

PENNSYLVANIA TURNPIKE COMMISSION
A COMPONENT UNIT OF THE COMMONWEALTH OF PENNSYLVANIA

Comprehensive Annual Financial Report

Fiscal years ended May 31, 2004 and 2003

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Pennsylvania Turnpike Commission
A Component Unit of the Commonwealth of Pennsylvania

Comprehensive Annual Financial Report

Fiscal years ended May 31, 2004 and 2003

Prepared by:

Sharon S. Jones, Senior General Accountant
Gina E. Sheller, Manager of General Accounting
Anthony Q. Maun, Director of Accounting and Payroll

Robert J. Smith, Director of Finance

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Fiscal years ended May 31, 2004 and 2003

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Introductory Section

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November 8, 2004

To the Bondholders of the Pennsylvania Turnpike Commission:

Introduction

The comprehensive annual financial report of the Pennsylvania Turnpike Commission (Commission) for the fiscal year ended May 31, 2004, is hereby submitted. Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the Commission. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position, results of operations, and cash flows of the Commission. All disclosures necessary to enable the reader to gain an understanding of the Commission's financial activities have been included.

The comprehensive annual financial report is presented in three sections: introductory, financial, and statistical. The introductory section includes this transmittal letter, the Commission's organization chart, a list of principal officials, and the 2003 Certificate of Achievement. The financial section includes the independent auditors' report on the financial statements, management's discussion and analysis (MD&A), and the financial statements. The statistical section includes selected financial, traffic, technical, and chronological information, generally presented on a multiyear basis.

The MD&A is required by GAAP and serves as an introduction to the Commission's basic financial statements. It includes an overview and analysis of the financial activities for the year ended May 31, 2004 and should be read in conjunction with the Commission's basic financial statements. Likewise, this letter of transmittal is designed to complement the MD&A, which can be found immediately following the report of the independent auditors.

The Pennsylvania Turnpike Commission was created as an instrumentality of the Commonwealth of Pennsylvania on May 21, 1937, with powers to construct, operate, and maintain the Turnpike System, and to issue Turnpike revenue bonds, repayable solely from tolls and other Commission revenues. The Commission is considered a component unit of the Commonwealth of Pennsylvania and presents its financial statements on the accrual basis of accounting. There were no other entities that would potentially qualify for inclusion in the Pennsylvania Turnpike Commission's financial reporting entity under accounting principles generally accepted in the United States.

In evaluating how to define the Commission for financial reporting purposes, management has considered all potential component units in accordance with Government Accounting Standards Board (GASB) Statement No. 14, *The Reporting Entity*. GASB No. 14 defines the reporting entity as the primary government and those component units for which the primary government is financially accountable. Based on the Commission's review of GASB No. 14, the Commission believes it has no component units.

The Commission consists of five members, one of whom is the Commonwealth of Pennsylvania's Secretary of Transportation. The other four are appointed for four-year terms by the Governor with the approval of a two-thirds majority of the Senate.

Turnpike System

The present Pennsylvania Turnpike System is composed of a 360-mile mainline section traversing the southern portion of Pennsylvania from east to west identified as the Turnpike Mainline and a 110-mile north-south section identified as the Northeast Extension. A north-south connection, known as the Beaver Valley Expressway, is approximately 16 miles in length and intersects the Turnpike Mainline. The Amos K. Hutchinson Bypass is approximately 13 miles in length and adjoins the Turnpike Mainline near the New Stanton Interchange. In addition, an initial six-mile section of the Mon/Fayette Project was opened as part of the Pennsylvania Turnpike System in 1990, the eight-mile Mason-Dixon link of the Mon/Fayette Expressway was opened on March 1, 2000 and a four-mile section, from Interstate 70 to Coyle Curtain Road, was opened on May 11, 2001. A 13-mile section of the Mon/Fayette Expressway, connecting I-70 to SR 51, was opened in April 2002. When completed, the Mon/Fayette Expressway will extend from Interstate Route 68 in West Virginia to Interstate Route 376 near Pittsburgh, a distance of 65 miles.

The Turnpike Mainline connects with the Ohio Turnpike at its western terminus and with the New Jersey Turnpike at its eastern terminus. Its total length is approximately 360 miles. The Turnpike Mainline commences on the eastern boundary of Pennsylvania at the Delaware River Bridge, which connects the Pennsylvania Turnpike System to the New Jersey Turnpike. The Turnpike Mainline traverses the state in a westerly direction generally paralleling the southern border of the state immediately north of Philadelphia and south of Harrisburg to the vicinity of Somerset. West of Somerset, the highway follows a northwesterly direction to the northeast of Pittsburgh and to the Ohio state line, south of Youngstown, Ohio.

The Northeast Extension is approximately 110 miles in length and connects the Turnpike Mainline and the area north of Scranton. The Northeast Extension meets the Turnpike Mainline at a point north of Plymouth Meeting and traverses the eastern portion of Pennsylvania in a northerly direction through Allentown and Scranton to its northern terminus where it connects with U.S. Route 6 and Interstate Route 81.

The Pennsylvania Turnpike was constructed prior to development of the National Interstate Highway System; however, portions have been designated as Interstate Routes. The Turnpike Mainline has been designated as Interstate Route 276 between the Valley Forge Interchange, Exit 326 and the Delaware River Bridge, Exit 359. The portion of the Turnpike Mainline west of the Valley Forge Interchange to the western terminus at the Ohio State line has been designated as Interstate Route 76. In addition, the Turnpike Mainline segment between the New Stanton and Breezewood Interchanges, Exits 75 through 161, respectively, has been designated as Interstate Route 70/76. The Northeast Extension has recently been designated as Interstate Route 476. No Federal Highway Trust Fund monies have been used for the construction of the Turnpike Mainline, Northeast Extension, Beaver Valley Expressway or the Amos K. Hutchinson Bypass sections of the Turnpike.

The Pennsylvania Turnpike System was constructed and opened to traffic in sections. The original Turnpike Mainline section between Irwin and Carlisle, Exits 67 through 226, respectively, was opened in 1940. Ten years later, in 1950, the 100-mile section between Carlisle and King of Prussia, Exits 226 through 326, was completed and opened for traffic. After 1950, construction of new sections of the Pennsylvania Turnpike System occurred at more frequent intervals with the Turnpike Mainline segment in service as of May 1956. The initial section of the Northeast Extension between the Turnpike Mainline and the temporary interchange just south of the Lehigh Tunnel was opened in 1955. The final section, from such interchange to Scranton, was completed and opened for traffic in November 1957.

The Delaware River Bridge, which connects the Turnpike Mainline with the New Jersey Turnpike System, is owned jointly by the Pennsylvania Turnpike Commission and the New Jersey Turnpike Authority and was opened for traffic in May 1956.

The Pennsylvania Turnpike Commission opened E-ZPass for passenger vehicles on December 2, 2000 in southeastern and south central Pennsylvania. E-ZPass is a comprehensive electronic toll collection system that allows account holders to pass through designated toll lanes at Commission facilities without stopping to pay a toll collector. The process begins with customers opening accounts with a customer service center offering E-ZPass. The customers are then issued transponders that are electronically linked to their established accounts. The transponders are mounted in or on the customers' vehicles. As the customers' transponder-equipped vehicles pass through the E-ZPass toll lanes, the transponder numbers are read by equipment mounted in the lanes and ultimately the required toll is calculated and deducted from the respective customer's account.

The initial E-ZPass opening was a regional implementation that included interchanges 242 (Harrisburg West) to 56 (Lehigh Valley) on the Northeast extension. Six additional interchanges (226 – Carlisle, 236 – Gettysburg Pike, and 74 – Mahoning Valley to 115 – Wyoming Valley on the Northeast extension) were added to the E-ZPass system on May 19, 2001. On December 15, 2001, the Commission opened E-ZPass for passenger vehicles on the remainder of the ticket system. The Commission opened E-ZPass to trucks and buses on the entire ticket system on December 15, 2002.

In June 2004, the E-ZPass system was improved by the opening of the Commission's first express E-ZPass lane at the Warrendale interchange. The express E-ZPass lanes allow traffic to travel at normal speeds (55 mph). Express lanes eliminate the need for travelers to enter and exit the turnpike system through the normal toll plaza interchanges.

Economic Conditions and Outlook

The Commonwealth of Pennsylvania is one of the most populous states, ranking sixth behind California, Texas, New York, Florida, and Illinois. With a population of over 12 million, Pennsylvania has maintained a 4.4% average of the total United States population over the past ten years. Pennsylvania is an established state with a diversified economy. Pennsylvania had been historically identified as a heavy industry state. That reputation has changed over the last 30 years as the coal, steel, and railroad industries declined and the Commonwealth's business environment readjusted with a more diversified economic base. This economic readjustment was a direct result of a long-term shift in jobs, investment, and workers away from the northeast part of the nation.

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

Manufacturing in the Commonwealth continues to be a major source of employment, although it has declined in relative importance in recent years comprising 15% of total industry employment. Other leading industries in Pennsylvania were educational, health and social services for a combined 23%, followed by retail trade at 12%.

Human resources are plentiful in Pennsylvania with an overall population of over 12 million. The labor force is estimated at over 6 million people. The high level of education embodied in the Commonwealth's workforce fosters a wide variety of employment capabilities. Pennsylvania's basic and higher education statistics compare favorably with other states in the nation. Approximately 86% of adults have earned the minimum of a high school degree. In addition, approximately 24% of adults have earned a bachelor's degree or higher, which is consistent with national averages. The per capita personal income was \$31,998 or 101.16% of the national average in 2003. Personal income increased 3.1% over the past year, and makes up 4.3% of the United States personal income. The unemployment rate in Pennsylvania has been close to the national average for the past 10 years.

Pennsylvania's extensive public and private forests provide a vast source of material for the lumber, furniture, and paper products industries. Additionally, the Commonwealth derives a good water supply from underground sources, abundant rainfall, and a large

number of rivers, streams, and lakes. Other natural resources include major deposits of coal, petroleum, and natural gas.

Pennsylvania is a Middle Atlantic state within easy reach of the populous eastern seaboard and, as such, is a gateway to the Midwest. A comprehensive transportation grid enhances the Commonwealth's strategic geographic position. The Commonwealth's water systems afford the unique feature of triple port coverage, a deep-water port at Philadelphia, a Great Lakes port at Erie and an inland water port at Pittsburgh. Pennsylvania combines characteristics of both the northeastern and midwestern regions with the major cities of Philadelphia in the southeastern part of the state and Pittsburgh in the southwestern part of the state.

Capital Improvements Program

Act 61 Projects

In 1985, the General Assembly of the Commonwealth enacted legislation, which among other things, authorized and empowered the Commission to undertake the construction of new projects and to operate them as part of the Pennsylvania Turnpike System. This legislation, known as the "Turnpike Organization, Extension and Toll Road Conversion Act," also known as Act 1985-61 (Act 61), included several groups of projects for the Pennsylvania Turnpike System. Act 61 grouped the improvement and extension authorizations into four major groups of projects. The initial group of projects includes, among others, the following, a portion of which have been financed and completed with bond proceeds: the Beaver Valley Climbing Lane, the Downingtown Interchange, the Fort Washington, Willow Grove and Philadelphia Interchanges, the six-lane widening between the Northeast Extension and the Delaware River Interchange, the Mid-County Expressway Connection (Montgomery County), the Beaver Valley Expressway, the Amos K. Hutchinson Bypass (formerly the Greensburg (North-South) Bypass), the Keyser Avenue Interchange (Wilkes-Barre/Scranton Area) and an additional tube at the Lehigh Tunnel on the Northeast Extension.

Mon/Fayette Expressway and Southern Beltway

The Pennsylvania portion of the proposed Mon/Fayette Expressway is a series of independent projects that extend from the West Virginia border, near Cheat Lake, in a generally northern direction paralleling the Monongahela River and connecting with Interstate Route 376 in Allegheny County. Three projects constructed as part of the Mon/Fayette Expressway are in operation. One is a six-mile toll road between U.S. Route 40 and Interstate Route 70 in Washington County. This project was built by the Department of Transportation and turned over to the Commission upon its opening in 1990. The second is an eight-mile section of toll road from the Pennsylvania/West Virginia border to Fairchance, which is located just south of Uniontown, Fayette County. The third is a 17-mile section of toll road from Interstate Route 70, Washington County to PA Route 51 in Allegheny County. These three sections of the Mon/Fayette Expressway are now part of the Pennsylvania Turnpike System.

Two other projects will complete the entire Mon/Fayette Expressway. The environmental design for the section from Uniontown, Fayette County to Brownsville, Washington County is complete and the engineering design and Right-of-Way acquisition is now underway for this 15 mile long project. A section, extending from PA Route 51 to Interstate Route 376 in Pittsburgh, is in the environmental study phase. The environmental clearance for this section is anticipated in late 2004.

The proposed Southern Beltway is planned to be constructed from the Mon/Fayette Expressway, near Finleyville, extending as part of a beltway south of Pittsburgh to Pennsylvania Route 60 at the Pittsburgh International Airport. It is presently planned for construction in three sections. Two of these sections are now in the environmental study phase. One section, adjacent to the Pittsburgh International Airport, is currently under construction and is scheduled to open to traffic in July 2006.

The total estimated cost of the Mon/Fayette Expressway and the Southern Beltway projects sponsored by the Pennsylvania Turnpike Commission is approximately \$4.2 billion. The proceeds of the Commission's Series A and B of 1998 Oil Franchise Tax Bonds and Series of 2001 Vehicle Registration Fee Revenue Bonds have been applied toward these costs. Proceeds from the issuance of Series A, B and C of 2003 Oil Franchise Tax Bonds have also been designated to finance these costs. It is anticipated that the Mon/Fayette Expressway and the Southern Beltway will be financed out of Oil Franchise Tax Revenues and Registration Fee Revenues along with other funding sources. Although these are now planned to be toll roads, Pennsylvania Turnpike fare revenues will not be pledged for the financing of their construction.

Internal Control

Management of the Commission is responsible for establishing and maintaining internal controls designed to ensure that the assets of the Commission are protected from loss, theft, or misuse and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with accounting principles generally accepted in the United States. The internal controls are designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

Trust Indentures

Operations of the Commission are substantially controlled by the provisions of a Trust Indenture, dated July 1, 1986, which has been amended and restated as of March 1, 2001, a Trust Indenture dated August 1998 (1998 Indenture) which has been amended as of August 1, 2003, and a Trust Indenture dated July 1, 2001, (collectively referred to as the Indentures). The Indentures require, among other things, the establishment and maintenance of various accounts, which are restricted to use for construction, Turnpike System maintenance and operation, and debt service.

As demonstrated by the statements included in the financial section of this report, the Commission continues to meet its responsibility for sound financial management and compliance with the Indentures.

Cash and Investment Management

Cash and short-term funds were invested primarily in repurchase agreements and United States Government obligations. The Indentures require that repurchase agreements be either insured or collateralized by a pledge of direct obligations of the United States Government or the Commonwealth of Pennsylvania, or otherwise in accordance with the laws of the Commonwealth of Pennsylvania governing trust funds of public bodies. Repurchase agreements were, accordingly, insured to collateralize with securities held by the pledging financial institution's trust department in the Commission's name.

Long-term funds were invested primarily in U.S. Government and Federal Agency Obligations. These funds totaled \$789 million and were all under external management at May 31, 2004.

Risk Management

The Commission maintains a Risk Management Department that is responsible for, among other things, minimizing the risks associated with operation of the Turnpike System. The Risk Management Department is responsible for insuring that all Commission assets have proper insurance coverage to protect the Commission and our bondholders. In accordance with the Trust Indentures, the Commission is required to maintain insurance on various assets. Currently the Commission maintains insurance in the following categories:

- Builders Risk Insurance during the construction of any projects financed under the Trust Indentures.
- Physical loss or damage insurance on all tunnels, certain bridges, buildings, and toll plazas on the turnpike.
- Use and occupancy insurance covering loss of revenues due to interruption in the use of the turnpike resulting from damage to or destruction of any part of the system.
- Property Damage and Public Liability Insurance.

The Commission is self insured for torts, injuries to employees, and injuries to third parties due to accidents caused by Commission automobiles.

Other Information

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reports to the Pennsylvania Turnpike Commission for its comprehensive annual financial report for the fiscal year ended May 31, 2003. This was the 16th consecutive year that the Commission has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to the Government Finance Officers Association to determine its eligibility for another certificate.

Independent Audit

The Trust Indentures require an annual audit by independent certified public accountants. The accounting firm of Ernst & Young LLP was engaged by the Commission to perform the audit for the fiscal year ended May 31, 2004. The auditors' report on the financial statements is included in the financial section of this report.

Acknowledgments

The timely preparation of the comprehensive annual financial report was made possible through the assistance of Gina E. Sheller and Sharon S. Jones of the Accounting Department; Anthony Q. Maun, Director of Accounting and Payroll; and Robert J. Smith, Director of Finance. We express our sincere appreciation for the contributions made by these individuals in the preparation of this report.

In addition, without the leadership and support of the Commissioners and executive staff of the Pennsylvania Turnpike Commission, preparation of this report would not have been possible.



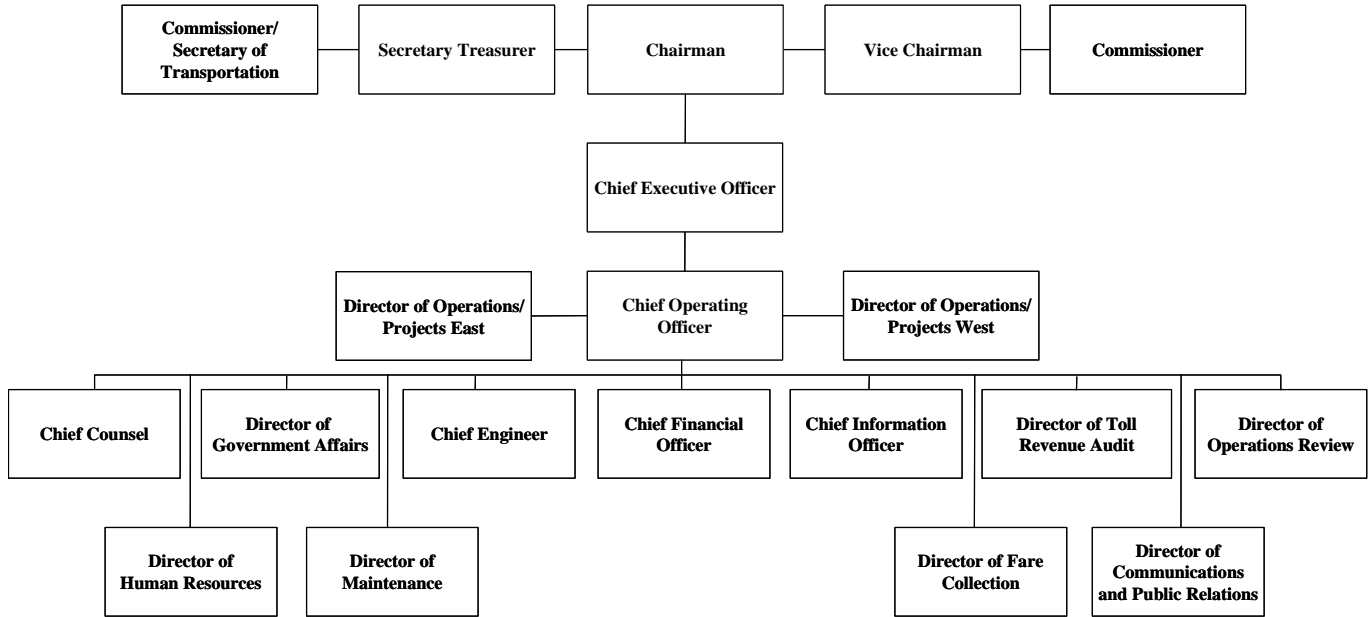
J. Blair Fishburn
Chief Financial Officer

Pennsylvania Turnpike Commission

Organization Chart

May 31, 2004

Executive Offices



Pennsylvania Turnpike Commission

List of Principal Officials

May 31, 2004

| Title | Name |
|---|--------------------------|
| Commission Chairman | Mitchell Rubin |
| Commission Vice Chairman | Timothy J. Carson |
| Commission Secretary Treasurer | J. William Lincoln |
| Commissioner | Pasquale T. Deon, Sr. |
| Commissioner/Secretary of Transportation | Allen D. Biehler |
| Chief Executive Officer | Joseph G. Brimmeier |
| Chief Operating Officer | Kevin F. Longenbach |
| Chief Counsel | William A. Chesnutt |
| Chief Engineer | Alexander R. Jansen |
| Chief Financial Officer | J. Blair Fishburn |
| Chief Information Officer | Jeffrey J. Mesaric |
| Director of Operations/Projects – East | Carmen J. Marrone |
| Director of Operations/Projects – West | Jeffry L. Bortz |
| Director of Communications & Public Relations | William J. Capone |
| Director of Fare Collection | Samuel G. Sadler |
| Director of Human Resources | Deborah L. Davis |
| Director of Government Affairs | John T. Martino |
| Director of Maintenance | John A. Stewart |
| Director of Operations Review | Michael D. Begler |
| Director of Toll Revenue Audit | Brenda L. Szeles-Bratina |

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Pennsylvania Turnpike Commission

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
May 31, 2003

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



President

Executive Director

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Financial Section

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Report of Independent Auditors

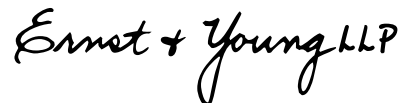
The Commissioners
Pennsylvania Turnpike Commission

We have audited the accompanying balance sheets of the Pennsylvania Turnpike Commission as of May 31, 2004 and 2003, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Pennsylvania Turnpike Commission'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. 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 financial position of the Pennsylvania Turnpike Commission as of May 31, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

Management's Discussion and Analysis on pages 19 to 25 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.



July 30, 2004

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Pennsylvania Turnpike Commission
Management's Discussion and Analysis

May 31, 2004

The management of the Pennsylvania Turnpike Commission (hereinafter referred to as the Commission) offers this narrative overview and analysis of the Commission's financial activities for the year ended May 31, 2004, which should be read in conjunction with the Commission's basic financial statements.

Overview of the Basic Financial Statements

This discussion and analysis is intended to serve as an introduction to the Commission's basic financial statements. While the Commission is considered a component unit of the Commonwealth of Pennsylvania, these financial statements are presented in a manner similar to a private-sector business. As such, the statements do not include any type of fund financial statements or analysis of fund balance, but they have been prepared according to accounting principles generally accepted in the United States (GAAP). All of the current year's revenues are recorded when earned and expenses are recorded as they are incurred, regardless of when the cash is received or disbursed.

The balance sheet presents information on all of the Commission's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets serve as a relative indicator of the change in financial position of the Commission.

The statement of revenues, expenses, and changes in net assets shows the result of the Commission's total operations during the fiscal year and reflects both operating and nonoperating activities. Changes in net assets (increases or decreases) reflect the current fiscal period's operating impact upon the overall financial position of the Commission.

The statement of cash flows provides a detailed analysis of all sources and uses of cash. The direct method of cash flows is presented, ending with a reconciliation of operating income to net cash provided by operating activities. The statement of cash flows is divided into four activities sections—operating, noncapital financing, capital financing, and investing.

Notes to the basic financial statements contain supplemental information, and often offer explanations to the basic financial statements. The notes are intended to assist the reader in understanding the Commission's basic financial statements.

Pennsylvania Turnpike Commission

Management's Discussion and Analysis (continued)

Financial Analysis

Comparative Condensed Balance Sheets

| | 2004 | May 31 2003 | 2002 |
|--|-----------------------|------------------------|---------------------|
| | <i>(In Thousands)</i> | | |
| Assets | | | |
| Current assets | \$ 323,271 | \$ 344,905 | \$ 323,027 |
| Long-term investments | 789,107 | 665,313 | 764,971 |
| Capital assets, net of accumulated depreciation | 2,674,605 | 2,707,586 | 2,693,454 |
| Other assets | 62,264 | 67,158 | 59,489 |
| Total assets | \$ 3,849,247 | \$ 3,784,962 | \$ 3,840,941 |
| Liabilities and net assets | | | |
| Current liabilities | \$ 153,053 | \$ 149,604 | \$ 168,179 |
| Bonds payable, net of unamortized premium and discount | 2,188,756 | 2,084,936 | 2,095,966 |
| Other noncurrent liabilities | 13,912 | 19,049 | 25,342 |
| Total liabilities | 2,355,721 | 2,253,589 | 2,289,487 |
| Net assets: | | | |
| Invested in capital assets, net of related debt | 470,593 | 612,434 | 558,802 |
| Restricted | 934,108 | 668,759 | 778,559 |
| Unrestricted | 88,825 | 250,180 | 214,093 |
| Total net assets | 1,493,526 | 1,531,373 | 1,551,454 |
| Total liabilities and net assets | \$ 3,849,247 | \$ 3,784,962 | \$ 3,840,941 |

As noted earlier, net assets serves as an indicator of the Commission's overall financial position. The Commission's net assets were \$1,493,526,000 and \$1,531,373,000, as of May 31, 2004 and 2003, respectively. Restricted net assets are reserved for projects defined in trust indentures and applicable bond issue official statements.

Pennsylvania Turnpike Commission

Management's Discussion and Analysis (continued)

Financial Analysis (continued)

Total assets and total liabilities increased by \$64.3 million and \$102.1 million, respectively. The increase in assets is mainly the result of a \$90.7 million increase in cash and investments, which was partially offset by a \$33.0 million decrease in capital assets. The increase in liabilities is the result of a \$103.8 million increase in bonds payable. The increase in cash and investments and bonds payable at May 31, 2004 was mostly attributable to two events: the issuance of the 2003 Series A, B and C Oil Company Franchise Tax Revenue Bonds and the partial defeasance of the 1998 Series A and B Oil Company Franchise Tax Revenue Bonds.

Comparative Condensed Statements of Revenues and Expenses

| | Year ended May 31 | |
|---|--------------------------|-------------|
| | 2004 | 2003 |
| | <i>(In Thousands)</i> | |
| Operating: | | |
| Operating revenues | \$ 427,778 | \$ 404,756 |
| Cost of services | 237,385 | 234,092 |
| Depreciation | 229,548 | 229,485 |
| Operating loss | (39,155) | (58,821) |
| Nonoperating: | | |
| Oil company franchise tax | 47,062 | 46,288 |
| Federal and state grants and reimbursements | 42,787 | 35,135 |
| Investment earnings | 30,901 | 58,704 |
| Other nonoperating revenues | 1,453 | 3,692 |
| Interest and bond expense | (120,895) | (105,079) |
| Nonoperating income | 1,308 | 38,740 |
| Change in net assets | \$ (37,847) | \$ (20,081) |

Operating revenues increased 5.7% over the prior year due to the revenue growth associated with an increase in vehicle volumes of 8.6 million or 4.8%. The operating revenue increase was offset by a 1.4% increase in cost of services. The net result is a \$19.7 million or 33.4% decrease in operating loss.

Pennsylvania Turnpike Commission

Management's Discussion and Analysis (continued)

Financial Analysis (continued)

The increases in operating revenues and cost of services netted to an 11.6% increase in operating income before depreciation. Although \$114.5 million of capital assets were added to the depreciable base during fiscal year ending May 31, 2004, there was little change in depreciation expense from the prior year because other assets were fully depreciated. For the fiscal year ending May 31, 2003, \$179.8 million of assets were added to the Commission's depreciable base.

Nonoperating income decreased by \$37.4 million. This decrease is the result of a \$27.8 million, or 47.4% decrease in investment income and a \$15.8 million or 15.1% increase in interest expense. The reduction in investment income was the result of an \$11 million decrease in the market value of investments compared with an \$18 million increase in fiscal year 2003. This decrease in market values was partially offset by \$10.7 million of miscellaneous income resulting from the Escrow Restructuring Agreement related to the partially defeased 1998 Series A and B Oil Company Franchise Tax Revenue Bonds. The increase in current year interest is mostly related to the issuance of the 2003 Series A, B and C Oil Company Franchise Tax Revenue Bonds. Capitalized interest remained much the same as the prior year and totaled \$6.9 million and \$6.5 million at May 31, 2004 and 2003, respectively. Additionally, reimbursement income increased \$7.7 million or 21.8%, while Oil Company Franchise Tax revenues increased at the same rate as in 2003, \$0.8 million or 1.7%.

Capital Assets and Debt Administration

Capital Assets

The Commission's investment in capital assets as of May 31, 2004, amounted to \$5.4 billion of gross asset value with accumulated depreciation of \$2.7 billion, leaving a net book value of \$2.7 billion. This investment represents more than 69% of the Commission's total assets. Capital assets consist of land, buildings, improvements, equipment, infrastructure, and construction in progress. Infrastructure assets are typically items that are immovable such as highways, bridges, and tunnels.

Acquisitions of capital assets in 2004 amounted to more than \$12 million. In addition, more than \$102 million of constructed capital assets were completed during the year. Construction in progress increased by \$74 million or 17.2%, which is consistent with the Commission's capital plan.

Pennsylvania Turnpike Commission

Management's Discussion and Analysis (continued)

Capital Assets and Debt Administration (continued)

Capital Assets (continued)

During the current fiscal year, the Commission spent \$156.5 million on mainline and support projects and \$54.0 million on the Mon-Fayette Expressway and Southern Beltway roadway expansion (Act 61) projects.

Roadway reconstruction continued on the \$132.0 million Somerset project that began in late 2001 and completion is expected in the fall of 2004. Work on the \$83.0 million Donegal project began in mid 2002 and is also scheduled for completion in the fall of 2004. The completion of these two major projects will result in an additional 22 miles of reconstructed roadway. The Commission also completed 27 miles of roadway repaving to maintain a quality-riding surface, which was confirmed with a system wide median IRI (International Roughness Index) of 80.

The Commission continues to expand and enhance the new toll collection system that includes E-ZPass (electronic toll collection) capability. Building and related projects focused on maintaining environmental compliance and the continuing maintenance and repairs of existing facilities.

Approximately half of the 70 mile Mon-Fayette Expressway project is open and operating. The final design of the Uniontown to Brownsville section of the expressway was initiated and a final environmental impact statement for the PA Route 51 to Pittsburgh section of the road was issued. The final design of the Findlay Connector portion of the Southern Beltway project that will connect the Pittsburgh International Airport to PA Route 22 was completed and construction was initiated.

Debt Administration

The issuance of new bonds is conducted in accordance with the terms of the applicable trust indenture and approval of the Commissioners. Since 1998 the credit ratings of the Commission's bonds have been Aa3, AA- and AA- by Moody's, Standard & Poor's and Fitch Ratings, Inc., respectively.

Pennsylvania Turnpike Commission

Management's Discussion and Analysis (continued)

Capital Assets and Debt Administration (continued)

Debt Administration (continued)

In July 2003, the Commission partially defeased 1998 Series A and B Oil Company Franchise Tax Revenue Bonds. Of the total \$498,808,000 bonds outstanding, \$340,225,000 of bonds were defeased. Approximately \$350 million of unrestricted cash and investments were used to defease these bonds. State and local government securities of \$350 million were then purchased and deposited according to the terms of an escrow agreement. Accordingly, these securities are not included in the Commission's financial statements. The defeased bonds will not be immediately redeemed. The remaining bonds in the amount of \$157,855,000 are due in varying installments through the original maturity date.

In October 2003, the Commission entered into an Escrow Restructuring Agreement. The purpose of the escrow restructuring was to substantially reduce the amount of negative arbitrage of approximately \$11 million that resulted due to the market conditions at the time of the original escrow agreement. As a result of the restructuring, the Commission recognized \$10.7 million of miscellaneous investment income.

The issuance in August 2003 of \$482,685,000 Series A, B, C of 2003 Oil Company Franchise Tax Revenue Bonds, completed the Commission's overall debt restructuring strategy to increase funding for the Mon-Fayette and Southern Beltway projects. The debt restructuring strategy included issuing new debt, defeasing existing higher coupon rate debt with lower coupon new bonds to lower overall debt service, and the adoption of the Second Supplemental Indenture, effective August 1, 2003, which amends the Trust Indenture dated August 1998.

The debt restructuring strategy also included the use of swaps to synthetically convert variable rate debt to fixed rate debt. Two forward interest rate swap agreements were issued in July 2003 for Oil Company Franchise Tax Multi-Modal Senior Revenue Bonds Series C of 2003. The swaps became effective upon the issuance of the respective bonds. The notional value of these swaps was approximately \$160 million at May 31, 2004.

The above paragraphs describe the changes in capital assets and debt administration occurring during the fiscal year. Please refer to the capital assets and bonds payable sections in the notes to the financial statements (Notes 5 and 6) for more detailed schedules of capital assets and long-term debt activity.

Pennsylvania Turnpike Commission

Management's Discussion and Analysis (continued)

Facts That Will Impact Financial Position

On January 20, 2004, the Commission approved a resolution to adopt a new fare rate schedule. The new fare rate schedule is effective August 1, 2004. This is the first toll increase since June 1, 1991. Tolls for passenger vehicles will increase 1.8 cents per mile from the current rate of 4.1 cents per mile, to a new rate of 5.9 cents per mile. Commercial vehicles will see an average increase of 5.3 cents per mile. As a result of this toll increase, the Commission expects net fare revenue in the 2005 fiscal year to increase by approximately \$90 million in comparison to net fare revenue in this fiscal year. Based upon Commission projections, the toll increase will enable the Commission to provide funding for all projects in its 2005-2014 ten-year capital plan, with estimated expenditures of approximately \$3.8 billion.

In June 2004, the Commission issued \$269 million Series A of 2004 Revenue Bonds. The proceeds from these bonds will be used to finance various capital expenditures to the Mainline System as set forth in the Commission's 10 year Capital Plan.

The Commission's program and project managers continually monitor capital plan project budgets using a capital planning and project reporting system to ensure that planned spending is maintained within affordable, budgeted limits. Unplanned or unusual events are always a concern and can potentially impact the capital program's overall affordability. The Commission's executive staff, as well as the Commission's Consulting Engineer, review the capital program on an ongoing basis to monitor, manage and adjust project schedules and budgets to meet spending targets.

A strategic plan is utilized to both guide and establish annual action plans and commitments that will be executed by staff to ensure that the organization stays focused on achieving its strategic objectives, consistent with its stated organizational vision and mission. All capital projects are reviewed to ensure that the primary focus of all capital spending is consistent with, and supports, the strategic plan vision.

The Commission has completed a highway long range plan that documents condition assessments and overall highway project priorities for maintaining and improving the quality and safety of all roadways, bridges, tunnels and interchanges. This effort will enhance the capital planning and programming efforts to ensure the physical integrity of the Commission's toll road system.

Pennsylvania Turnpike Commission

Balance Sheets

| | May 31 | |
|-----------------------------------|----------------------------|----------------------------|
| | 2004 | 2003 |
| | <i>(In Thousands)</i> | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 228,455 | \$ 277,602 |
| Short-term investments | 43,921 | 27,864 |
| Accounts receivable | 24,473 | 21,737 |
| Accrued interest receivable | 9,646 | 5,427 |
| Inventories | 16,776 | 12,275 |
| Total current assets | <u>323,271</u> | 344,905 |
| Long-term investments | 789,107 | 665,313 |
| Capital assets: | | |
| Land | 132,277 | 123,955 |
| Buildings | 638,979 | 588,153 |
| Improvements other than buildings | 53,486 | 53,486 |
| Equipment | 291,241 | 271,279 |
| Infrastructure | 3,789,194 | 3,749,954 |
| Construction in progress | 505,778 | 431,702 |
| | <u>5,410,955</u> | 5,218,529 |
| Less accumulated depreciation | <u>2,736,350</u> | 2,510,943 |
| | <u>2,674,605</u> | 2,707,586 |
| Other assets: | | |
| Other assets | 40,993 | 47,553 |
| Deferred bond issuance costs | 21,271 | 19,605 |
| Total other assets | <u>62,264</u> | 67,158 |
| Total assets | <u><u>\$ 3,849,247</u></u> | <u><u>\$ 3,784,962</u></u> |

| | May 31 | |
|--|-----------------------|--------------|
| | 2004 | 2003 |
| | <i>(In Thousands)</i> | |
| Liabilities and net assets | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | \$ 108,893 | \$ 107,234 |
| Current portion of bonds payable | 44,160 | 42,370 |
| Total current liabilities | 153,053 | 149,604 |
| | | |
| Bonds payable, less current portion, net of unamortized premium of \$6,041 in 2004 and unamortized discount of (\$3,244) in 2003 | 2,188,756 | 2,084,936 |
| Other noncurrent liabilities | 13,912 | 19,049 |
| | 2,202,668 | 2,103,985 |
| Total liabilities | 2,355,721 | 2,253,589 |
| | | |
| Net assets: | | |
| Invested in capital assets, net of related debt | 470,593 | 612,434 |
| Restricted for certain construction and maintenance purposes | 934,108 | 668,759 |
| Unrestricted | 88,825 | 250,180 |
| Total net assets | 1,493,526 | 1,531,373 |
| | | |
| Total liabilities and net assets | \$ 3,849,247 | \$ 3,784,962 |

See accompanying notes.

Pennsylvania Turnpike Commission

Statements of Revenues, Expenses, and Changes in Net Assets

| | Year ended May 31 | |
|---|----------------------------|----------------------------|
| | 2004 | 2003 |
| | <i>(In Thousands)</i> | |
| Operating revenues: | | |
| Net fares | \$ 408,744 | \$ 387,222 |
| Other | 19,034 | 17,534 |
| | <u>427,778</u> | <u>404,756</u> |
| Operating expenses: | | |
| Cost of services | 237,385 | 234,092 |
| Depreciation | 229,548 | 229,485 |
| | <u>466,933</u> | <u>463,577</u> |
| Operating loss | (39,155) | (58,821) |
| Nonoperating revenues (expenses): | | |
| Oil company franchise tax revenues | 47,062 | 46,288 |
| Federal and state grants and reimbursements | 42,787 | 35,135 |
| Investment earnings | 30,901 | 58,704 |
| Other nonoperating revenues | 1,453 | 3,692 |
| Interest and bond expenses | (120,895) | (105,079) |
| | <u>1,308</u> | <u>38,740</u> |
| Change in net assets | (37,847) | (20,081) |
| Net assets at beginning of year | <u>1,531,373</u> | 1,551,454 |
| Net assets at end of year | <u><u>\$ 1,493,526</u></u> | <u><u>\$ 1,531,373</u></u> |

See accompanying notes.

Pennsylvania Turnpike Commission

Statements of Cash Flows

| | Year ended May 31 | |
|--|--------------------------|-------------------|
| | 2004 | 2003 |
| | <i>(In Thousands)</i> | |
| Operating activities | | |
| Cash received from tolls/customers | \$ 455,325 | \$ 410,047 |
| Cash payments for goods and services | (140,262) | (135,763) |
| Cash payments to employees | (141,389) | (117,752) |
| Cash received from other operating activities | 15,623 | 11,787 |
| Net cash provided by operating activities | <u>189,297</u> | <u>168,319</u> |
| Investing activities | | |
| Proceeds from sales of investments, excluding cash equivalents | 8,429,994 | 9,302,213 |
| Proceeds from maturities of investments | 23,139 | 49,091 |
| Interest received on investments | 30,370 | 47,416 |
| Purchases of investments | (8,610,386) | (9,229,900) |
| Net cash (used in) provided by investing activities | <u>(126,883)</u> | <u>168,820</u> |
| Capital and related financing activities | | |
| Capital grants received | 7,079 | 7,042 |
| Acquisition of capital assets | (184,698) | (245,314) |
| Proceeds from sale of capital assets | 1,290 | 3,948 |
| Payments for bond expenses | (5,651) | (2,403) |
| Payments for redemption of revenue bonds | (386,360) | (477,923) |
| Interest paid on bonds | (112,467) | (107,116) |
| Proceeds from new bonds | 483,335 | 447,798 |
| Proceeds from escrow restructuring | 10,713 | 0 |
| Net cash used in capital and related financing activities | <u>(186,759)</u> | <u>(373,968)</u> |
| Noncapital financing activities | | |
| Cash proceeds from motor license grant | 28,000 | 28,000 |
| Cash proceeds from oil company franchise tax | 47,198 | 46,135 |
| Net cash provided by noncapital financing activities | <u>75,198</u> | <u>74,135</u> |
| (Decrease) increase in cash and cash equivalents | <u>(49,147)</u> | <u>37,306</u> |
| Cash and cash equivalents at beginning of year | <u>277,602</u> | <u>240,296</u> |
| Cash and cash equivalents at end of year | <u>\$ 228,455</u> | <u>\$ 277,602</u> |

Continued on the following page – see accompanying schedule of reconciliation.

Pennsylvania Turnpike Commission

Statements of Cash Flows (continued)

| | Year ended May 31 | |
|---|--------------------------|-------------------|
| | 2004 | 2003 |
| | <i>(In Thousands)</i> | |
| Reconciliation of operating loss to net cash provided by operating activities | | |
| Operating loss | \$ (39,155) | \$ (58,821) |
| Adjustments to reconcile operating loss to net cash provided by operating activities: | | |
| Depreciation | 229,548 | 229,485 |
| Change in operating assets and liabilities: | | |
| Accounts receivable, net of nonoperating receivables | 91 | (4,461) |
| Inventories | (4,501) | 1,876 |
| Other assets | 16 | 12 |
| Accounts payable and accrued liabilities, excluding interest payable | 6,287 | 6,521 |
| Other noncurrent liabilities | (2,989) | (6,293) |
| Net cash provided by operating activities | <u>\$ 189,297</u> | <u>\$ 168,319</u> |

Noncash Activities

The Commission recorded a decrease of \$11,094 and an increase of \$18,967 in the fair value of its investments for the years ended May 31, 2004 and 2003, respectively.

See accompanying notes.

Pennsylvania Turnpike Commission

Notes to Financial Statements

May 31, 2004

1. Financial Reporting Entity

The Pennsylvania Turnpike Commission (Commission) was created as an instrumentality of the Commonwealth of Pennsylvania on May 21, 1937, with powers to construct, operate, and maintain the Turnpike System and to issue Turnpike revenue bonds, repayable solely from tolls and other Commission revenues. The Commission is considered a component unit of the Commonwealth of Pennsylvania (Commonwealth).

In evaluating how to define the Commission for financial reporting purposes, management has considered all potential component units in accordance with Government Accounting Standards Board (GASB) Statement No. 14, *The Reporting Entity*. GASB Statement No. 14 defines the reporting entity as the primary government and those component units for which the primary government is financially accountable. Based on the Commission's review of GASB Statement No. 14, the Commission believes it has no component units.

The Commission consists of five members, one of whom is the Secretary of Transportation. The other four are appointed to four-year terms by the Governor with the approval of a majority of the Senate.

The Commission's revenue bonds have been issued under the provisions of a Trust Indenture, dated July 1, 1986, which has been amended and restated as of March 1, 2001, a Trust Indenture dated August 1998 (1998 Indenture) which has been amended as of August 1, 2003, and a Trust Indenture dated July 1, 2001, (collectively referred to as the Indentures) between the Commission and the Trustees (Wachovia Bank and National City Bank of Pennsylvania). Accordingly, certain activities of the Commission are restricted by the Indentures.

2. Accounting Policies

Basis of Accounting

The Commission's basic financial statements are presented on the accrual basis of accounting

Cash Equivalents

For purposes of the statements of cash flows, the Commission considers all highly liquid debt investment securities with a maturity of three months or less to be cash equivalents.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

2. Accounting Policies (continued)

Investments

Investments are stated at fair value with the exception of certain nonparticipating contracts such as repurchase agreements, which are reported at cost. Fair values are based on published market rates.

Capital Assets

Capital assets are stated at cost. Donated capital assets are valued at their estimated fair market value on the date received. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Acquisitions of capital assets valued at \$15,000 or greater are capitalized. The following lives are used:

| | |
|-------------------------|-------------|
| Buildings | 10-40 years |
| Improvements | 15-20 years |
| Machinery and equipment | 3-40 years |
| Infrastructure | 20-50 years |

Inventories

Inventories are valued at the lower of average cost (determined on a first-in, first-out method) or market.

Bond Premium/Discount and Issuance Costs

Bond premium/discount and issuance costs are being amortized using the effective interest method over the varying terms of the bonds issued.

Operating Revenues

Revenues associated with operations of the toll road are considered operating revenues. The principal operating revenues of the Commission are fare revenues from customers. Most other revenues of the Commission are considered nonoperating revenues.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

2. Accounting Policies (continued)

Fare Revenues

Fare revenues are recognized when vehicles exit the Turnpike System. As of May 31, 2004 and 2003, approximately 64% and 79%, respectively, of the fare revenues were simultaneously realized through cash collection or a credit card program for commercial vehicles, with the remainder realized through electronic collection.

Operating Expenses

Operating expenses relate directly to operating and maintaining the toll road. The principal operating expenses of the Commission are cost of services and depreciation. Other expenses are considered nonoperating expenses.

Cost of Services

Cost of services includes salaries, wages, benefits, purchased services, along with purchased goods, including materials and supplies.

Oil Company Franchise Tax Revenues

The Commission receives 14% of the additional 55 mills of the Commonwealth's Oil Company Franchise Tax revenues pursuant to Act 26 established in 1991. The revenues are recorded as nonoperating revenue. Such revenues totaled \$47.1 million and \$46.3 million for the fiscal years ended May 31, 2004 and 2003, respectively. As required by the applicable indenture, these revenues are kept in a separate fund. This fund's assets, consisting essentially of cash and investments, aggregated \$620.1 million and \$292.4 million as of May 31, 2004 and 2003, respectively.

Grants

The Commission receives grants from other governments for reimbursement of costs for various highway construction projects. The revenues from these grants are recorded as nonoperating revenue when the costs for these projects are incurred.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

2. Accounting Policies (continued)

Grants (continued)

The Commission received \$28.0 million in grants during each of the fiscal years ended May 31, 2004 and 2003 from the Commonwealth's Motor License Fund. The revenue from this grant is recorded as nonoperating revenue. The Commission has elected to account for this grant in a separate fund. This fund's assets, consisting essentially of cash and investments, totaled \$395.7 million and \$563.7 million as of May 31, 2004 and 2003, respectively.

Self-Insurance

The Commission is exposed to various risks of losses such as theft of, damage to, and destruction of assets, errors and omissions, third-party torts, injuries to employees, injuries to third parties due to accidents caused by Commission automobiles, and natural disasters. The Commission has purchased commercial insurance for all risks of losses, including employee medical benefits, except for torts, injuries to employees, and injuries to third parties due to accidents caused by Commission automobiles. No settlements exceeded insurance coverage for each of the past three years.

The Commission recorded a liability of \$16.2 million and \$19.1 million for loss and loss adjustment expenses on claims relating to self-insurance that have been incurred but not reported as of May 31, 2004 and 2003, respectively. This liability is based on GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, which requires that a liability for claims be recorded if information prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. The liability is calculated based on the Commission's past loss experience. The liability was discounted using a rate of 3.5% as of May 31, 2004 and 2003. The liability includes amounts for claims adjustment expense and is net of any salvage and subrogation. Salvage and subrogation were not material for the years ended May 31, 2004 and 2003. The Commission believes the liability established is reasonable and appropriate to provide for settlement of losses and related loss adjustment expenses.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

2. Accounting Policies (continued)

Net Assets

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

Reclassifications

Certain reclassifications were made to the 2003 operating revenues, cost of services, investment earnings, net asset amounts and cash flow statement in order to conform to the 2004 presentation.

Application of FASB Pronouncements

The Commission has elected not to apply any FASB statements or interpretations issued after November 30, 1989.

3. Indenture Requirements and Restrictions

The Commission is required to maintain certain accounts with the Trustees as specified by the Indentures. Funds maintained in such accounts are restricted to use for construction, Turnpike System maintenance and operation, and debt service. Nonrestricted funds of \$88.8 million and \$250.2 million represent residual amounts after all mandatory transfers have been made as required by the Indentures and were included in cash, investments, and accounts receivable at May 31, 2004 and 2003, respectively.

4. Cash and Investments

Cash deposits are in various financial institutions. The Indentures require that cash deposits be either insured or collateralized by a pledge of direct obligations of the United States Government or the Commonwealth of Pennsylvania or otherwise in accordance with the laws of the Commonwealth of Pennsylvania governing trust funds of public bodies.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

4. Cash and Investments (continued)

The following summary presents the amount of Commission deposits all of which are fully insured or collateralized with securities held by the Commission or its agent in the Commission's name:

| | Total Bank Balance | Total Book Balance |
|-----------------------|-------------------------------|-------------------------------|
| <i>(In Thousands)</i> | | |
| May 31, 2004 | | |
| Demand deposits | \$ 95,826 | \$ 77,823 |
| May 31, 2003 | | |
| Demand deposits | \$ 138,196 | \$ 131,761 |

The Indentures permit investments in obligations of, or guaranteed by, the United States of America, its agencies and instrumentalities (United States Government obligations); certificates of deposit issued by institutions insured by the FDIC or fully collateralized with United States Government obligations; investment agreements with certain financial institutions; commercial paper and asset-backed securities rated in the highest category by applicable rating agencies; money market funds and auction rate certificates rated in one of the two highest categories by applicable rating agencies; corporate bonds and medium term notes with a minimum rating of AA-; investments in long-term debt obligations of any state or political subdivision but only to the extent that the applicable rating agency has assigned a rating to such obligations which at the time of purchase is not lower than the highest underlying rating assigned to any series of Commission bonds then outstanding; and repurchase agreements with banks or primary government dealers reporting to the Federal Reserve Bank of New York collateralized with obligations of, or guaranteed by, the United States of America. The Indentures also require that no investment have an original maturity greater than 15 years.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

4. Cash and Investments (continued)

The following is a categorization of cash and cash equivalents and investment securities by risk and type:

| | May 31 | |
|--|-----------------------|-------------|
| | 2004 | 2003 |
| | <i>(In Thousands)</i> | |
| Uninsured, unregistered, and held by the counterparty's trust department in the Commission's name: | | |
| United States Government obligations | \$ 610,428 | \$ 393,714 |
| Municipal obligations | 24,763 | 52,720 |
| Corporate bonds | 24,831 | 39,192 |
| Repurchase agreements | 75,708 | 77,010 |
| | 735,730 | 562,636 |
| Uncategorized: | | |
| Guaranteed investment income contracts | 247,930 | 276,382 |
| Total investment securities and cash equivalents | 983,660 | 839,018 |
| Demand deposits | 77,823 | 131,761 |
| Total cash and cash equivalents and investments | \$ 1,061,483 | \$ 970,779 |

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

5. Capital Assets

Net interest costs of \$6.9 million and \$6.5 million were capitalized as part of capital assets for the years ended May 31, 2004 and 2003, respectively. The amount capitalized includes interest costs incurred during the years ended May 31, 2004 and 2003, of \$6.9 million and \$9.2 million, net of \$2.7 million of interest earned on related investments acquired with revenue bond proceeds for 2003.

A summary of changes in the capital assets for the years ended May 31, 2004 and 2003 is as follows:

| | Balance June 1, 2003 | Additions | Transfers | Deletions | Balance May 31, 2004 |
|--|---------------------------------------|--------------------|------------------|------------------|---------------------------------------|
| | <i>(In Thousands)</i> | | | | |
| Capitalized assets not being depreciated (cost) | | | | | |
| Land | \$ 123,955 | \$ 8,415 | \$ - | \$ 93 | \$ 132,277 |
| Construction in progress | 431,702 | 176,215 | (102,139) | - | 505,778 |
| Total capital assets not being depreciated | <u>555,657</u> | <u>184,630</u> | <u>(102,139)</u> | <u>93</u> | <u>638,055</u> |
| Capitalized assets being depreciated (cost) | | | | | |
| Buildings | 588,153 | - | 50,826 | - | 638,979 |
| Improvements | 53,486 | - | - | - | 53,486 |
| Machinery and equipment | 271,279 | 5,998 | 18,471 | 4,507 | 291,241 |
| Infrastructure | 3,749,954 | 6,398 | 32,842 | - | 3,789,194 |
| Total capital assets being depreciated | <u>4,662,872</u> | <u>12,396</u> | <u>102,139</u> | <u>4,507</u> | <u>4,772,900</u> |
| Less accumulated depreciation for: | | | | | |
| Buildings | 144,889 | 17,441 | - | - | 162,330 |
| Improvements | 32,101 | 2,356 | - | - | 34,457 |
| Machinery and equipment | 176,472 | 35,543 | - | 4,141 | 207,874 |
| Infrastructure | 2,157,481 | 174,208 | - | - | 2,331,689 |
| Total accumulated depreciation | <u>2,510,943</u> | <u>229,548</u> | <u>-</u> | <u>4,141</u> | <u>2,736,350</u> |
| Total capital assets being depreciated, net | <u>2,151,929</u> | <u>(217,152)</u> | <u>102,139</u> | <u>366</u> | <u>2,036,550</u> |
| Total capital assets | <u>\$ 2,707,586</u> | <u>\$ (32,522)</u> | <u>\$ -</u> | <u>\$ 459</u> | <u>\$ 2,674,605</u> |

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

5. Capital Assets (continued)

| | Balance | | | | Balance |
|--|-----------------------|------------------|------------------|------------------|---------------------|
| | June 1, 2002 | Additions | Transfers | Deletions | May 31, 2003 |
| | <i>(In Thousands)</i> | | | | |
| Capitalized assets not being depreciated (cost) | | | | | |
| Land | \$ 121,380 | \$ 2,575 | \$ - | \$ - | \$ 123,955 |
| Construction in progress | 334,128 | 264,737 | (167,163) | - | 431,702 |
| Total capital assets not being depreciated | 455,508 | 267,312 | (167,163) | - | 555,657 |
| Capitalized assets being depreciated (cost) | | | | | |
| Buildings | 568,494 | - | 19,659 | - | 588,153 |
| Improvements | 53,464 | - | 22 | - | 53,486 |
| Machinery and equipment | 250,938 | 6,380 | 17,340 | 3,379 | 271,279 |
| Infrastructure | 3,649,109 | 6,229 | 130,142 | 35,526 | 3,749,954 |
| Total capital assets being depreciated | 4,522,005 | 12,609 | 167,163 | 38,905 | 4,662,872 |
| Less accumulated depreciation for: | | | | | |
| Buildings | 129,107 | 15,782 | - | - | 144,889 |
| Improvements | 29,723 | 2,378 | - | - | 32,101 |
| Machinery and equipment | 147,253 | 29,219 | - | - | 176,472 |
| Infrastructure | 1,977,976 | 187,974 | - | 8,469 | 2,157,481 |
| Total accumulated depreciation | 2,284,059 | 235,353 | - | 8,469 | 2,510,943 |
| Total capital assets being depreciated, net | 2,237,946 | (222,744) | 167,163 | 30,436 | 2,151,929 |
| Total capital assets | <u>\$ 2,693,454</u> | <u>\$ 44,568</u> | <u>\$ -</u> | <u>\$ 30,436</u> | <u>\$ 2,707,586</u> |

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

6. Bonds Payable

Bonds payable consist of the following:

| | May 31 | |
|---|-----------------------|-----------|
| | 2004 | 2003 |
| | <i>(In Thousands)</i> | |
| Revenue bonds payable: | | |
| 1998 Series Q: Issued \$53,000 in July 1998 at a variable rate, due in varying installments through June 1, 2028 | \$ 53,000 | \$ 53,000 |
| 2001 Series R: Issued \$186,025 in March 2001 at 5.00%, due in varying installments through December 1, 2030 | 186,025 | 186,025 |
| 2001 Series S: Issued \$244,925 in May 2001 at 3.40% to 5.60%, due in varying installments through June 1, 2015 | 219,250 | 232,355 |
| 2001 Series T: Issued \$86,660 in September 2001 at 4.10% to 5.50%, due in varying installments through December 1, 2013 | 84,610 | 86,660 |
| 2001 Series U: Issued \$169,820 in September 2001 at a variable rate, due in varying installments through December 1, 2019 | 169,820 | 169,820 |
| 2002 Series A: Issued \$288,265 in September 2002 at a variable rate, due in varying installments through December 1, 2030 | 288,265 | 288,265 |
| 2002 Series B: Issued \$160,880 in September 2002 at a variable rate, due in varying installments through December 1, 2012 | 131,685 | 144,310 |
| Total revenue bonds payable | 1,132,655 | 1,160,435 |
| Tax revenue bonds payable: | | |
| 1998 Series A and B Oil Company Franchise Tax Revenue: Issued \$538,880 in August 1998 at 3.85% to 5.50%, partially defeased in July 2003, due in varying installments through December 1, 2027 | 153,965 | 498,080 |
| 2003 Series A and B Oil Company Franchise Tax Revenue: Issued \$322,685 in August 2003 at 2.50% to 5.50%, due in varying installments through December 1, 2032 | 312,520 | - |
| 2003 Series C Oil Company Franchise Tax Multi-Modal Revenue: Issued \$160,000 in August 2003 at a variable rate, due in varying installments through December 1, 2032 | 160,000 | - |
| Total tax revenue bonds payable | 626,485 | 498,080 |
| Registration fee revenue bonds payable: | | |
| 2001 Series: Issued \$476,065 in July 2001 at 3.00% to 5.50%, due in varying installments through July 15, 2041 | 467,735 | 472,035 |
| | 2,226,875 | 2,130,550 |

Continued on the following page.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

6. Bonds Payable (continued)

| | May 31 | |
|---|-----------------------|---------------------|
| | 2004 | 2003 |
| | <i>(In Thousands)</i> | |
| Unamortized premium (discount): | | |
| (Includes unamortized discount relating to the 1998 Series A and B Oil Company Franchise Tax Revenue Bonds payable of \$2,010 and \$6,590 as of May 31, 2004 and 2003, respectively, and unamortized premium relating to the 2003 Series A and B Oil Company Franchise Tax Revenue Bonds payment of \$5,555 as of May 31, 2004 and unamortized discount relating to the 2001 Registration Fee Bonds payable of \$6,526 and \$6,701 as of May 31, 2004 and 2003, respectively) | 6,041 | (3,244) |
| | 2,232,916 | 2,127,306 |
| Less current portion | 44,160 | 42,370 |
| | \$ 2,188,756 | \$ 2,084,936 |

Changes in bonds payable are as follows:

| | Balance at June 1, 2003 | Additions | Reductions | Balance at May 31, 2004 | Due Within One Year |
|--------------------------------|----------------------------|-------------------|-------------------|-------------------------------|------------------------|
| | <i>(In Thousands)</i> | | | | |
| Revenue bonds payable | \$ 1,160,435 | \$ – | \$ 27,780 | \$ 1,132,655 | \$ 29,090 |
| Tax revenue bonds payable | 498,080 | 482,685 | 354,280 | 626,485 | 10,600 |
| Registration fee bonds payable | 472,035 | – | 4,300 | 467,735 | 4,470 |
| | \$ 2,130,550 | \$ 482,685 | \$ 386,360 | \$ 2,226,875 | \$ 44,160 |

| | Balance at June 1, 2002 | Additions | Reductions | Balance at May 31, 2003 | Due Within One Year |
|--------------------------------|----------------------------|-------------------|-------------------|-------------------------------|------------------------|
| | <i>(In Thousands)</i> | | | | |
| Revenue bonds payable | \$ 1,167,210 | \$ 449,145 | \$ 455,920 | \$ 1,160,435 | \$ 27,780 |
| Tax revenue bonds payable | 507,960 | – | 9,880 | 498,080 | 10,290 |
| Registration fee bonds payable | 476,065 | – | 4,030 | 472,035 | 4,300 |
| | \$ 2,151,235 | \$ 449,145 | \$ 469,830 | \$ 2,130,550 | \$ 42,370 |

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

6. Bonds Payable (continued)

In August 2003 the Commission issued Series A, B, and C of 2003 Oil Company Franchise Tax Revenue Bonds. Series A was issued in the amount of \$124,730,000. Series B was issued in the amount of \$197,955,000. Both Series A and B bonds were issued with interest rates from 2.50% to 5.50% and are payable in varying installments, maturing December 1, 2032. The Series C bonds are multi-modal senior revenue bonds and were issued in four subseries. Subseries C-1 and C-2 were issued in the amount of \$50,000,000 each. Subseries C-3 and C-4 were issued at \$30,000,000 each. Interest payments on C-1 and C-2 bonds are due every seven days, while C-3 and C-4 are due every 35 days. Interest rates vary and are based on current auction rates, with the bonds payable in varying installments through December 1, 2032.

On September 5, 2002, the Commission issued \$288.3 million in Series A Revenue Bonds and \$160.9 million in Series B Revenue Bonds. The proceeds of the bonds were used to advance refund the Commission's Series O and P Revenue Bonds. As a result of the Series A and B advance refundings, the Commission incurred losses of \$10.4 million and \$5.8 million, respectively, which will be amortized over the life of the new bonds. The advance refundings resulted in a decrease in debt service requirements at May 31, 2003 of \$11.8 million.

In prior years as well as the current year, the Commission defeased certain revenue bonds by placing funds in irrevocable trusts to provide for all future debt service payments on the defeased bonds. Accordingly, the trust account assets and the liability for the defeased bonds were not included in the Commission's financial statements. At May 31, 2004, the Commission had \$424.5 million of defeased bonds outstanding.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

6. Bonds Payable (continued)

Debt service requirements subsequent to May 31, 2004, are as follows:

| Year ending May 31 | Principal Maturities | Interest | Total |
|---------------------------|---------------------------------|---------------------|---------------------|
| | <i>(In Thousands)</i> | | |
| 2005 | \$ 44,160 | \$ 79,261 | \$ 123,421 |
| 2006 | 48,260 | 77,819 | 126,079 |
| 2007 | 50,415 | 76,262 | 126,677 |
| 2008 | 52,720 | 74,604 | 127,324 |
| 2009 | 55,210 | 72,788 | 127,998 |
| 2010-2014 | 319,185 | 329,345 | 648,530 |
| 2015-2019 | 376,530 | 257,589 | 634,119 |
| 2020-2024 | 339,025 | 204,279 | 543,304 |
| 2025-2029 | 422,260 | 133,925 | 556,185 |
| 2030-2034 | 338,315 | 71,573 | 409,888 |
| 2035-2039 | 104,620 | 32,756 | 137,376 |
| 2040-2042 | 76,175 | 5,899 | 82,074 |
| | <u>\$ 2,226,875</u> | <u>\$ 1,416,100</u> | <u>\$ 3,642,975</u> |

Interest on the following bonds: 2001 Series R, 2001 Series S, 2001 Series T, 1998 Series A and B Oil Company Franchise Tax Revenue, and 2003 Series A and B Oil Company Franchise Tax Revenue is payable semiannually on June 1 and December 1 of each year. The interest on the 1998 Series Q Revenue Bonds, Series U Revenue Refunding Bonds, 2002 Series A and B Revenue Bonds is payable the first of every month. The interest on the 2003 Series C Oil Company Franchise Tax Revenue bonds is payable every seven days for Subseries C-1 and C-2 and every 35 days for Subseries C-3 and C-4. The interest on the 2001 Series Registration Fee Revenue Bonds is payable semiannually on January 15 and July 15 of each year.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

6. Bonds Payable (continued)

Debt service requirements subsequent to May 31, 2004 related to the 1998 Series A and B Oil Company Franchise Tax Revenue Bonds and the 2003 Series A, B and C Oil Company Franchise Tax Revenue Bonds only, are as follows:

| Year ending May 31 | Principal Maturities | Interest | Total |
|---------------------------|---------------------------------|-------------------|---------------------|
| | <i>(In Thousands)</i> | | |
| 2005 | \$ 10,600 | \$ 24,272 | \$ 34,872 |
| 2006 | 10,960 | 23,906 | 34,866 |
| 2007 | 11,335 | 23,549 | 34,884 |
| 2008 | 11,770 | 23,150 | 34,920 |
| 2009 | 12,260 | 22,681 | 34,941 |
| 2010-2014 | 70,255 | 104,831 | 175,086 |
| 2015-2019 | 89,965 | 85,766 | 175,731 |
| 2020-2024 | 116,230 | 60,163 | 176,393 |
| 2025-2029 | 138,450 | 32,117 | 170,567 |
| 2030-2033 | 154,660 | 10,467 | 165,127 |
| | <u>\$ 626,485</u> | <u>\$ 410,902</u> | <u>\$ 1,037,387</u> |

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

6. Bonds Payable (continued)

Debt service requirements subsequent to May 31, 2004 related to the 2001 Registration Fee Revenue Bonds only, are as follows:

| Year ending May 31 | Principal Maturities | Interest | Total |
|--------------------|-------------------------|------------|--------------|
| | <i>(In Thousands)</i> | | |
| 2005 | \$ 4,470 | \$ 23,455 | \$ 27,925 |
| 2006 | 4,615 | 23,300 | 27,915 |
| 2007 | 4,780 | 23,117 | 27,897 |
| 2008 | 4,980 | 22,903 | 27,883 |
| 2009 | 5,205 | 22,680 | 27,885 |
| 2010-2014 | 29,855 | 109,386 | 139,241 |
| 2015-2019 | 38,430 | 100,527 | 138,957 |
| 2020-2024 | 49,700 | 89,015 | 138,715 |
| 2025-2029 | 63,625 | 74,781 | 138,406 |
| 2030-2034 | 81,280 | 56,589 | 137,869 |
| 2035-2039 | 104,620 | 32,756 | 137,376 |
| 2040-2042 | 76,175 | 5,899 | 82,074 |
| | \$ 467,735 | \$ 584,408 | \$ 1,052,143 |

The Amended and Restated Trust Indenture of 2001 requires that tolls be adequate to provide funds to cover current expenses and provide (1) funds in an amount not less than the greater of 130% of the maximum principal and interest requirements for the succeeding year; or (2) 100% of the maximum principal and interest payments for the next fiscal year plus the amount required for maintenance of the Turnpike System as determined by the Commission's Consulting Engineer. Should any deficiencies occur, the Commission is authorized to raise tolls appropriately.

The 1998 Series A and Series B Oil Company Franchise Tax Revenue Bonds and the 2003 Series A, Series B, Series C Oil Company Franchise Tax Revenue Bonds are secured by a pledge and assignment by the Commission to the Trustee of: (1) all proceeds from the Commission's allocation of the Commonwealth of Pennsylvania's Oil Company Franchise Tax; (2) the Commission's right to receive its allocation of the Oil Company Franchise Tax and any portion of the allocation actually received by the Commission; (3) all monies deposited into accounts or funds created by the 1998 Indenture, amended August 1, 2003; and (4) all investment earnings on all monies held in accounts and funds established by the 1998 Indenture, amended August 1, 2003.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

6. Bonds Payable (continued)

The 1998 Indenture, amended August 1, 2003, requires the Commission to petition the General Assembly of the Commonwealth of Pennsylvania for additional funds in the event that the Commission's allocation of the Oil Company Franchise Tax is inadequate to pay maximum principal and interest payments for the succeeding year.

The Registration Fee Revenue Bonds 2001 Series are secured by a pledge and assignment by the Commission to the Trustee of any receipts, revenues and other moneys received by the Trustee on or after the date of the Indenture from the Commission Allocations and the interest and income earned on any fund or account established pursuant to the Indenture. Pursuant to Section 20 of Act 3, \$28,000,000 of the Act 3 revenues are appropriated annually to the Commission and are payable monthly to the Commission in the amount of \$2,333,333.

Swap Payments and Associated Debt

As of May 31, 2004, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same, for their term were as follows.

| Year ending May 31 | Variable-Rate Bonds | | | Total |
|--------------------|-----------------------|-------------------|--------------------------|---------------------|
| | Principal Maturities | Interest | Interest Rate Swaps, Net | |
| | <i>(In Thousands)</i> | | | |
| 2005 | \$ 13,235 | \$ 7,861 | \$ 25,478 | \$ 46,574 |
| 2006 | 16,070 | 7,704 | 24,969 | 48,743 |
| 2007 | 16,815 | 7,528 | 24,397 | 48,740 |
| 2008 | 17,625 | 7,344 | 23,798 | 48,767 |
| 2009 | 18,470 | 7,151 | 23,170 | 48,791 |
| 2010-2014 | 49,470 | 33,652 | 109,017 | 192,139 |
| 2015-2019 | 201,455 | 27,579 | 88,877 | 317,911 |
| 2020-2024 | 102,550 | 19,056 | 60,167 | 181,773 |
| 2025-2029 | 180,600 | 12,148 | 37,476 | 230,224 |
| 2030-2034 | 133,480 | 3,324 | 6,887 | 143,691 |
| | <u>\$ 749,770</u> | <u>\$ 133,347</u> | <u>\$ 424,236</u> | <u>\$ 1,307,353</u> |

As rates vary, variable-rate bond interest payments and net swap payments will vary. Please refer to Note 8 Commitments and Contingencies – Interest Rate Swaps for additional information pertaining to the individual swaps.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

7. Retirement Benefits

Substantially all employees of the Commission participate in the Commonwealth of Pennsylvania State Employees' Retirement System (System), a cost-sharing multiple-employer public employee retirement system that was established under the provisions of Public Law 858, No. 331.

Membership in the System is mandatory for most Commission employees. The System provides retirement, death, and disability benefits which were established and can be amended according to statute. Retirement benefits vest after 5 years of credited service. Employees who retire at age 60, or with 35 years of service if under age 60, are entitled to an unreduced annual retirement benefit.

Article II of the Pennsylvania Constitution provides the General Assembly the authority to establish or amend benefit provisions. Act 2001-9, signed into law on May 17, 2001 established Class AA membership whereby, generally, annual full retirement benefits for electing active members is 2.5% of the member's highest three-year average salary (final average salary) multiplied by years of service. Commission employees hired after June 30, 2001 are Class AA members. Members hired on or before June 30, 2001 had the option, but were not required, to elect Class AA membership. Those members not electing Class AA membership are considered Class A. The general annual benefit for full retirement for Class A members is 2% of the member's final average salary multiplied by years of service.

Covered Class A and Class AA employees are required by statute to contribute to the System at a rate of 5% and 6.25%, respectively of their gross pay. The employees' contributions are recorded in an individually identified account, which is also credited with interest, calculated quarterly to yield 4% per annum, as mandated by statute. Accumulated employee contributions and credited interest vest immediately and are returned to the employee upon termination of service if the employee is not eligible for other benefits.

Participating agency contributions, including those for the Commission, are also mandated by statute and are based upon an actuarially determined percentage of gross pay that is necessary to provide the System with assets sufficient to meet the benefits to be paid to System members.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

7. Retirement Benefits (continued)

The Commission's required contributions and percentage contributed are as follows:

| Year ended May 31 | Commission Required Contribution | % Contributed |
|--------------------------|---|--------------------------|
| | <i>(Dollars are in millions)</i> | |
| 2004 | \$ 0.5 | 100% |
| 2003 | \$ 0.0 | 100% |
| 2002 | \$ 0.0 | 100% |
| 2001 | \$ 1.0 | 100% |

A copy of the System's annual financial statements can be obtained by writing to: State Employees' Retirement System, 30 North Third Street, P.O. Box 1147, Harrisburg, Pennsylvania 17108-1147.

8. Commitments and Contingencies

Litigation

The Commission is a defendant in a number of legal proceedings pertaining to matters normally incidental to routine operations. Such litigation includes, but is not limited to, claims asserted against the Commission arising from alleged torts, alleged breaches of contracts, and condemnation proceedings. Tort claims against the Commission are generally barred by sovereign immunity, except as waived by statute. Further, to the extent waived, damages for any loss are limited by sovereign immunity to \$250,000 for each person and \$1,000,000 for each accident. Based on the current status of all of the Commission's legal proceedings, it is the opinion of Commission management and counsel that they will not have a material effect on the Commission's financial position.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

8. Commitments and Contingencies (continued)

Construction Commitments

At May 31, 2004, the Commission had contractual commitments for various Turnpike System improvement projects. A summary of construction commitments and their related funding source at May 31, 2004, is as follows:

| | Scheduled Completion Date | Estimated Project Cost | Contracts Awarded Through May 31, 2004 | Incurred Through May 31, 2004 |
|---|--|---------------------------------------|---|--|
| <i>(In Thousands)</i> | | | | |
| Funded previously by 1998 Bonds and currently with Registration Fee Revenue Bonds 2001 Series and 2003 Bonds: | | | | |
| Mon-Fayette Extension | 2014 | \$ 1,848,733 | \$ 476,420 | \$ 209,439 |
| Funded by operations and various bond proceeds: | | | | |
| Other construction projects | Various | 4,556,877 | 738,877 | 541,630 |
| | | <u>\$ 6,405,610</u> | <u>\$ 1,215,297</u> | <u>\$ 751,069</u> |

Interest Rate Swaps

In July 2003, the Commission entered into two interest swap agreements on a portion of its debt to synthetically convert variable interest rates to fixed interest rates and thus hedge its variable rate exposure as well as preserve lower interest rates. These swaps were placed on the 2003 Series C Oil Company Franchise Tax Revenue Bonds with two different swap providers (counterparties). Based on these swap agreements, the Commission owes interest calculated at a fixed rate to the counterparties to the swaps. In return, the counterparties owe the Commission interest based on a variable rate that approximates the rate on the bonds. Only the net difference in interest payments is actually exchanged with the counterparties. The total notional amount of these swaps was approximately \$160 million at May 31, 2004. The \$160 million in bond principal is not exchanged, it is only the basis on which the interest payments are calculated. Additionally, the Commission continues to pay interest to the bondholders at the variable rate on the bonds.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

8. Commitments and Contingencies (continued)

Interest Rate Swaps (continued)

Following is a summary of the swaps in place as of May 31, 2004. These swap agreements contain certain risks as described below.

| Swap | Notional Value | Final Maturity | Floating Rate Index (Receivable) | Fixed Rate (Payable) | Fair Value from (to) Counterparty |
|---------------|-----------------------|----------------|---|----------------------|-----------------------------------|
| Series U 2001 | \$ 127,365,000 | 12/1/2019 | 67% of 1 mo. LIBOR ⁽¹⁾ | 4.214% | \$ (8,471,500) |
| | 42,455,000 | 12/1/2019 | | | (2,823,900) |
| Series A 2002 | 72,066,250 | 12/1/2030 | 67% of 1 mo. LIBOR ⁽¹⁾ | 4.403% | (7,728,200) |
| | 144,070,000 | 12/1/2030 | | | (15,449,700) |
| | 72,066,250 | 12/1/2030 | | | (7,728,200) |
| Series B 2002 | 32,921,250 | 12/1/2012 | BMA ⁽²⁾ | 4.538% | (1,640,200) |
| | 65,842,500 | 12/1/2012 | | | (3,280,400) |
| | 32,921,250 | 12/1/2012 | | | (1,640,200) |
| Series C 2003 | 48,000,000 | 12/1/2032 | 63% of 1 mo. LIBOR ⁽¹⁾ plus 20 basis points | 3.838% | (1,936,000) |
| | <u>112,000,000</u> | 12/1/2032 | | | <u>(829,700)</u> |
| Total | <u>\$ 749,707,500</u> | | | | <u>\$ (51,528,000)</u> |

⁽¹⁾ 1 month LIBOR was 1.11375% at May 31, 2004

⁽²⁾ BMA was 1.06% at May 31, 2004

- **Credit Risk** – As of May 31, 2004, the Commission was not exposed to credit risk because all of the swaps had negative fair values. However, should interest rates change and the fair values of the swaps become positive, the Commission would be exposed to credit risk in the amount of the derivatives' fair values. To mitigate the potential for credit risk, the swap agreements include collateral provisions in the event of downgrades to the swap counterparties' credit ratings. Collateral would be posted with a third-party custodian and would be in the form of cash, U.S. Treasury Obligations or U.S. Government Agency Securities. The Commission had five counterparties at May 31, 2004. The credit ratings of the swap providers as of May 31, 2004 were AAA to AA- and Aaa to Aa3 by Standard & Poor's and Moody's, respectively.
- **Interest Rate Risk** – The Commission will be exposed to variable interest rates if one or more of the swap providers defaults or if a swap is terminated.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

8. Commitments and Contingencies (continued)

Interest Rate Swaps (continued)

- **Basis Risk** – The underlying variable rates for the Commission’s Series U and Series A bonds are based on BMA while the Series U and Series A swaps are based on a percentage of LIBOR. Therefore, the Commission is exposed to basis risk to the extent BMA exceeds 67% of one month LIBOR. The underlying variable rates for the Commission’s 2003 Series C bonds are based on auction rates. The auction rates approximate BMA. The Series C swaps, with a combined notional value of \$160 million, are based on a percentage of LIBOR plus 20 basis points. Therefore, the Commission is exposed to basis risk to the extent auction rates exceed 63% of one month LIBOR plus 20 basis points.
- **Termination Risk** – The swap agreements may be terminated due to a number of circumstances and the Commission retains the option to terminate the swaps at any time. If the Commission were required to make a termination payment because of a termination event (by either party), then the Commission would have the option to enter into a new swap to match the remaining amortization of the underlying bonds and apply the payment it received toward the termination payment. It is the Commission’s intent to maintain the swap transactions for the life of the financing.

Union Contracts

Approximately 80% of the Commission’s employees are represented by three Teamster locals. Agreements between the Commission and the Teamsters expired on September 30, 2003. The Commission continues to maintain the status quo for union members and continues to meet its legal obligation to negotiate with the union in good faith. Union members continue to work without a contract under the terms and conditions of the expired contract.

9. Related Party Transactions

The Commission incurred costs to the Commonwealth of \$24.6 million and \$22.9 million related to its use of the Commonwealth’s State Police in patrolling the Turnpike System in 2004 and 2003, respectively.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

10. Postretirement Benefits

The Commission offers certain postretirement medical, prescription drug, dental, and eye care benefits to management employees who have reached 20 years of service and are under age 60. Benefit eligibility changes from 20 to 10 years for retirees 60 years of age or older.

The Commission offers certain postretirement medical and prescription drug benefits to union employees who have reached 25 years of service and are under age 60. Benefit eligibility changes from 25 to 3 years of service for retirees 60 years of age or older.

As of May 31, 2004, 725 retirees were eligible for such benefits. The Commission has elected to account for the postretirement benefits as expenses are incurred. The Commission's expense for postretirement benefits was \$2.9 million and \$2.1 million in 2004 and 2003, respectively.

11. Segment Information

The Pennsylvania Turnpike Commission consists of three segment types. These segments are based on the types of revenues and the associated bond issues. The Mainline consists of income and expenses directly associated with the operations of the toll road. In addition, all bonds pledged against this revenue source are included in this segment.

The Oil Company Franchise segment consists of revenues received from the Commission's allocation of the Commonwealth of Pennsylvania's Oil Company Franchise Tax. This revenue is pledged against the associated 1998 Series A and Series B Oil Company Franchise Tax Revenue Bonds and the 2003 Series A, Series B, Series C Oil Company Franchise Tax Revenue Bonds.

The Motor License segment consists of an annual income of \$28 million which has been awarded to the Commission pursuant to Section 20 of Act 3 of the Commonwealth of Pennsylvania. This income is pledged against the Registration Fee Revenue Bonds 2001 Series.

Pennsylvania Turnpike Commission
Notes to Financial Statements (continued)

11. Segment Information (continued)

| | Balance Sheet | | | Total |
|-----------------------------------|--------------------------------|----------------------|----------------------|---------------------|
| | Year ended May 31, 2004 | | | |
| | Mainline | Oil Franchise | Motor License | |
| | <i>(In Thousands)</i> | | | |
| Assets | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | \$ 150,798 | \$ 59,514 | \$ 18,143 | \$ 228,455 |
| Short-term investments | 5,021 | 38,900 | – | 43,921 |
| Accounts receivable | 17,807 | 4,327 | 2,339 | 24,473 |
| Accrued interest receivable | 446 | 4,827 | 4,373 | 9,646 |
| Inventories | 16,776 | – | – | 16,776 |
| Total current assets | <u>190,848</u> | <u>107,568</u> | <u>24,855</u> | <u>323,271</u> |
| Long-term investments | 37,558 | 502,130 | 249,419 | 789,107 |
| Capital assets: | | | | |
| Land | 132,277 | – | – | 132,277 |
| Buildings | 638,979 | – | – | 638,979 |
| Improvements other than buildings | 53,486 | – | – | 53,486 |
| Equipment | 291,241 | – | – | 291,241 |
| Infrastructure | 3,789,194 | – | – | 3,789,194 |
| Construction in progress | 387,555 | 1,991 | 116,232 | 505,778 |
| | <u>5,292,732</u> | <u>1,991</u> | <u>116,232</u> | <u>5,410,955</u> |
| Less accumulated depreciation | 2,736,350 | – | – | 2,736,350 |
| | <u>2,556,382</u> | <u>1,991</u> | <u>116,232</u> | <u>2,674,605</u> |
| Other assets: | | | | |
| Other assets | 40,423 | 570 | – | 40,993 |
| Deferred bond issuance costs | 8,289 | 7,829 | 5,153 | 21,271 |
| Total other assets | <u>48,712</u> | <u>8,399</u> | <u>5,153</u> | <u>62,264</u> |
| Total assets | <u>\$ 2,833,500</u> | <u>\$ 620,088</u> | <u>\$ 395,659</u> | <u>\$ 3,849,247</u> |

Continued on the following page.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

11. Segment Information (continued)

Balance Sheet (continued)

| | Year ended May 31, 2004 | | | Total |
|--|-------------------------|---------------|---------------|--------------|
| | Mainline | Oil Franchise | Motor License | |
| | <i>(In Thousands)</i> | | | |
| Liabilities and net assets | | | | |
| Current liabilities: | | | | |
| Accounts payable and accrued liabilities | \$ 85,104 | \$ 11,692 | \$ 12,097 | \$ 108,893 |
| Current portion of bonds payable | 29,090 | 10,600 | 4,470 | 44,160 |
| Total current liabilities | 114,194 | 22,292 | 16,567 | 153,053 |
| Bonds payable, less current portion, net of unamortized premium/discount | 1,112,587 | 619,430 | 456,739 | 2,188,756 |
| Other noncurrent liabilities | 13,700 | 212 | – | 13,912 |
| | 1,126,287 | 619,642 | 456,739 | 2,202,668 |
| Total liabilities | 1,240,481 | 641,934 | 473,306 | 2,355,721 |
| Net assets: | | | | |
| Invested in capital assets, net of related debt | 1,450,173 | (630,933) | (348,647) | 470,593 |
| Restricted for certain construction and maintenance purposes | 141,916 | 539,700 | 252,492 | 934,108 |
| Unrestricted | 930 | 69,387 | 18,508 | 88,825 |
| Total net assets | 1,593,019 | (21,846) | (77,647) | 1,493,526 |
| Total liabilities and net assets | \$ 2,833,500 | \$ 620,088 | \$ 395,659 | \$ 3,849,247 |

Pennsylvania Turnpike Commission
Notes to Financial Statements (continued)

11. Segment Information (continued)

Statement of Revenues, Expenses, and Changes in Net Assets

| | Year ended May 31, 2004 | | | Total |
|---|-------------------------|--------------------|--------------------|---------------------|
| | Mainline | Oil Franchise | Motor License | |
| | <i>(In Thousands)</i> | | | |
| Operating revenues: | | | | |
| Net fares | \$ 408,744 | \$ – | \$ – | \$ 408,744 |
| Other | 19,034 | – | – | 19,034 |
| | <u>427,778</u> | <u>–</u> | <u>–</u> | <u>427,778</u> |
| Operating expenses: | | | | |
| Cost of services | 236,759 | 451 | 175 | 237,385 |
| Depreciation | 229,548 | – | – | 229,548 |
| | <u>466,307</u> | <u>451</u> | <u>175</u> | <u>466,933</u> |
| Operating loss | (38,529) | (451) | (175) | (39,155) |
| Nonoperating revenues (expenses): | | | | |
| Oil company franchise tax revenues | – | 47,062 | – | 47,062 |
| Federal and state grants and reimbursements | 6,159 | – | 36,628 | 42,787 |
| Investment earnings | 6,945 | 1,205 | 22,751 | 30,901 |
| Other nonoperating revenues | 1,453 | – | – | 1,453 |
| Interest and bond expenses | (51,115) | (45,870) | (23,910) | (120,895) |
| | <u>(36,558)</u> | <u>2,397</u> | <u>35,469</u> | <u>1,308</u> |
| Change in net assets | (75,087) | 1,946 | 35,294 | (37,847) |
| Net assets at beginning of year | 1,654,753 | (211,446) | 88,066 | 1,531,373 |
| Asset transfers | 13,353 | 187,654 | (201,007) | – |
| Net assets at end of year | <u>\$ 1,593,019</u> | <u>\$ (21,846)</u> | <u>\$ (77,647)</u> | <u>\$ 1,493,526</u> |

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

11. Segment Information (continued)

Statement of Cash Flows

| | Year ended May 31, 2004 | | | Total |
|---|-------------------------|---------------|---------------|-------------|
| | Mainline | Oil Franchise | Motor License | |
| | <i>(In Thousands)</i> | | | |
| Operating activities | | | | |
| Cash received from tolls/customers | \$ 455,325 | \$ – | \$ – | \$ 455,325 |
| Cash payments for goods and services | (141,863) | (51) | 1,652 | (140,262) |
| Cash payments to employees | (141,389) | – | – | (141,389) |
| Cash received from other operating activities | 15,623 | – | – | 15,623 |
| Net cash provided by (used in) operating activities | 187,696 | (51) | 1,652 | 189,297 |
| Investing activities | | | | |
| Proceeds from sales of investments, excluding cash equivalents | 7,895,666 | 359,891 | 174,437 | 8,429,994 |
| Proceeds from maturities of investments | 3,611 | 11,518 | 8,010 | 23,139 |
| Interest received on investments | 2,902 | 11,075 | 16,393 | 30,370 |
| Purchases of investments | (7,906,375) | (679,766) | (24,245) | (8,610,386) |
| Net cash (used in) provided by investing activities | (4,196) | (297,282) | 174,595 | (126,883) |
| Capital and related financing activities | | | | |
| Capital grants received | – | – | 7,079 | 7,079 |
| Acquisition of capital assets | (130,466) | (2,744) | (51,488) | (184,698) |
| Proceeds from sale of capital assets | 1,290 | – | – | 1,290 |
| Payments for bond expenses | (2,319) | (3,289) | (43) | (5,651) |
| Payments for redemption of revenue bonds | (27,780) | (354,280) | (4,300) | (386,360) |
| Interest paid on bonds | (53,280) | (35,573) | (23,614) | (112,467) |
| Proceeds from new bonds | – | 483,335 | – | 483,335 |
| Proceeds from escrow restructuring | – | – | 10,713 | 10,713 |
| Net cash (used in) provided by capital and related financing activities | (212,555) | 87,449 | (61,653) | (186,759) |

Continued on the following page.

Pennsylvania Turnpike Commission
Notes to Financial Statements (continued)

11. Segment Information (continued)

Statement of Cash Flows (continued)

| | Year ended May 31, 2004 | | | Total |
|--|-------------------------|------------------|------------------|-------------------|
| | Mainline | Oil Franchise | Motor License | |
| | <i>(In Thousands)</i> | | | |
| Noncapital financing activities | | | | |
| Interfund transfers | \$ - | \$ 186,537 | \$(186,537) | \$ - |
| Cash proceeds from motor license grant | - | - | 28,000 | 28,000 |
| Cash proceeds from oil company franchise tax | - | 47,198 | - | 47,198 |
| Net cash provided by (used in) noncapital financing activities | - | 233,735 | (158,537) | 75,198 |
| (Decrease) increase in cash and cash equivalents | (29,055) | 23,851 | (43,943) | (49,147) |
| Cash and cash equivalents at beginning of year | 179,853 | 35,663 | 62,086 | 277,602 |
| Cash and cash equivalents at end of year | \$ 150,798 | \$ 59,514 | \$ 18,143 | \$ 228,455 |

Continued on the following page – see accompanying schedule of reconciliation.

Pennsylvania Turnpike Commission
Notes to Financial Statements (continued)

11. Segment Information (continued)

Statement of Cash Flows (continued)

| | Year ended May 31, 2004 | | | |
|---|-------------------------|---------------|---------------|-------------|
| | Mainline | Oil Franchise | Motor License | Total |
| | <i>(In Thousands)</i> | | | |
| Reconciliation of operating loss to net cash provided by (used in) operating activities | | | | |
| Operating loss | \$ (38,529) | \$ (451) | \$ (175) | \$ (39,155) |
| Adjustments to reconcile operating loss to net cash provided by (used in) operating activities: | | | | |
| Depreciation | 229,548 | - | - | 229,548 |
| Change in operating assets and liabilities: | | | | |
| Accounts receivable, net of nonoperating receivables | 91 | - | - | 91 |
| Inventories | (4,501) | - | - | (4,501) |
| Other assets | 16 | - | - | 16 |
| Accounts payable and accrued liabilities, excluding interest payable | 4,060 | 400 | 1,827 | 6,287 |
| Other noncurrent liabilities | (2,989) | - | - | (2,989) |
| Net cash provided by (used in) operating activities | \$ 187,696 | \$ (51) | \$ 1,652 | \$ 189,297 |
| Noncash activities | | | | |
| Increase (decrease) in fair value of investments | \$ 1,293 | \$ (10,916) | \$ (1,471) | \$ (11,094) |

Pennsylvania Turnpike Commission
Notes to Financial Statements (continued)

11. Segment Information (continued)

Balance Sheet

Year ended May 31, 2003

Motor

Mainline Oil Franchise License Total

(In Thousands)

Assets

Current assets:

| | | | | |
|-----------------------------|----------------|---------------|---------------|----------------|
| Cash and cash equivalents | \$ 179,853 | \$ 35,663 | \$ 62,086 | \$ 277,602 |
| Short-term investments | 121 | 11,773 | 15,970 | 27,864 |
| Accounts receivable | 17,083 | 4,463 | 191 | 21,737 |
| Accrued interest receivable | 363 | 2,382 | 2,682 | 5,427 |
| Inventories | 12,275 | - | - | 12,275 |
| Total current assets | 209,695 | 54,281 | 80,929 | 344,905 |

| | | | | |
|-----------------------|--------|---------|---------|---------|
| Long-term investments | 34,046 | 228,917 | 402,350 | 665,313 |
|-----------------------|--------|---------|---------|---------|

Capital assets:

| | | | | |
|-----------------------------------|------------------|----------|---------------|------------------|
| Land | 123,955 | - | - | 123,955 |
| Buildings | 588,153 | - | - | 588,153 |
| Improvements other than buildings | 53,486 | - | - | 53,486 |
| Equipment | 271,279 | - | - | 271,279 |
| Infrastructure | 3,749,954 | - | - | 3,749,954 |
| Construction in progress | 356,540 | - | 75,162 | 431,702 |
| | 5,143,367 | - | 75,162 | 5,218,529 |
| Less accumulated depreciation | 2,510,943 | - | - | 2,510,943 |
| | 2,632,424 | - | 75,162 | 2,707,586 |

Other assets:

| | | | | |
|------------------------------|---------------------|-------------------|-------------------|---------------------|
| Other assets | 43,843 | 3,710 | - | 47,553 |
| Deferred bond issuance costs | 8,827 | 5,486 | 5,292 | 19,605 |
| Total other assets | 52,670 | 9,196 | 5,292 | 67,158 |
| Total assets | \$ 2,928,835 | \$ 292,394 | \$ 563,733 | \$ 3,784,962 |

Continued on the following page.

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

11. Segment Information (continued)

Balance Sheet (continued)

| | Year ended May 31, 2003 | | | Total |
|--|-------------------------|---------------|---------------|--------------|
| | Mainline | Oil Franchise | Motor License | |
| | <i>(In Thousands)</i> | | | |
| Liabilities and net assets | | | | |
| Current liabilities: | | | | |
| Accounts payable and accrued liabilities | \$ 84,551 | \$ 12,350 | \$ 10,333 | \$ 107,234 |
| Current portion of bonds payable | 27,780 | 10,290 | 4,300 | 42,370 |
| Total current liabilities | 112,331 | 22,640 | 14,633 | 149,604 |
| Bonds payable, less current portion, net of unamortized premium/discount | 1,142,702 | 481,200 | 461,034 | 2,084,936 |
| Other noncurrent liabilities | 19,049 | – | – | 19,049 |
| Total liabilities | 1,274,082 | 503,840 | 475,667 | 2,253,589 |
| Net assets: | | | | |
| Invested in capital assets, net of related debt | 1,500,847 | (494,646) | (393,767) | 612,434 |
| Restricted for certain construction and maintenance purposes | 152,903 | 121,649 | 394,207 | 668,759 |
| Unrestricted | 1,003 | 161,551 | 87,626 | 250,180 |
| Total net assets | 1,654,753 | (211,446) | 88,066 | 1,531,373 |
| Total liabilities and net assets | \$ 2,928,835 | \$ 292,394 | \$ 563,733 | \$ 3,784,962 |

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

11. Segment Information (continued)

Statement of Revenues, Expenses, and Changes in Net Assets

| | Year ended May 31, 2003 | | | Total |
|---|-------------------------|--------------------|------------------|---------------------|
| | Mainline | Oil Franchise | Motor License | |
| | <i>(In Thousands)</i> | | | |
| Operating revenues: | | | | |
| Net fares | \$ 387,222 | \$ – | \$ – | \$ 387,222 |
| Other | 17,534 | – | – | 17,534 |
| | <u>404,756</u> | <u>–</u> | <u>–</u> | <u>404,756</u> |
| Operating expenses: | | | | |
| Cost of services | 234,474 | (400) | 18 | 234,092 |
| Depreciation | 229,485 | – | – | 229,485 |
| | <u>463,959</u> | <u>(400)</u> | <u>18</u> | <u>463,577</u> |
| Operating (loss) income | (59,203) | 400 | (18) | (58,821) |
| Nonoperating revenues (expenses): | | | | |
| Oil company franchise tax revenues | – | 46,288 | – | 46,288 |
| Federal and state grants and reimbursements | 1,780 | – | 33,355 | 35,135 |
| Investment earnings | 8,429 | 23,067 | 27,208 | 58,704 |
| Other nonoperating revenues | 3,692 | – | – | 3,692 |
| Interest and bond expenses | (53,885) | (27,947) | (23,247) | (105,079) |
| | <u>(39,984)</u> | <u>41,408</u> | <u>37,316</u> | <u>38,740</u> |
| Change in net assets | (99,187) | 41,808 | 37,298 | (20,081) |
| Net assets at beginning of year | 1,758,164 | (296,049) | 89,339 | 1,551,454 |
| Asset transfers | (4,224) | 42,795 | (38,571) | – |
| Net assets at end of year | <u>\$ 1,654,753</u> | <u>\$(211,446)</u> | <u>\$ 88,066</u> | <u>\$ 1,531,373</u> |

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

11. Segment Information (continued)

Statement of Cash Flows

| | Year ended May 31, 2003 | | | Total |
|--|-------------------------|---------------|---------------|-------------|
| | Mainline | Oil Franchise | Motor License | |
| | <i>(In Thousands)</i> | | | |
| Operating activities | | | | |
| Cash received from tolls/customers | \$ 410,047 | \$ – | \$ – | \$ 410,047 |
| Cash payments for goods and services | (136,145) | 400 | (18) | (135,763) |
| Cash payments to employees | (117,752) | – | – | (117,752) |
| Cash received from other operating activities | 11,787 | – | – | 11,787 |
| Net cash provided by (used in) operating activities | 167,937 | 400 | (18) | 168,319 |
| Investing activities | | | | |
| Proceeds from sales of investments, excluding cash equivalents | 8,962,400 | 171,982 | 167,831 | 9,302,213 |
| Proceeds from maturities of investments | 9,130 | 25,640 | 14,321 | 49,091 |
| Interest received on investments | 9,316 | 12,287 | 25,813 | 47,416 |
| Purchases of investments | (8,887,467) | (195,610) | (146,823) | (9,229,900) |
| Net cash provided by investing activities | 93,379 | 14,299 | 61,142 | 168,820 |
| Capital and related financing activities | | | | |
| Capital grants received | – | – | 7,042 | 7,042 |
| Acquisition of capital assets | (196,883) | (501) | (47,930) | (245,314) |
| Proceeds from sale of capital assets | 3,948 | – | – | 3,948 |
| Payments for bond expenses | (2,321) | – | (82) | (2,403) |
| Payments for redemption of revenue bonds | (464,013) | (9,880) | (4,030) | (477,923) |
| Interest paid on bonds | (58,238) | (25,098) | (23,780) | (107,116) |
| Proceeds from new bonds | 447,798 | – | – | 447,798 |
| Net cash used in capital and related financing activities | (269,709) | (35,479) | (68,780) | (373,968) |

Continued on the following page.

Pennsylvania Turnpike Commission
Notes to Financial Statements (continued)

11. Segment Information (continued)

Statement of Cash Flows (continued)

| | Year ended May 31, 2003 | | | Total |
|--|-------------------------|---------------|---------------|------------|
| | Mainline | Oil Franchise | Motor License | |
| | <i>(In Thousands)</i> | | | |
| Noncapital financing activities | | | | |
| Interfund transfers | \$ — | \$ (16,525) | \$ 16,525 | \$ — |
| Cash proceeds from motor license grant | — | — | 28,000 | 28,000 |
| Cash proceeds from oil company franchise tax | — | 46,135 | — | 46,135 |
| Net cash provided by noncapital financing activities | — | 29,610 | 44,525 | 74,135 |
| (Decrease) increase in cash and cash equivalents | (8,393) | 8,830 | 36,869 | 37,306 |
| Cash and cash equivalents at beginning of year | 188,246 | 26,833 | 25,217 | 240,296 |
| Cash and cash equivalents at end of year | \$ 179,853 | \$ 35,663 | \$ 62,086 | \$ 277,602 |

Continued on the following page – see accompanying schedule of reconciliation.

Pennsylvania Turnpike Commission
Notes to Financial Statements (continued)

11. Segment Information (continued)

Statement of Cash Flows (continued)

| | Year ended May 31, 2003 | | | Total |
|--|-------------------------|------------------|-----------------|-------------------|
| | Mainline | Oil Franchise | Motor License | |
| | <i>(In Thousands)</i> | | | |
| Reconciliation of operating (loss) income to net cash provided by (used in) operating activities | | | | |
| Operating (loss) income | \$ (59,203) | \$ 400 | \$ (18) | \$ (58,821) |
| Adjustments to reconcile operating (loss) income to net cash provided by (used in) operating activities: | | | | |
| Depreciation | 229,485 | - | - | 229,485 |
| Change in operating assets and liabilities: | | | | |
| Accounts receivable, net of nonoperating receivables | (4,461) | - | - | (4,461) |
| Inventories | 1,876 | - | - | 1,876 |
| Other assets | 12 | - | - | 12 |
| Accounts payable and accrued liabilities, excluding interest payable | 6,521 | - | - | 6,521 |
| Other noncurrent liabilities | (6,293) | - | - | (6,293) |
| Net cash provided by (used in) operating activities | <u>\$ 167,937</u> | <u>\$ 400</u> | <u>\$ (18)</u> | <u>\$ 168,319</u> |
| Noncash activities | | | | |
| Increase in fair value of investments | <u>\$ 2,293</u> | <u>\$ 10,809</u> | <u>\$ 5,865</u> | <u>\$ 18,967</u> |

Pennsylvania Turnpike Commission

Notes to Financial Statements (continued)

12. Subsequent Events

On June 7, 2004, the Commission issued 2004 Series A Revenue Bonds in the amount of \$269,245,000. The bond interest rate varies from 5.00% to 5.50%, due in varying installments through December 1, 2034. The proceeds of the bonds will be used to fund various capital expenditures as set forth in the Commission's 10-year capital plan.

On January 20, 2004, the Commission approved a resolution to adopt a new fare rate schedule. The new fare rate schedule is effective August 1, 2004. This is the first toll increase since June 1, 1991. Rates on average will increase 1.8 cents/mile for cars and 5.3 cents/mile for trucks.

Statistical Section

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Pennsylvania Turnpike Commission

Summary of Revenues and Expenses (\$000s Omitted)

Fiscal years ended May 31

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|--|-----------|-----------|-----------|-----------|-----------|-----------|------------|-----------|-------------|-------------|
| | | | | | | | (Restated) | | | |
| Operating revenues: | | | | | | | | | | |
| Net fares | \$297,599 | \$308,608 | \$320,140 | \$335,326 | \$350,565 | \$367,336 | \$365,900 | \$375,751 | \$387,222 | \$408,744 |
| Other | 12,240 | 14,078 | 10,250 | 11,235 | 12,700 | 11,623 | 12,741 | 12,320 | 17,534 | 19,034 |
| Total operating revenues | 309,839 | 322,686 | 330,390 | 346,561 | 363,265 | 378,959 | 378,641 | 388,071 | 404,756 | 427,778 |
| Operating expenses: | | | | | | | | | | |
| Cost of services | 146,325 | 162,150 | 158,705 | 165,763 | 190,179 | 180,671 | 212,365 | 216,077 | 234,092 | 237,385 |
| Depreciation | 144,025 | 157,983 | 155,574 | 144,782 | 132,866 | 139,962 | 156,180 | 183,707 | 229,485 | 229,548 |
| Total operating expenses | 290,350 | 320,133 | 314,279 | 310,545 | 323,045 | 320,633 | 368,545 | 399,784 | 463,577 | 466,933 |
| Operating income (loss) | 19,489 | 2,553 | 16,111 | 36,016 | 40,220 | 58,326 | 10,096 | (11,713) | (58,821) | (39,155) |
| Nonoperating revenues | | | | | | | | | | |
| (expenses): | | | | | | | | | | |
| Oil company franchise tax revenues | 42,167 | 40,708 | 42,313 | 41,431 | 41,891 | 42,143 | 44,379 | 45,512 | 46,288 | 47,062 |
| Federal and state grants and reimbursements | – | – | – | – | – | – | 39,920 | 36,197 | 35,135 | 42,787 |
| Investment earnings | 23,748 | 26,380 | 26,194 | 22,274 | 36,079 | 37,626 | 67,474 | 60,783 | 58,704 | 30,901 |
| Other nonoperating revenues | – | – | – | – | – | – | – | – | 3,692 | 1,453 |
| Interest and bond expenses | (55,023) | (58,324) | (54,426) | (58,769) | (79,895) | (78,679) | (55,696) | (115,279) | (105,079) | (120,895) |
| Change in net assets before extraordinary item | 30,381 | 11,317 | 30,192 | 40,952 | 38,295 | 59,416 | 106,173 | 15,500 | (20,081) | (37,847) |
| Extraordinary item | – | – | – | (2,775) | – | – | – | – | – | – |
| Change in net assets | \$ 30,381 | \$ 11,317 | \$ 30,192 | \$ 38,177 | \$ 38,295 | \$ 59,416 | \$ 106,173 | \$ 15,500 | \$ (20,081) | \$ (37,847) |

Source: Pennsylvania Turnpike Commission

Beginning for the fiscal year ended May 31, 2001, amounts are presented in conformity with GASB Statement No. 33, which requires reporting of certain federal and state grants and reimbursements as revenues rather than contributed capital.

Pennsylvania Turnpike Commission

Revenue Bond Coverage (\$000s Omitted)

Fiscal years ended May 31

| | Gross Revenues | Direct Operating Expenses | Net Revenues Available for Debt Service | Principal | Interest | Total | Coverage |
|------|---------------------------|--|--|------------------|-----------------|--------------|-----------------|
| 1995 | \$ 375,754 | \$ 146,325 | \$ 229,429 | \$ 15,715 | \$ 72,548 | \$ 88,263 | 2.60 |
| 1996 | 389,774 | 162,150 | 227,624 | 23,900 | 72,118 | 96,018 | 2.37 |
| 1997 | 398,897 | 158,705 | 240,192 | 22,845 | 71,058 | 93,903 | 2.56 |
| 1998 | 410,266 | 165,763 | 244,503 | 28,240 | 70,615 | 98,855 | 2.47 |
| 1999 | 441,235 | 190,179 | 251,056 | 29,085 | 72,406 | 101,491 | 2.47 |
| 2000 | 458,728 | 180,671 | 278,057 | 36,775 | 85,704 | 122,479 | 2.27 |
| 2001 | 501,891 | 213,902 | 287,989 | 39,120 | 84,079 | 123,199 | 2.34 |
| 2002 | 519,160 | 217,653 | 301,507 | 31,650 | 103,007 | 134,657 | 2.24 |
| 2003 | 529,608 | 234,187 | 295,421 | 43,050 | 107,116 | 150,166 | 1.97 |
| 2004 | 561,075 | 240,144 | 320,931 | 46,135 | 112,467 | 158,602 | 2.02 |

Source: Pennsylvania Turnpike Commission

Beginning for the fiscal year ended May 31, 2001, amounts are presented in conformity with GASB Statement No. 33, which requires reporting of certain federal and state grants and reimbursements as revenues rather than contributed capital.

Pennsylvania Turnpike Commission

Ten Largest Commercial Customers
(\$000s Omitted)

Fiscal year ended May 31, 2004

| | <u>Annual Fares</u> |
|--|------------------------------|
| Werner Enterprises, Inc. | \$ 2,932 |
| United Parcel Service, Inc. | 2,839 |
| J. B. Hunt Transport, Inc. | 2,664 |
| Schneider National Carriers | 2,649 |
| New York State Motor Truck Association | 1,840 |
| U. S. Xpress Leasing | 1,727 |
| Overnite Transportation | 1,515 |
| Yellow Transportation, Inc. | 1,326 |
| ABF Freight System, Inc. | 1,289 |
| Swift Transportation Co. | 1,178 |
| | <hr/> <u>\$ 19,959</u> <hr/> |

Source: Pennsylvania Turnpike Commission

Pennsylvania Turnpike Commission

Traffic Statistics
(\$000s Omitted)

Fiscal years ended May 31

| | Passenger | | | Commercial | | | Total | | |
|------|--------------------|---------------|---------------------|--------------------|---------------|---------------------|--------------------|---------------|---------------------|
| | Number of Vehicles | Revenue Miles | Gross Fare Revenues | Number of Vehicles | Revenue Miles | Gross Fare Revenues | Number of Vehicles | Revenue Miles | Gross Fare Revenues |
| 1995 | 114,033 | 3,530,221 | \$165,850 | 15,620 | 934,007 | \$141,152 | 129,653 | 4,464,228 | \$307,002 |
| 1996 | 121,911 | 3,636,551 | \$172,339 | 16,719 | 961,404 | \$145,503 | 138,630 | 4,597,955 | \$317,842 |
| 1997 | 126,654 | 3,752,124 | \$179,303 | 17,479 | 982,894 | \$150,554 | 144,133 | 4,735,018 | \$329,857 |
| 1998 | 132,472 | 3,906,200 | \$186,290 | 18,627 | 1,044,002 | \$159,514 | 151,099 | 4,950,202 | \$345,804 |
| 1999 | 136,399 | 4,033,446 | \$191,804 | 19,833 | 1,118,232 | \$169,852 | 156,232 | 5,151,678 | \$361,656 |
| 2000 | 138,762 | 4,089,528 | \$195,301 | 21,341 | 1,202,179 | \$184,352 | 160,103 | 5,291,707 | \$379,653 |
| 2001 | 140,777 | 4,121,689 | \$199,991 | 22,588 | 1,186,919 | \$178,353 | 163,365 | 5,308,608 | \$378,344 |
| 2002 | 150,496 | 4,494,885 | \$212,765 | 22,298 | 1,178,514 | \$175,476 | 172,794 | 5,673,399 | \$388,241 |
| 2003 | 156,220 | 4,604,731 | \$219,201 | 23,179 | 1,229,094 | \$180,299 | 179,399 | 5,833,825 | \$399,500 |
| 2004 | 163,612 | 4,515,417 | \$230,356 | 24,407 | 1,218,841 | \$189,960 | 188,019 | 5,734,258 | \$420,316 |

Source: Pennsylvania Turnpike Commission

Pennsylvania Turnpike Commission

Miscellaneous Statistics

Fiscal year ended May 31, 2004

| | | |
|---------------------------------------|---|--------------|
| Length of Highway: | Delaware River to Ohio Line | 360 miles |
| | Northeast Extension | 110 miles |
| | Southwestern Expansions | 60 miles |
| | | 530 miles |
| Number of Interchanges: | Delaware River to Ohio Line | 32 |
| | Northeast Extension | 10 |
| | Southwestern Expansions | 17 |
| | | 59 |
| Number of Maintenance Facilities | | 21 |
| Number of Service Plazas: | Delaware River to Ohio Line | 19 |
| | Northeast Extension | 2 |
| | | 21 |
| Average Traffic Volume: | Vehicles per day (FY 2004) | 513,713 |
| | Vehicles per year (FY 2004) | 188 million |
| | Vehicles in 1941 (first full year of operation) | 2.4 million |
| Traffic Composition: | Passenger Cars | 87% |
| | Commercial Vehicles | 13% |
| | | 100% |
| Number of Miles Traveled on Turnpike: | Revenue Miles | 5.7 billion |
| Commercial Weight: | Maximum without permit Higher loading over 125,000 lbs. permitted after structural analysis by bridge unit | 100,000 lbs. |
| Number of Employees: | Management | 402 |
| | Union | 1,928 |
| | | 2,330 |
| Bargaining Unit Affiliation: | International Brotherhood of Teamsters, Chauffeurs, Warehousemen, and Helpers of America | |

Source: Pennsylvania Turnpike Commission

Pennsylvania Turnpike Commission

Technical Data

Fiscal year ended May 31, 2004

| | | |
|------------------------|---|--|
| Right-of-Way Width: | Minimum | 200 feet |
| Turnpike Width: | Delaware River to Ohio Line (4 lanes) | 78 feet |
| | Northeastern Extension Junction to Philadelphia Interchange (6 lanes) | 106 feet |
| | Northeastern Extension (4 lanes) | 72 feet |
| | Southwestern Expansion | 132 feet |
| Lane Width: | Standard | 10 feet |
| | Northeastern Extension Junction to Philadelphia Interchange | 12 feet |
| | Width of climbing lane at various locations (both lanes) | 24 feet |
| Curves: | Maximum (approximately 955 feet minimum radius) on Allegheny Mountain climbing lanes only | 6 degrees |
| | Western Extension (Irwin – Ohio Line) | 4 degrees |
| | Eastern, Delaware River, Northeastern Extension and Remainder of Turnpike | 3 degrees |
| Grades: | Maximum (three-foot rise for every 100 feet of forward travel) | 3 percent |
| Tunnels: | Blue Mountain | 4,339 feet |
| | Kittatinny | 4,727 feet |
| | Tuscarora | 5,326 feet |
| | Allegheny | 6,070 feet |
| | Lehigh | 4,461 feet |
| Major Bridges: | Delaware River | 6,571 feet |
| | Schuylkill River | 1,228 feet |
| | Susquehanna River | 4,526 feet |
| | Allegheny River | 2,186 feet |
| | Beaver River | 1,546 feet |
| | Lehigh River South Crossing | 1,494 feet |
| | Clarks Summit | 1,627 feet |
| | Mahoning River (Twin Bridges) | 1,700 feet |
| | Joe Montana (Twin Bridges) | 2,507 feet |
| Highest Elevation: | Milepost 100.45 | 2,603.33 feet above sea level |
| Mainline Interchanges: | | |
| | Largest | 17 lanes |
| | Most Heavily Used | 1,162,988 vehicles per month |
| | Least Heavily Used | Willow Hill 17,658 vehicles per month |

Source: Pennsylvania Turnpike Commission

Pennsylvania Turnpike Commission

Chronology, Turnpike Construction

May 31, 2004

| Turnpike Section | Length (Miles) | Construction Cost (Millions) | Bill Signed | Ground- breaking | Open to Traffic |
|--|---------------------------|---|--------------------|-----------------------------|----------------------------|
| Original Turnpike: Carlisle-Irwin | 160 | \$ 76 | May 21, 1937 | Oct. 27, 1938 | Oct. 1, 1940 |
| Philadelphia Extension: Carlisle-Valley Forge | 100 | 87 | May 16, 1940 | Sept. 28, 1948 | Nov. 20, 1950 |
| Western Extension: Irwin-Ohio Line | 67 | 77.5 | June 11, 1941 | Oct. 24, 1949 | Dec. 26, 1951 |
| Delaware River Extension: Valley Forge-Delaware River | 33 | 65 | May 23, 1951 | Nov. 20, 1952 | Nov. 17, 1954 |
| Delaware River Bridge | 1.5 | Not available | May 23, 1951 | June 22, 1954 | May 23, 1956 |
| Northeastern Extension: East/West Turnpike to Scranton | 110 | 233 | Sept. 27, 1951 | Mar. 25, 1954 | Nov. 7, 1957 |
| Mon/Fayette Expressway – California Interchange | 6 | 7 | Sept. 1985 | June 9, 1988 | Oct. 12, 1990 |
| Beaver Valley Expressway | 16 | 240 | Sept. 1985 | Oct. 20, 1989 | Nov. 20, 1992 |
| Mid-County Interchange | – | 80 | Sept. 1985 | Dec. 20, 1989 | Dec. 15, 1992 |
| Amos K. Hutchinson Bypass | 13 | 271 | Sept. 1985 | Aug. 20, 1990 | Dec. 9, 1993 |
| Keyser Avenue Interchange | – | 47 | Sept. 1985 | Not available | Feb. 1, 1995 |
| Mon/Fayette Expressway – Mason-Dixon Link | 8 | 132 | Sept. 1985 | Nov. 1, 1994 | Mar. 1, 2000 |
| Mon/Fayette Expressway – I-70 to Coyle Curtain Road | 4 | 90 | Sept. 1985 | June 19, 1997 | May 11, 2001 |
| Mon/Fayette Expressway – Coyle Curtain Road to SR 51 | 13 | 604 | Sept. 1985 | Sept. 1997 | Apr. 12, 2002 |

Source: Pennsylvania Turnpike Commission

Pennsylvania Turnpike Commission

Chronology, Turnpike Improvements

May 31, 2004

| Date | Improvement |
|-------------------|---|
| September 6, 1962 | Groundbreaking on Laurel Hill Bypass and boring of second Allegheny Tunnel |
| October 30, 1964 | Laurel Hill Bypass (3.1 miles) opened, eliminating two-lane 4,541 foot long Laurel Hill tunnel |
| March 15, 1965 | Second Allegheny Tunnel opened; original tunnel closed for refurbishing |
| December 1965 | Median barriers completed on entire east-west turnpike |
| April 1966 | Work begins at second tunnels at Blue, Kittatinny and Tuscarora Mountains |
| August 25, 1966 | Original Allegheny Tunnel reopened |
| November 26, 1968 | Sideling Hill Bypass (13.3 miles) opened, eliminating two two-lane tunnels: Ray's Hill (3,532 feet) and Sideling Hill (6,782 feet) |
| November 26, 1968 | Second Blue, Kittatinny, and Tuscarora Tunnels opened |
| August 14, 1969 | Median barrier completed on entire Turnpike |
| December 2, 1981 | Completion of three climbing lane projects (Allegheny, Indian Creek, and Jacob's Creek) |
| May 20, 1982 | Computerization and renovation of toll collection system begins |
| March 10, 1986 | Six-lane widening project begins (junction of Northeastern Extension to Philadelphia Interchange) |
| July 22, 1987 | Computerized toll collection system placed into service |
| November 27, 1987 | Opening of six-lane section near Philadelphia |
| June 9, 1988 | Groundbreaking on the Mon/Fayette, six-mile link between I-70 and U.S. 40 |
| February 14, 1989 | Groundbreaking for second Lehigh Tunnel |
| October 20, 1989 | Groundbreaking for Mahoning River Bridge |
| December 19, 1989 | Groundbreaking for Mid-County Interchange |
| June 14, 1990 | Groundbreaking for Beaver Valley Expressway |
| August 15, 1990 | Groundbreaking for Amos K. Hutchinson Bypass |
| October 12, 1990 | Opening of the first six-mile section of the Mon-Valley/Fayette Expressway linking I-70 and U.S. 40 in Washington County |
| November 22, 1991 | Complete installation of call boxes along the Turnpike System |
| November 22, 1991 | Opening of the second Lehigh Tunnel |
| November 20, 1992 | Opening of the Beaver Valley Expressway (Toll 60, James E. Ross Highway), the world's first weigh barrier toll system |
| December 15, 1992 | Opening of the new Mid-County Interchange |
| December 9, 1993 | Opening of Amos K. Hutchinson Bypass |
| November 1, 1994 | Groundbreaking on first section of the Mon/Fayette Expressway, at Fairchance |
| February 1, 1995 | Opening and collecting tolls at the Keyser Avenue Interchange |
| May 26, 1995 | Opening of the Allentown and Sideling Hill Farmers' Markets |
| June 2, 1995 | Groundbreaking on the Mon/Fayette Route 70 to Route 51 Transportation project |
| November 1, 1996 | Northeast extension designated I-476 |
| March 1, 2000 | Opening of Mon/Fayette Expressway – Mason-Dixon Link |
| August 25, 2000 | Total reconstruction MP 94 – 99 |
| December 2, 2000 | Implementation of E-ZPass (electronic toll collection system) for passenger vehicles in southeastern and south central PA (interchanges 242 – 56) |
| May 7, 2001 | Reopening of the newly renovated and expanded central office administration building in Highspire, PA |
| May 11, 2001 | Opening of I-70 to Coyle Curtain Road section of the Mon/Fayette Expressway |

Pennsylvania Turnpike Commission

Chronology, Turnpike Improvements (continued)

May 31, 2004

| Date | Improvement |
|-------------------|--|
| May 19, 2001 | Expansion of E-ZPass system to six additional interchanges 226, 236 and 74 (Mahoning Valley) to 115 (Wyoming Valley) Toll Plaza on the Northeast extension |
| August 17, 2001 | Total reconstruction MP 186 – 199 |
| November 2001 | Interchange dual-numbering system installation completed |
| December 15, 2001 | E-ZPass lanes for passenger vehicles available at all of the Turnpike's Mainline Interchanges |
| April 12, 2002 | Opening of Coyle Curtain Road to SR 51 section of the Mon/Fayette Expressway |
| June 1, 2002 | Implementation of a Wide Area Network (WAN) |
| August 23, 2002 | Total reconstruction MP 75 – 85 |
| December 15, 2002 | E-ZPass lanes for commercial vehicles available at all of the Turnpike's Mainline Interchanges |
| June 1, 2003 | Opening of the new Warrendale Interchange |
| June 2, 2004 | Opening of the first express E-ZPass lane at Warrendale Interchange (eastbound) |
| June 26, 2004 | Opening of the second express E-ZPass lane at Warrendale Interchange (westbound) |

Source: Pennsylvania Turnpike Commission

Pennsylvania Turnpike Commission

Chronology, Speed Limits

May 31, 2004

| Date | Speed Limit |
|------------------|--|
| October 1, 1940 | No speed limit established by law |
| April 15, 1941 | 70 MPH; various lower commercial speeds depending on vehicle weight |
| December 1941 | Wartime restriction of 35 MPH for all traffic |
| August 1945 | Wartime restriction lifted. Speed limits revert to those of April 15, 1941 |
| July 9, 1951 | 70 MPH for cars, buses, motorcycles 50 MPH for all other traffic |
| January 15, 1953 | Gateway to Breezewood: 60 MPH for cars, buses 45 MPH for trucks |
| May 7, 1956 | Breezewood to Valley Forge: 70 MPH for cars, buses 50 MPH for trucks Bridges: 45 MPH for all traffic |
| July 24, 1966 | 65 MPH for cars, buses, motorcycles 55 MPH for commercial vehicles |
| November 1973 | 55 MPH restriction nationwide, enforced on Turnpike beginning December 2, 1973 |
| July 13, 1995 | 65 MPH for cars, buses, motorcycles, and commercial vehicles, except in urban areas where speed limit is 55 mph |
| April 3, 2001 | 55 MPH from milepost 75 to milepost 130 for all vehicles |

Source: Pennsylvania Turnpike Commission