using the economic resources measurement focus and accrual basis of accounting. Under the accrual basis of accounting revenues are recorded when earned and expenses are recorded when they have been incurred. The statements are intended to report the Authority as an economic unit that includes all measurable assets and liabilities, financial and capital, of the Authority.

All activities of the Authority are accounted for within a single proprietary (enterprise) fund. A proprietary fund is used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination or revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The Authority follows the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis*. Within the Statements of Revenues, Expenses and Changes in Net Position, Statement No. 34 requires operating income and expenses to be separated from non-operating income in order to report net operating income or loss. Operating income and expenses are defined as those activities directly related to the Authority's primary business of providing employment through economic development lending. Non-operating revenues and expenses consist of those revenues and expenses that are related to financing and investing types of activities and result from non-exchange transactions, such as investment income/loss.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2013 AND 2012

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Cash and Cash Equivalents

Cash and cash equivalents, for the purposes of the Statement of Cash Flows, include cash on hand or on deposit in highly liquid financial debt instruments with a maturity of three months or less at the date of purchase.

D. Allowance for Loan Losses

The allowance for loan losses is a reserve account for possible future loan losses. Provision for loan losses is credited to the allowance account. Loan losses which are charged-off and recoveries of previously charged-off loans are charged or credited directly to the allowance account. The provision for loan losses is adjusted monthly at the rate of 2% of outstanding loan balances at the respective month-end.

E. Interest Income

Interest income on cash equivalents and loans are recorded when earned.

Uncollectible interest on loans that are contractually past due is charged off, or an allowance established based on management's periodic evaluations. The allowance is established by a charge-to-interest income equal to all previously accrued, and income is subsequently recognized only to the extent that cash payments are received until, in management's judgment, the borrower's ability to make periodic interest and principal payments is back to normal.

In addition to fixed interest arrangements, some loans contain provisions which provide lump sum interest payments based upon certain conditions being met. The additional income is recognized when earned.

F. Loan Origination Fees and Costs

The Authority recognizes loan origination fees and costs in accordance with GASB Statement No. 62 "*Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*".

For the years ended June 30, 2013 and 2012, (\$160,706) and (\$42,565), respectively, of net deferred fees are included in loans receivable.

G. Bond Issuance Costs

Bond issuance costs consist of legal, underwriting and other fees charged in connection with the issuance of bond debt. The costs are amortized over the lives of the bonds, which range from 20 to 30 years. The bonds mature through 2042. Amortization was \$678,700 and \$642,017 for the years ended June 30, 2013 and 2012, respectively.

H. Utilization of Resources

When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first, then unrestricted resources as needed.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2013 AND 2012

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

I. Bond Premium and Discount

The difference between the cash received from bondholders at issuance and the principal amount due to bondholders at maturity is recognized as bond premium or discount. Bond premium or discount is amortized using the straight-line method over the lives of the bonds issued, which approximates the interest method.

J. Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Accordingly, actual results could differ from those estimates.

K. Reclassifications

For comparative purposes, certain prior year financial statement amounts have been reclassified to conform to the current year presentation.

L. Adoption of Governmental Accounting Standards Board Statements

The Authority adopted the requirements of GASB Statement No. 60, "*Accounting and Financial Reporting for Service Concession Arrangements*". The adoption of this statement had no effect on previously reported amounts.

The Authority adopted the requirements of GASB Statement No. 61 "*The Financial Reporting Entity Omnibus-an amendment of GASB Statements No. 14 and No. 34*". The adoption of this statement had no effect on previously reported amounts.

The Authority adopted the requirements of GASB Statement No. 62, "*Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*". The adoption of this statement had no effect on previously reported amounts.

The Authority adopted the requirements of GASB Statement No. 63, "*Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*". The adoption of this statement resulted in replacing the term "net assets" with the term "net position".

M. Pending Changes in Accounting Principles

In March 2012, the GASB issued a Statement No. 65, "*Items Previously Reported as Assets and Liabilities*". The Authority is required to adopt statement No. 65 for its fiscal year 2014 financial statements.

In March 2012, the GASB issued a Statement No. 66, "*Technical Corrections – 2012 – An Amendment of GASB Statements No. 10 and No. 62*". The Authority is required to adopt statement No. 66 for its fiscal year 2014 financial statements.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2013 AND 2012

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

M. Pending Changes in Accounting Principles (Continued)

In June 2012, the GASB issued a Statement No. 67, "*Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25*". The Authority is required to adopt statement No. 67 for its fiscal year 2014 financial statements.

In June 2012, the GASB issued a Statement No. 68, "*Accounting and Financial Reporting – an amendment of GASB Statement No. 27*". The Authority is required to adopt statement No. 68 for its fiscal year 2015 financial statements.

In January 2013, the GASB issued a Statement No. 69, "*Government Combinations and Disposals of Government Operations*". The Authority is required to adopt statement No. 69 for its fiscal year 2015 financial statements.

In April 2013, the GASB issued a Statement No. 70, "*Accounting and Financial Reporting for Nonexchange Financial Guarantees*". The Authority is required to adopt statement No. 70 for its fiscal year 2014 financial statements.

The Authority has not yet completed the various analyses required to estimate the financial statement impact of these new pronouncements.

NOTE 2: FINANCIAL SUPPORT

The Authority reported a deficit net position of \$760,493,339 and \$643,386,717 as of June 30, 2013 and 2012, respectively. The Authority's business purpose will result in continued losses from operation due to the disbursement of grant awards to help promote economic growth in the Commonwealth. In addition, the Authority transferred part of its bond proceeds to the Commonwealth Department of Environmental Protection and the Ben Franklin Technology Development Authority in the current year and in prior years to the Commonwealth for the Machinery and Equipment Loan Fund (MELF) program, which contributed to the deficit in net position.

Through a service agreement with the Authority, the Commonwealth has pledged to seek annual appropriations to pay the Authority's annual debt service obligations. Therefore, factors listed above do not raise doubt as to the Authority's ability to meet obligations when due.

NOTE 3: CASH AND CASH EQUIVALENTS

Custodial Credit Risk

Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits or investments may not be returned to it. The Authority does not have a deposit or investment policy for custodial credit risk. As of June 30, 2013 and 2012, due to the nature of the cash and cash equivalents balances, there is no custodial credit risk.

Additionally, due to the short-term maturity of the cash equivalents, there is limited interest rate risk.

NOTE 4: LOANS RECEIVABLE

The Authority provides loans, in accordance with its enabling legislation and statutory requirements to spur economic development activity within the Commonwealth of Pennsylvania. The loans have amortization periods not to exceed 20 years and bear interest at rates ranging from 1% to 8% depending on the nature of the loan and the Authority program from which the loan was funded.

The Authority, through the New Venture Capital Investment Program, provides loans to venture capital partnerships for investments in Pennsylvania-related companies.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2013 AND 2012

NOTE 4: LOANS RECEIVABLE (CONTINUED)

At June 30, 2013 and 2012, the outstanding balance of loans receivable were as follows:

	2013		
	Current Portion	Long-term Portion	Total
Loan receivable	\$ 17,407,845	\$ 316,875,745	\$ 334,283,590
Deferred loan origination fees - net	(18,116)	(142,590)	(160,706)
Allowance for loan losses	(348,157)	(11,126,910)	(11,475,067)
Balance, end of year	<u>\$ 17,041,572</u>	<u>\$ 305,606,245</u>	<u>\$ 322,647,817</u>

	2012		
	Current Portion	Long-term Portion	Total
Loan receivable	\$ 18,524,920	\$ 318,644,333	\$ 337,169,253
Deferred loan origination fees - net	(2,367)	(40,198)	(42,565)
Allowance for loan losses	(370,498)	(11,202,615)	(11,573,113)
Balance, end of year	<u>\$ 18,152,055</u>	<u>\$ 307,401,520</u>	<u>\$ 325,553,575</u>

An analysis of the allowance for loan losses for the years ended June 30, 2013 and 2012 is as follows:

	2013	2012
Balance, beginning of year	\$ 11,573,113	\$ 6,584,747
Provision for loan losses	(98,046)	4,988,366
Balance, end of year	<u>\$ 11,475,067</u>	<u>\$ 11,573,113</u>

NOTE 5: BONDS PAYABLE

Changes in long-term liabilities for the year ended June 30, 2013:

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Economic revenue bonds	\$ 1,387,990,000	\$ 330,000,000	\$ (50,210,000)	\$ 1,667,780,000	\$ 55,870,000
Bond premium	7,766,941	40,376,278	(971,741)	47,171,478	-
Bond discount	(1,082,496)	-	57,938	(1,024,558)	-
Total	<u>\$ 1,394,674,445</u>	<u>\$ 370,376,278</u>	<u>\$ (51,123,803)</u>	<u>\$ 1,713,926,920</u>	<u>\$ 55,870,000</u>

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2013 AND 2012

NOTE 5: BONDS PAYABLE (CONTINUED)

Changes in long-term liabilities for the year ended June 30, 2012:

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Economic revenue bonds	\$ 1,427,275,000	-	\$ (39,285,000)	\$ 1,387,990,000	\$ 50,210,000
Bond premium	8,200,123	-	(433,182)	7,766,941	-
Bond discount	(1,140,436)	-	57,940	(1,082,496)	-
Total	<u>\$ 1,434,334,687</u>	<u>\$ -</u>	<u>\$ (39,660,242)</u>	<u>\$ 1,394,674,445</u>	<u>\$ 50,210,000</u>

	2013	2012
Series 2013 Revenue Bonds, issued \$75,000,000 fixed rate, taxable revenue bonds, Series A-1 and \$48,000,000, fixed rate, tax-exempt revenue bonds, Series A-2 at 0.545% - 5.0%, interest payable semi-annually and principle payable annually through June 1, 2033	\$ 123,000,000	-
Series 2013 Revenue Bonds, issued \$207,000,000 fixed rate, tax-exempt revenue bonds, Series B at 2% - 5%, interest payable semi-annually and principle payable annually through June 1, 2042	207,000,000	-
Series 2010 Revenue Bonds, issued \$53,080,000 fixed rate, tax-exempt revenue bonds, Series C-1 and \$96,920,000, fixed rate, federal taxable revenue bonds, Series C-2 at 2% - 3.4%, interest payable semi-annually and principle payable annually through June 1, 2040.	\$ 142,200,000	\$ 145,145,000
Series 2010 Revenue Bonds, issued \$62,000,000 fixed rate, federal taxable revenue bonds, Series A and \$80,000,000 fixed rate, tax-exempt revenue bonds, Series B at .93% - 5.5%, interest payable semi-annually and principal payable annually through May 1, 2039.	\$ 129,940,000	\$ 134,260,000
Series 2009 Revenue Bonds, issued \$400,000,000 fixed rate, federally taxable revenue bonds, Series D at 3.4% - 5.1%, interest payable semi-annually and principal payable annually through May 1, 2039.	\$ 390,780,000	\$ 400,000,000
Series 2009 Revenue Bonds, issued \$50,000,000 fixed rate, federal taxable revenue bonds, Series A and \$50,000,000 fixed rate, tax-exempt revenue bonds, Series B at 3.0% - 6.4%, interest payable semi-annually and principal payable annually through June 1, 2031.	\$ 91,345,000	\$ 94,330,000

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2013 AND 2012

NOTE 5: BONDS PAYABLE (CONTINUED)

	2013	2012
Series 2008 Revenue Bonds, issued \$187,500,000 fixed rate, federally taxable revenue bonds, Series A at 3.1% - 5.2%, interest payable semi-annually and principal payable annually through June 1, 2027.	\$ 155,160,000	\$ 162,540,000
Series 2006 Revenue Bonds, issued \$187,500,000 fixed rate, federally taxable revenue bonds, Series C at 4.9% - 5.2%, interest payable semi-annually and principal payable annually through June 1, 2026.	\$ 145,915,000	\$ 153,715,000
Series 2006 Revenue Bonds, issued \$45,000,000 fixed rate, tax exempt revenue bonds, Series A and \$142,500,000 fixed rate, federal taxable revenue bonds, Series B at 4.5% - 5.6%, interest only payable semi-annually through June 1, 2026 and principal payable annually through June 1, 2026.	\$ 144,265,000	\$ 151,690,000
Series 2005 Revenue Bonds, issued \$62,500,000 fixed rate, tax exempt revenue bonds, Series A and \$125,000,000 fixed rate, federally taxable revenue bonds, Series B at 4.5% - 5.3%, interest payable semi-annually and principal payable annually through June 1, 2025.	\$ 138,175,000	\$ 146,310,000
Total Bonds Payable - Principle	\$ 1,667,780,000	\$ 1,387,990,000
Less current portion	(55,870,000)	(50,210,000)
Unamortized bond premium	47,171,478	7,766,941
Unamortized bond discount	(1,024,558)	(1,082,496)
	\$ 1,658,056,920	\$ 1,344,464,445

Bond payable requirements subsequent to June 30, 2013 are as follows:

	Principal Maturities	Interest
For the Years Ending June 30,		
2014	\$ 55,870,000	\$ 92,016,458
2015	63,250,000	84,505,129
2016	65,890,000	81,737,217
2017	68,735,000	78,730,529
2018	71,850,000	75,451,419
2019-2023	415,140,000	318,228,516
2024-2028	396,820,000	203,503,214
2029-2033	252,990,000	119,607,249
2034-2038	188,745,000	58,038,540
2039-2042	88,490,000	9,131,496
Total	\$ 1,667,780,000	\$ 1,120,949,767

COMMONWEALTH FINANCING AUTHORITY
 (COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 YEARS ENDED JUNE 30, 2013 AND 2012

NOTE 5: BONDS PAYABLE (CONTINUED)

Bond payable requirements subsequent to June 30, 2012 are as follows:

For the Years Ended June 30,	<u>Principal Maturities</u>	<u>Interest</u>
2013	\$ 50,210,000	\$ 74,826,251
2014	52,290,000	72,954,021
2015	54,570,000	70,585,946
2016	57,025,000	68,054,367
2017	59,655,000	63,509,188
2018-2022	345,920,000	267,066,553
2023-2027	379,345,000	161,328,847
2028-2032	184,950,000	88,431,574
2033-2037	134,305,000	42,306,537
2038-2040	69,720,000	4,985,390
Total	<u>\$ 1,387,990,000</u>	<u>\$ 914,048,674</u>

The 2013A Bonds were issued to provide additional funding for the Alternative Energy Development Program established under the Alternative Energy Investment Act, and other Project Costs for program-related administration, and to pay the costs of issuing the 2013A Bonds. The bonds were issued at a premium of \$7,900,243 and had issuance costs of \$807,407. Specific terms of the Bonds can be found in the previous tables.

The 2013B Bonds were issued to provide additional funds for grants to be used to fund water and sewer projects, storm water projects, flood control projects and high hazard unsafe dam projects (the "H2O Grant Program") pursuant to the H2O PA Act, and other Project Costs for program-related administration, and to pay the costs of issuing the 2013B Bonds. The bonds were issued at a premium of \$32,476,035 and had issuance costs of \$1,250,134. Specific terms of the Bonds can be found in the previous tables.

The Authority, with Commonwealth approval, issued the above noted revenue bonds to fund the activities of the Authority. Repayments with respect to the revenue bonds are derived solely from project revenues which are defined as annual appropriations and transfers by the Commonwealth per the Official Statement. The Revenue Bonds described above are limited obligations of the Authority and are considered non-recourse, as the Authority is not obligated to bondholders beyond amounts received by the Authority from annual appropriations and transfers to the Authority by the Commonwealth. The Commonwealth has not pledged its full faith and credit nor the taxing power of the Commonwealth or any political subdivision for the payment of the Authority's Revenue Bonds and the payments by the Commonwealth to the Authority are subject to annual appropriation and transfers of funds for such purposes by the General Assembly and there is no assurance that such funds will be appropriated in any fiscal year. Repayments of loans do not constitute project revenues.

NOTE 6: RELATED PARTY TRANSACTIONS

The Authority entered into an agreement with the Commonwealth of Pennsylvania, through the Department of Community and Economic Development (DCED) and the Department of Environmental Protection (DEP) to provide administrative and operational support services for the Authority. The Authority owns no capital assets; the employees performing services for the Authority are DCED employees. As such, under the Memorandum of Understanding, the Authority reimburses DCED for services rendered by DCED employees to the Authority. During the fiscal years ended June 30, 2013 and 2012, the services provided by DCED and DEP to the Authority and recorded as Administrative/Operating expenses totaled \$2,604,614 and \$2,902,175, respectively.

COMMONWEALTH FINANCING AUTHORITY
(COMPONENT UNIT OF COMMONWEALTH OF PENNSYLVANIA)
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED JUNE 30, 2013 AND 2012

NOTE 6: RELATED PARTY TRANSACTIONS (CONTINUED)

During the fiscal years ended June 30, 2013 and 2012, the Authority received \$119,534,974 and \$115,816,425, respectively, in transfers from the Commonwealth to pay debt services with respect to Revenue Bonds. See Note 5 for details with respect to the Revenue Bonds.

The Authority also received \$27,486,806 and \$29,353,879 in gaming monies from the Commonwealth to fund approved projects in select areas of the state in the fiscal years ended June 30, 2013 and 2012, respectively.

The Authority transferred part of its bond proceeds to the Commonwealth Department of Environment Protection and the Ben Franklin Technology Development Authority totaling \$20,000,000 and \$9,000,000 for the fiscal years ending June 30, 2013 and 2012, respectively.

NOTE 7: LINE OF CREDIT

In December 2009, the Authority entered into a secured line of credit with the Commonwealth of Pennsylvania Treasury Department, which, under a revolving credit agreement, is limited to borrowings of \$50,000,000. Under the revolving credit agreement, interest accrues on the aggregate unpaid principle amount outstanding on the draws. The interest rate is the greater of the rate of the United States Federal Funds Target Rate plus 75 basis points or the rate set by the British Bankers Association for London Interbank Offered Rate (LIBOR) for a six month term in United States dollars plus 45 basis points. The interest rate is reset as of the 20th of each month. The line of credit expired as of December 28, 2011, the Authority did not extend or obtain a new line of credit.

NOTE 8: COMMITMENTS AND CONTINGENCIES

The Authority, through various economic development programs, provided loan guarantees as follows:

	2013	2012
First Industries loan guarantees	\$ 48,735,633	\$ 47,625,633
Tax increment financing gaurantees	43,500,000	38,500,000
Second stage loan gaurantees	3,360,000	1,485,000
Venture capital gaurantees	197,500,000	197,500,000
Total Loan Gaurantees	<u>\$ 293,095,633</u>	<u>\$ 285,110,633</u>

The Authority has been called upon, from time to time with respect to loan guarantees, to make principal or interest payments on behalf of the ultimate borrowers. Accordingly, expenses totaling \$2,734,748 and \$1,191,529, have been reported in the Authority's financial statements for loan guarantees as of June 30, 2013 and 2012, respectively.

Through various Authority loan and grant programs to promote economic development within the Commonwealth of Pennsylvania, the Authority has approved loans, and grants of \$83,161,378 and \$229,487,944, respectively, which have not been disbursed as of June 30, 2013.

Zelenkofske Axelrod LLC

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

Board of Directors
Commonwealth Financing Authority
Harrisburg, Pennsylvania

We have audited, 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, the financial statements of the business-type activities of the COMMONWEALTH FINANCING AUTHORITY ("the AUTHORITY"), a component unit of the Commonwealth of Pennsylvania, as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the AUTHORITY's basic financial statements and have issued our report thereon dated October 2, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Authority's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the AUTHORITY's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Zelenkofske Axelrod LLC

ZELENKOFSCHE AXELROD LLC

Harrisburg, Pennsylvania
October 2, 2013

<u>Harrisburg</u>	<u>Lehigh Valley</u>	<u>Philadelphia</u>	<u>Pittsburgh</u>
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[Pa.B. Doc. No. 14-575. Filed for public inspection March 14, 2014, 9:00 a.m.]

