Massachusetts School Building Authority

Steven Grossman
Chairman, State Treasurer

Katherine P. Craven
Executive Director

To: Administration, Operations and Finance Subcommittee
Massachusetts School Building Authority

From: Katherine Craven
Executive Director

Subject: Results of the MSBA's 2011 Audit

Date: November 10, 2011

I am pleased to report that KPMG has issued a "clean opinion" in their recently completed audit of MSBA financial statements as of and for the year ended June 30, 2011. KPMG found that the 2011 financial statements are presented fairly in accordance with GAAP (Generally Accepted Accounting Principles), that there were no material weaknesses and they will not be issuing a management letter.

Since our inception in 2004, KPMG has issued a clean opinion on our financial statements. In each of the MSBA's seven years of existence, there have been:

- No material weaknesses involving internal control over financial reporting and its operation;
- No difficulties encountered by KPMG in performing the audit;
- No disagreements between management and KPMG, and
- No significant audit adjustments affecting the financial reporting process.

As you may remember, in addition to the MSBA's annual KPMG audit, the Office of the State Auditor (SAO) conducted an audit of the MSBA in 2008. The objectives of that audit were primarily to:

- Review MSBA's internal controls over its financial operations,
- Based on an audit of the former program as administered under the Department of Education (DOE), determine whether appropriate corrective action had been taken regarding issues identified by the SAO of the former program as administered by DOE; and
- Determine whether the MSBA's audit functions and oversight practices were comprehensive.

Based upon its audit, the Office of the State Auditor concluded that the MSBA had taken appropriate corrective action regarding all of the issues noted in a prior audit (of the DOE's school building assistance program), had implemented internal controls and audit oversight activities to ensure that adequate documentation and project records existed in support of construction costs incurred by local authorities under the new MSBA.

I am proud of the results from our most recent audit by KPMG as well as our seven years of positive audit results.

KPMG will be presenting a report to you today with the results of the 2011 audit, including certain required communications to the Board. Attached please find KPMG's presentation and the MSBA 2011 financial statements for your review.

KPMG

cutting through complexity

Report to the Board

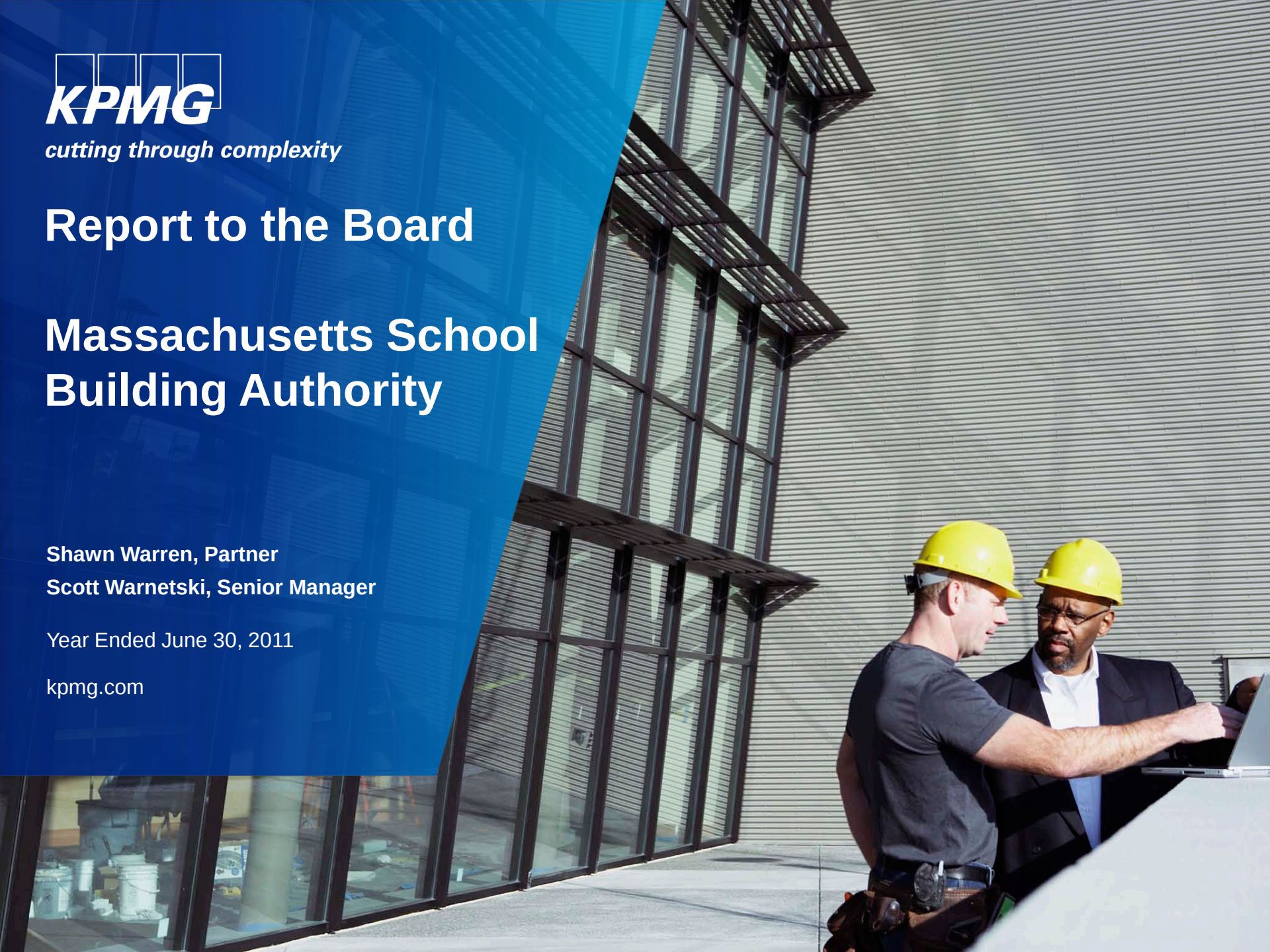
Massachusetts School Building Authority

Shawn Warren, Partner

Scott Warnetski, Senior Manager

Year Ended June 30, 2011

kpmg.com



Items for Discussion

- Results of 2011 Audit
  - Independent Auditors' Report
- Areas of Emphasis
  - Grants Payable
  - Debt Financing
  - Investments
  - Other 2011 Focus Areas
  - Control Environment
- Emerging Issues
- Required Communications
- 2011 Management Representation Letter
- 2011 Financial Statements

Results of 2011 Audit

Independent Auditors' Reports

- Our 2011 report on the financial statements indicates that:
  - The financial statements are the responsibility of management
  - Our responsibility is to express an opinion on the basic financial statements
  - We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards (GAS)
  - The report refers to our report on compliance and internal control, which is integral to our opinion under GAS
  - In our opinion, the 2011 financial statements are presented fairly in accordance with GAAP
  - Our report refers to management's discussion and analysis (MD&A), but does not opine on this section.

- Our 2011 report on compliance and on internal control over financial reporting indicates:
  - No material weaknesses involving internal control over financial reporting and its operation
  - No instances of non-compliance or other matters that are required to be reported under Government Auditing Standards.

Areas of Emphasis

Grants Payable

- Accounting, disclosure and valuation of grants payable:
  - Prior grants
  - Wait-list grants
  - Commitments
  - Grant payments
  - Project audits

Debt Financing

- Review of arbitrage calculation and recognition of liability
- Evaluation of required disclosures
- Confirmation of outstanding balances.

Areas of Emphasis, continued

Investments

- Review investment portfolio for asset impairment
- Confirmed ending balances with financial institutions
- Tested components of investment income
- Reviewed required disclosures.

Other 2011 Focus Areas

- Reviewed financial statements and notes for conformity with GASB pronouncements and consistency with industry practice
- Obtained legal letters and reviewed litigation assessments made
- Reviewed disclosure of other commitments and contingencies
- Obtained management representation letter
- Evaluated form and content of MD&A
- Performed standard tax review in relation to financial statements
- Reviewed minutes of Board meetings

Areas of Emphasis, continued

Control Environment

- Nature, timing and extent of our procedures determined by:
  - Our understanding of the internal control system
  - Our tests of control effectiveness
  - Discussions with management regarding risks and strategies
  - Results of analysis of risk profile and primary business processes
  - Assessment of the risk of fraud.

- Conclusions reached regarding the control environment:
  - We noted no matters involving the internal control structure and its operations that we consider to be material weaknesses.

Emerging Issues

Future Changes to Pension Accounting

- Currently in exposure draft with anticipated final standard by June 2012.
- Timing in exposure draft would make this apply to the MSBA for its year ending June 30, 2014
- Proposed changes to the way cost-sharing plans report pension information.

Required Communications

Topic	Response
Our responsibilities under generally accepted auditing standards and Government Auditing Standards	▪ Our audit was designed to obtain reasonable assurance that basic financial statements are free of material misstatement
Significant accounting policies	▪ Discussed quality/acceptability of principles
Management judgments and accounting estimates, including: ▪ Grants payable ▪ OPEB liability	▪ Accounting estimates are an integral part of the financial statements ▪ We evaluated key factors and assumptions used to develop management's estimates and found them reasonable in relation to the financial statements taken as a whole
Significant audit adjustments affecting the financial reporting process	▪ No audit adjustments were identified
Other information in documents containing audited financial statements	▪ Evaluated form and content of MD&A
Disagreements with management	▪ None
Consultation with other accountants	▪ None
Major issues discussed with management prior to retention	▪ We discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year. Such discussions occurred in the normal course of our professional relationship and our responses were not a condition of our retention.
Difficulties encountered in performing the audit	▪ No difficulties were noted
Independence	▪ We hereby confirm that we are independent accountants with respect to the MSBA under all relevant professional and regulatory standards

2011 Management Representation Letter

Massachusetts School Building Authority

Steven Grossman
Chairman, State Treasurer

Katherine P. Craven
Executive Director

October 14, 2011

KPMG LLP
Two Financial Center
60 South Street
Boston, MA 02111

Ladies and Gentlemen:

We are providing this letter in connection with your audit of the financial statements of the Massachusetts School Building Authority (the Authority), as of and for the year ended June 30, 2011, for the purpose of expressing opinions as to whether the financial statements present fairly, in all material respects, the financial position of the governmental activities and each major fund of the Authority, and the respective changes in financial position in conformity with U.S. generally accepted accounting principles. We confirm that we are responsible for the fair presentation in the financial statements of financial position, changes in financial position in conformity with U.S. generally accepted accounting principles. We are also responsible for establishing and maintaining effective internal control over financial reporting.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following representations made to you during your audit:

1. The financial statements referred to above are fairly presented in conformity with U.S. generally accepted accounting principles.

2. We have made available to you:

    a. All financial records and related data.

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b. All minutes of the meetings of the board, or summaries of actions of recent meetings for which minutes have not yet been prepared.

3. There have been no communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.

4. There are no:

a. Violations or possible violations of laws or regulations, whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.

b. Unasserted claims or assessments that our lawyers have advised us are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting Standards (SFAS) No. 5, *Accounting for Contingencies.*

c. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by SFAS No. 5.

d. Material transactions, for example, grants and other contractual arrangements, that have not been properly recorded in the accounting records underlying the financial statements.

e. Events that have occurred subsequent to the date of the statement of net assets and through the date of this letter that would require adjustment to or disclosure in the financial statements.

5. We acknowledge our responsibility for the design and implementation of programs and controls to prevent, deter, and detect fraud. We understand that the term "fraud" includes misstatements arising from fraudulent financial reporting and misstatements arising from misappropriation of assets.

6. We have no knowledge of any fraud or suspected fraud affecting the entity involving:

a. Management

b. Employees who have significant roles in internal control over financial reporting, or

c. Others where the fraud could have a material effect on the financial statements.

7. We have no knowledge of any allegations of fraud or suspected fraud affecting the entity received in communications from employees, former employees, analysts, regulators, short sellers, or others.

8. The Authority has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.

9. We have no knowledge of any officer or board member of the Authority, or any other person acting under the direction thereof, having taken any action to fraudulently influence, coerce, manipulate, or mislead you during your audit.

10. The following have been properly recorded or disclosed in the financial statements:

    a. Related party transactions including sales, purchases, loans, transfers, leasing arrangements, guarantees, ongoing contractual commitments, and amounts receivable from or payable to related parties.

       The term "related party" refers to affiliates of the enterprise; entities for which investments in their equity securities would be required to be accounted for by the equity method by the enterprise; trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management; principal owners of the enterprise; its management; members of the immediate families of principal owners of the enterprise and its management; and other parties with which the enterprise may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. Another party also is a related party if it can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

    b. Guarantees, whether written or oral, under which the Authority is contingently liable.

    c. Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances and lines of credit or similar arrangements.

    d. Agreements to repurchase assets previously sold, including sales with recourse.

    e. Changes in accounting principle affecting consistency.

f. The existence of and transactions with joint ventures and other related organizations.

11. There are no liens or encumbrances on the Authority's assets, nor has any asset been pledged as collateral.

12. The Authority has complied, in all material respects, with applicable laws, regulations, contracts, and grants that could have a material effect on the financial statements in the event of noncompliance.

13. Management is responsible for compliance with the laws, regulations, and provisions of contracts and grant agreements applicable to the Authority. Management has identified and disclosed to you all laws, regulations, and provisions of contracts and grant agreements that have a direct and material effect on the determination of financial statement amounts.

14. There are no deficiencies, significant deficiencies, or material weaknesses in the design or operation of internal control over financial reporting of which we are aware, which could adversely affect the Authority's ability to initiate, authorize, record, process, or report financial data. We have applied the definitions of a "significant deficiency" and a "material weakness" in accordance with the definitions in Statement on Auditing Standards No. 115, Communicating Internal Control Related Matters Identified in an Audit.

15. Receivables reported in the financial statements represent valid claims against debtors arising on or before the date of the statement of net assets and have been appropriately reduced to their estimated net realizable value.

16. Deposits and investment securities are properly classified and reported.

17. The Authority is responsible for determining the fair value of certain investments as required by GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools,* as amended. The amounts reported represent the Authority's best estimate of fair value of investments required to be reported under the Statement. The Authority also has disclosed the methods and significant assumptions used to estimate the fair value of its investments, and the nature of investments reported at amortized cost.

18. The Authority has no:

a. Commitments for the purchase or sale of services or assets at prices involving material probable loss.

b. Loss to be sustained as a result of other-than-temporary declines in the fair value of investments.

19. The Authority has complied with all debt limits and with all debt related covenants.

20. We have received opinions of counsel upon each issuance of tax-exempt bonds that the interest on such bonds is exempt from federal income taxes under section 103 of the Internal Revenue Code of 1986, as amended. We have no knowledge of any occurrences, subsequent to the issuance of such opinions, that would jeopardize the tax-exempt status of the bonds. Provision has been made, where material, for the amount of any required arbitrage rebate.

21. We believe that the actuarial assumptions and methods used to measure financial statement liabilities and costs associated with other post-employment benefits and to determine information related to the Authority's funding progress related to such benefits for financial reporting purposes are appropriate in the Authority's circumstances and that the related actuarial valuation was prepared in conformity with U.S. generally accepted accounting principles.

22. Net asset components (invested in capital assets, net of related debt; restricted; and unrestricted) and fund balance components (nonspendable; restricted; committed; assigned; and unassigned) are properly classified and, if applicable, approved.

23. Revenues are appropriately classified in the statement of activities.

24. The Authority has identified and properly accounted for all nonexchange transactions.

25. Expenses have been appropriately classified in or allocated to functions and programs in the statement of activities, and allocations have been made on a reasonable basis.

26. We agree with the findings of specialists in evaluating the other post-employment benefit liability and have adequately considered the qualifications of the specialist in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give or cause any instructions to be given to specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an impact on the independence or objectivity of the specialists.

27. The Authority has presented all required supplementary information. This information has been measured and prepared within prescribed guidelines.

28. The Authority has complied with all applicable laws and regulations in adopting, approving and amending the Authority's budgets.

Very truly yours,

Massachusetts School Building Authority

Katherine P. Craven

Katherine P. Craven

Executive Director

Vincent Alabiso

Chief Financial Officer

Joanna Aalto

Joanna Aalto

Controller and Director of Audits

2011 Financial Statements

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Financial Statements and Required
Supplementary Information

June 30, 2011

(With Independent Auditors' Report Thereon)

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Table of Contents

KPMG LLP
Two Financial Center
60 South Street
Boston, MA 02111

Independent Auditors' Report

Board Members
Massachusetts School Building Authority:

We have audited the financial statements of the governmental activities (Statement of Net Assets (Deficit) and Statement of Activities) and the major funds of the Massachusetts School Building Authority (the MSBA), a blended component unit of the Commonwealth of Massachusetts (the Commonwealth), as of and for the year ended June 30, 2011, which collectively comprise the MSBA's basic financial statements as listed in the accompanying table of contents. These financial statements are the responsibility of the MSBA's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the MSBA's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the major funds of the MSBA, as of June 30, 2011, and the respective changes in financial position for the year then ended in conformity with U.S. generally accepted accounting principles.

As described in note 2, the MSBA, in fiscal 2011, implemented Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 14, 2011 on our consideration of the MSBA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's discussion and analysis on pages 3 through 8 and the schedule of funding progress on page 27 are not required parts of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on them.

KPMG LLP

October 14, 2011

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Management's Discussion and Analysis – Required Supplementary Information

June 30, 2011

(Unaudited)

This section of the Massachusetts School Building Authority's (the MSBA) annual financial report presents a discussion and analysis of the MSBA's financial performance during the fiscal year ended June 30, 2011. Please read it in conjunction with the MSBA's financial statements, which follow this section.

Background

Chapter 208 of the Acts of 2004 (Chapter 208, together with Chapter 70B of the Massachusetts General Laws, Section 35BB of Chapter 10 of the Massachusetts General Laws, and Chapter 210 of the Acts of 2004, all as most recently amended, collectively referred to as the Act) eliminated the former school building assistance program and created the MSBA to administer and fund a new program (the New Program) for grants to cities, towns and regional school districts for school construction and renovation projects.

The MSBA's major revenue source is the portion of the Commonwealth's sales tax revenue dedicated to the MSBA. Pursuant to the Act, all moneys received by the Commonwealth raised by a one percent (1%) statewide sales tax (drawn from the existing statewide 6.25% sales tax, excluding sales tax revenues on meals and from certain additional statutorily exempted revenues from sales (Dedicated Sales Tax Revenue)) are deposited into the School Modernization and Reconstruction Trust (SMART) Fund, and are available to the MSBA without further appropriation or allotment.

Under the former program, the Commonwealth of Massachusetts (the Commonwealth) was reimbursing cities, towns and regional school districts for 728 previously approved projects (Prior Grant projects). The Commonwealth's share ranged from 50% to 90% of approved, eligible costs for each project. In addition, under the former program, 428 school projects were maintained on a waiting list for funding (the Waiting List). Pursuant to the Act, the MSBA became responsible for funding the Commonwealth's share of the 728 Prior Grant projects and 428 Waiting List projects. As of October 1, 2011, the MSBA had paid in full its share of 357 of the 428 Waiting List Projects and 351 of the 728 Prior Grant Projects.

In fiscal year 2008, the MSBA began approving grants under the New Program for school construction and renovation projects. Under the New Program, no city, town or regional school district or independent agricultural and technical school has any entitlement to funds from the MSBA. Grants approved by the MSBA for projects may range from 31% to 80% of approved eligible project costs. Under the New Program, the MSBA is limited in the amount of grants it can approve in a fiscal year. The limit established for fiscal year 2008 was $500 million. The limit may change annually by the lesser of 4.5% of the limit for the prior fiscal year or the percentage change in the Dedicated Sales Tax Revenue Amount (see note 3) over the prior fiscal year.

Financial Highlights

- The government-wide net deficit at June 30, 2011 was $5.8 billion. The MSBA's government-wide net deficit decreased by $97.8 million in fiscal year 2011 primarily due to reductions of grant payment obligations, of which $44.4 million is due to MSBA audits and debt refundings by the local communities in which the MSBA recoups a share of the savings based on the reimbursement rate of the project.
- Total government-wide liabilities at June 30, 2011 were approximately $7.0 billion, a decrease of $504.4 million from the prior year. Total liabilities include grants payable to municipalities totaling approximately $2.3 billion to fund school construction and renovation projects. The grants payable liability decreased by $389.2 million in fiscal year 2011 due to grant payments made to municipalities during the

year and reductions of grant payment obligations due to MSBA audits and debt refundings by the local communities in which the MSBA recoups a share of the savings based on the reimbursement rate of the project. In addition, total liabilities include $4.4 billion of outstanding Dedicated Sales Tax Bonds to fund school construction and renovation projects.

- During the year, the MSBA had general revenues of $680.3 million, comprised of $654.6 million of sales tax revenue, $8.3 million of interest income, and $17.4 million of grant income as compared to general revenues of $647.6 million in fiscal year 2010. Total revenues increased by $32.7 million primarily due to an increase of $49.4 million in dedicated sales tax revenue and an increase in grant income of $12.7 million partially offset by a decrease of $29.4 million in interest income. The decrease in interest income of $29.4 million is primarily related to the MSBA investments in U.S. Treasuries which are recorded at fair value. Fluctuations in the market value of these U.S. Treasuries are recorded as interest income (loss). In fiscal year 2011, interest income (loss) related to the fair value of U.S. Treasuries was ($12.1) million versus interest income of $15.5 million in fiscal year 2010. The MSBA intends to hold these U.S. Treasuries to maturity. The increase in sales tax revenue in fiscal year 2011 versus fiscal year 2010 relates primarily to the phase-in of the Dedicated Sales Tax Revenue. In fiscal year 2010, the MSBA received 95% of the total Dedicated Sales Tax Revenue. In fiscal year 2011, the MSBA was entitled to receive 100% of the Dedicated Sales Tax Revenue Amount. (see note 3).
- As of June 30, 2011, the value of the grants payable liability totaled $2.3 billion, consisting of Prior Grant projects of $1.9 billion, Waiting List projects of $305.4 million, and $86.7 million of New Program projects. Although New Program projects are funded on a progress payment basis, this represents costs incurred in the New Program prior to June 30, 2011 but paid after June 30, 2011. The MSBA has $1.1 billion of commitments related to the New Program, which are not reflected in the MSBA's financial statements.
- As of June 30, 2011, the value of the outstanding Waiting List projects totaled approximately $448.0 million, composed of the Waiting List Liability of $305.4 million and commitments of $142.6 million. The $142.6 million is not currently reflected in the MSBA's financial statements, but is reflected as a commitment in the notes to the financial statements (see note 6).
- Total assets of the Special Revenue Fund at June 30, 2011 were $1.1 billion compared to $1.6 billion at June 30, 2010. Cash and cash equivalents decreased by $438.2 million and was primarily used to fund grant payments.
- Special Revenue Fund operations expenditures for the year ended June 30, 2011 were approximately $10.3 million, which also included approximately $1.3 million of accrued expenditures. Operations expenditures consisted of two major categories. Administrative expenditures totaling $7.2 million consisted primarily of payroll and employee related benefits and rent and utilities. Project related expenditures totaled $3.1 million.
- The Special Revenue Fund reported a fund balance of $1.1 billion at June 30, 2011 as compared to a fund balance of $1.5 billion at June 30, 2010. The decrease is primarily due to the fact that expenditures were $450.3 million higher than revenues. Expenditures consisted of grant payments of $790.9 million, debt service of $314.6 million and operations expenditures of $10.3 million.

- Assets of the Special Revenue Fund included cash and investments of $383.9 million; restricted cash and investments of $578.8 million; an amount due from the Commonwealth related to the 2011 Dedicated Sales Tax Revenue totaling $55.9 million, 100% of which was collected subsequent to year-end; loans receivable of $121.2 million in connection with the MSBA's intergovernmental loan program for cities and towns; and, an interest receivable of $8.8 million.

Overview of the Financial Statements

The financial section of this report consists of the following parts: management's discussion and analysis (this section), the basic financial statements, the notes to the financial statements, and required supplementary information.

This report consists of four financial statements presented on two pages. The first two financial statements are the Governmental Fund Balance Sheet/Statement of Net Assets (Deficit) found on page 9. The final two financial statements are the Statement of Revenues, Expenditures and Changes in Fund Balance/Statement of Activities found on page 10.

In Fiscal Year 2011, the MSBA adopted GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This new standard requires entities to classify fund balances as restricted, committed, assigned, or unassigned. The MSBA Board of Directors has the ability to commit and un-commit funds while financial management of the MSBA has the ability to assign and un-assign funds. Restricted balances are restricted in their use by bond covenants and statute.

Reporting the MSBA's Governmental Funds

The fund financial statements provide detailed information about the MSBA's Governmental Funds – not the MSBA as a whole. The fund financial statements are prepared using a different approach than the government-wide financial statements. The MSBA's expenditures are reported in its Governmental Funds, which focuses on cash inflows and outflows in the funds and the balance left at year-end that are available for spending. The Governmental Funds are reported using modified accrual accounting, which measures revenues as they become both measurable and available and are expected to be collected within the next fiscal year. Expenditures are recorded in the period the liability is incurred and expected to be paid within the next fiscal year. The Governmental Fund Statements provide a detailed short-term view (less than one year) of the MSBA's government operating requirements for the year ended June 30, 2011.

The MSBA as a Whole

The Statement of Net Assets (Deficit) and the Statement of Activities provide information about the activities of the MSBA as a whole and present a longer-term view of the MSBA's finances by focusing on total available resources and changes therein. The fund financial statements tell how operations are financed in the short term as well as what remains for future spending.

Condensed Financial Information

Summary of Net Assets (Deficit)

(In thousands)

		2011	2010
Cash and investments	$	980,520	1,420,597
Receivables		189,626	154,666
Other assets		30,652	32,069
Total assets		1,200,798	1,607,332
Current liabilities		609,805	621,815
Noncurrent liabilities		6,404,214	6,896,565
Total liabilities		7,014,019	7,518,380
Net deficit	$	(5,813,221)	(5,911,048)

Summary of Activities

(In thousands)

		2011	2010
Dedicated sales tax	$	654,643	605,228
Interest income		8,292	37,667
Grant income		17,377	4,701
Total general revenues		680,312	647,596
Other expenses		375,966	221,644
Interest expense		206,519	181,899
Total expenses		582,485	403,543
Contributions to Commonwealth		—	(150,000)
Change in net deficit		97,827	94,053
Net deficit, beginning of year		(5,911,048)	(6,005,101)
Net deficit, end of year	$	(5,813,221)	(5,911,048)

These statements report the MSBA's net assets (deficit) and changes to the MSBA's net assets (deficit). Annual changes in the MSBA's net assets (deficit) – the difference between assets and liabilities – are one way to measure the MSBA's health or financial position. Over time, increases or decreases in the MSBA's net assets (deficit) are one indicator of whether its financial health is improving or deteriorating. The MSBA's major revenue source is the portion of the Commonwealth's sales tax revenue dedicated to the MSBA. Pursuant to the Act, all moneys received by the Commonwealth raised by a one percent (1%) statewide sales tax (drawn from the existing statewide 6.25% sales tax, excluding sales tax revenues on meals and from certain additional statutorily exempted revenues from sales (Dedicated Sales Tax Revenue)), are available to the MSBA without further appropriation or allotment. The Commonwealth has covenanted that the Dedicated Sales Tax Revenue will not be diverted from the control of the MSBA and has pledged not to reduce the sales tax rate below that prescribed by the Act. The Act states that, under the New Program, no project can be approved for funding unless the MSBA determines that the school project is within the capacity of the MSBA to finance with revenues projected to be available to the MSBA.

The MSBA reported a deficit in its net assets. The deficit in the MSBA's net assets is due to the fact that the MSBA assumed responsibility for funding the Commonwealth's share of the 428 Waiting List and 728 Prior Grant school construction and renovation projects. As of October 1, 2011, the MSBA had paid in full its share of 357 of the 428 Waiting List Projects and 351 of the 728 Prior Grant Projects. This net deficit of $5.8 billion will be funded primarily through the receipt of Dedicated Sales Tax Revenue.

The change between currently expendable resources and total available resources is identified in the adjustment columns found on the financial statements (pages 9 and 10). To arrive at the Statement of Net Assets (Deficit), there are adjustments for deferred assets as well as long-term and short-term liabilities that are not reported as fund assets and liabilities. Further, to arrive at the Statement of Activities, transactions relating to assets and long-term liabilities are added to or eliminated from the Statement of Revenues, Expenditures and Changes in Fund Balances. Amounts relating to the aforementioned transactions are displayed in the Adjustments column to the left of the Statement of Net Assets (Deficit) and the Statement of Activities and in note 7 to the basic financial statements.

Debt

The Act provides the MSBA with the power to issue bonds and notes. The MSBA may issue either general obligation or special obligation bonds. Pursuant to the Act, the aggregate outstanding principal amount of the bonds shall not exceed $10 billion. To date, the MSBA has issued a total of $4.9 billion of Dedicated Sales Tax Bonds for the purpose of funding school construction and renovation projects. As of June 30, 2011, the MSBA had $4.4 billion of Dedicated Sales Tax Bonds outstanding. Coupons on the bonds range from 4% to 6% and each series is payable semiannually with the latest maturity occurring in fiscal year 2040. A portion of the interest on the Dedicated Sales Tax Bonds is reimbursed by the federal government, as further described in the following paragraph.

On December 22, 2009, the MSBA issued $150.0 million of Dedicated Sales Tax Bonds (2009 Series A Bonds) and $450.0 million of Dedicated Sales Tax Bonds (2009 Series B Bonds) for the purpose of funding school construction and renovation projects. Interest on the Series B Bonds is 5.715% and is payable semiannually each August 15, and February 15, until maturity in fiscal year 2040. The MSBA elected to issue the 2009 Series B Bonds as "Build America Bonds" pursuant to the American Recovery and Reinvestment Act of 2009 (ARRA).

As a result, the MSBA is eligible to receive interest subsidy payments from the United States Treasury equal to 35% of the interest payable on the 2009B Bonds. On June 24, 2010, the MSBA issued $151.0 million of Subordinated Dedicated Sales Tax Bonds (the 2010 Series A Bonds). The MSBA elected to issue these bonds as "Qualified School Construction Bonds". As a result, the MSBA is eligible to receive interest subsidy payments from the United States Treasury equal to 100% of the interest payable on the 2010 Series A Bonds.

On July 20, 2011, the MSBA issued $142.4 million of Subordinated Dedicated Sales Tax Bonds (the 2011 Series A Bonds). The Bonds mature on July 15, 2028. The MSBA elected to issue the 2011 Series A Bonds as "Qualified School Construction Bonds". As a result, the MSBA is eligible to receive interest subsidy payments from the United States Treasury equal to 100% of the interest payable on the 2011 Series A Bonds.

As of June 30, 2011, the ratings assigned to the MSBA's Dedicated Sales Tax Bonds are as follows: Aa1 by Moody's Investor Services, AA+ by Standards & Poor's Investor Services, and AA+ by Fitch Ratings. As of June 30, 2011, the ratings assigned to the MSBA's Subordinated Dedicated Sales Tax Bonds are as follows: Aa2 by Moody's Investor Services, AA by Standards & Poor's Investor Services, and AA by Fitch Ratings.

Contacting the MSBA's Financial Management

This financial report is designed to provide citizens, taxpayers, investors and creditors with a general overview of the MSBA's finances and to show the MSBA's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Massachusetts School Building Authority at 40 Broad Street, Suite 500, Boston, MA 02109.

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Governmental Fund Balance Sheet/Statement of Net Assets (Deficit)

June 30, 2011

(Dollars in thousands)

Assets		Special Revenue Fund	Debt Service Fund	Adjustments (note 7)	Statement of net assets (deficit)
Current assets:					
Cash and cash equivalents (note 4)	$	383,914	—	—	383,914
Restricted cash and investments (note 4)		578,841	17,765	—	596,606
Amount due from Commonwealth (note 3)		55,923	—	—	55,923
Interest receivable		8,821	—	—	8,821
Grant receivable		—	—	3,702	3,702
Loan receivable (note 9)		5,870	—	—	5,870
Noncurrent assets:					
Other assets		—	—	30,652	30,652
Loan receivable (note 9)		115,310	—	—	115,310
Total assets	$	1,148,679	17,765	34,354	1,200,798
Liabilities					
Current liabilities:					
Accounts payable	$	1,287	—	—	1,287
Accrued interest		—	—	78,225	78,225
Current portion of grants payable (notes 5 and 6)		71,572	—	338,755	410,327
Current portion of long-term debt (note 5)		—	—	94,505	94,505
Current portion of compensated absences (note 5)		—	—	240	240
Current portion of bond premium		—	—	14,866	14,866
Current portion of other liabilities		—	—	10,355	10,355
Long-term liabilities:					
Long-term debt (note 5)		—	—	4,300,885	4,300,885
Grants payable (notes 5 and 6)		—	—	1,914,590	1,914,590
Bond premium		—	—	180,656	180,656
Compensated absences (note 5)		—	—	163	163
Other liabilities (notes 5 and 10)		—	—	7,920	7,920
Total liabilities		72,859	—	6,941,160	7,014,019
Fund Balance/Net Assets (Deficit)					
Restricted		697,144	17,765	(714,909)	—
Committed		1,422	—	(1,422)	—
Assigned		377,254	—	(377,254)	—
Total fund balance		1,075,820	17,765	(1,093,585)	—
Total liabilities and fund balance	$	1,148,679	17,765		
Restricted for debt service				—	596,606
Unrestricted				—	(6,409,827)
Commitments and contingencies (notes 8 and 10)					
Net deficit				$ (5,813,221)	(5,813,221)

See accompanying notes to financial statements.

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Statement of Revenues, Expenditures, and Changes in Fund Balance/Statement of Activities

Year ended June 30, 2011

(Dollars in thousands)

	Special Revenue Fund	Debt Service Fund	Adjustments (note 7)	Statement of activities
General revenues:				
Dedicated sales tax (note 3)	$ 654,643	—	—	654,643
Interest income	11,281	—	(2,989)	8,292
Grant income	17,051	—	326	17,377
Total revenues	682,975	—	(2,663)	680,312
Expenditures/expenses:				
Grant payments (note 6)	790,854	—	(425,727)	365,127
Operations	10,250	—	589	10,839
Bond issuance costs	202	—	(202)	—
Debt service	314,584	—	(108,065)	206,519
Total expenditures/expenses	1,115,890	—	(533,405)	582,485
Other financing sources (uses):				
Arbitrage rebate payment	(8,529)	—	8,529	—
Transfer to (from) funds (note 2)	(8,883)	8,883	—	—
Total other financing sources (uses)	(17,412)	8,883	8,529	—
Change in fund balance/net deficit	(450,327)	8,883	539,271	97,827
Fund balance/net deficit, beginning of year	1,526,147	8,882	(7,446,077)	(5,911,048)
Fund balance/net deficit, end of year	$ 1,075,820	17,765	(6,906,806)	(5,813,221)

See accompanying notes to financial statements.

(1) Organization and Background

Chapter 208 of the Acts of 2004 (Chapter 208, together with Chapter 70B of the Massachusetts General Laws, Section 35BB of Chapter 10 of the Massachusetts General Laws and Chapter 210 of the Acts of 2004, all as most recently amended, collectively referred to as the Act), eliminated the former school building assistance program and created the Massachusetts School Building Authority (the MSBA) to administer and fund a new program (the New Program) for grants to cities, towns and regional school districts for school construction and renovation projects.

Under the former program, the Commonwealth of Massachusetts (the Commonwealth) was reimbursing cities, towns and regional school districts for its share of 728 previously approved projects (Prior Grant Projects). The Commonwealth's share ranged from 50% to 90% of approved eligible costs. In addition, under the former program, 428 school projects were maintained on a waiting list for funding (the Waiting List). Pursuant to the Act, the MSBA became responsible for funding the Commonwealth's share of the 728 Prior Grant projects and 428 Waiting List projects. As of October 1, 2011, the MSBA had paid in full its share of 357 of the 428 Waiting List Projects and 351 of the 728 Prior Grant Projects.

In fiscal year 2008, the MSBA began approving grants under the New Program for school construction and renovation. Under the New Program, no city, town or regional school district or independent agricultural and technical school has any entitlement to funds from the MSBA. Grants approved by the MSBA for projects may range from 31% to 80% of approved eligible project costs. Under the New Program, the MSBA is limited in the amount of grants it can approve in a fiscal year. The limit may change by the lesser of 4.5% of the limit for the prior fiscal year or the percentage change in the Dedicated Sales Tax Revenue Amount (see note 3) over the prior fiscal year.

The MSBA is mandated with achieving the effective planning, management and financial sustainability of a school building assistance program. The MSBA is an independent public Authority not subject to the supervision and control of any other executive office, department, agency or political subdivision of the Commonwealth. The MSBA is funded by a dedicated portion of the Commonwealth's statewide sales tax revenue. The Commonwealth has covenanted that the Dedicated Sales Tax Revenue will not be diverted from the control of the MSBA and has pledged not to reduce the sales tax rate below that prescribed by the Act. The Act prohibits the MSBA from filing for bankruptcy. The Act provides the MSBA with the power to issue bonds and notes. The MSBA may issue either general obligation or special obligation bonds. Pursuant to the Act, the aggregate outstanding principal amount of the bonds shall not exceed $10 billion.

Under the Act, the MSBA Board shall consist of the Treasurer and Receiver General of the Commonwealth (the Treasurer), the Secretary of Administration and Finance, and the Commissioner of Education, each *ex officio*, or such persons' designees, and four other members appointed by the Treasurer, each of whom shall serve two year terms and shall be eligible for reappointment. Of the four members appointed by the Treasurer, two are required to have practical experience in educational facilities planning, school building construction or architecture and school design, and two are required to be persons in the field of education with demonstrated knowledge of the Commonwealth's curriculum frameworks and other relevant federal and state educational standards. The Treasurer serves as the chairperson of the MSBA. The Executive Director of the MSBA serves as Secretary of the MSBA Board, *ex officio*.

(2) Summary of Significant Accounting Policies

(a) Reporting Entity and Basis of Presentation

The accompanying financial statements of the MSBA have been prepared in accordance with U.S. generally accepted accounting principles (GAAP). The MSBA has prepared government-wide financial statements titled "Statements of Net Assets (Deficit)" and "Statement of Activities" as well as the required supplementary information titled "Management's Discussion and Analysis" and "Schedule of Funding Progress" which precedes and follows, respectively, the financial statements. The MSBA also prepares the fund financial statements, which are the Special Revenue Fund and Debt Service Fund "Balance Sheet" and "Statement of Revenues, Expenditures and Changes in Fund Balance." The MSBA's basic financial statements which include both the government-wide and the fund financial statements have been combined together and presented on the same pages.

Fund Financial Statements – The MSBA utilizes the modified accrual basis of accounting, which focuses on changes in current financial resources, in the preparation of the fund financial statements. Revenues and related receivables are recognized when they become both measurable and available. "Available" means collectible within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures and related liabilities are recorded in the period in which the liability is incurred. However, expenditures related to compensated absences and grants payable are recorded only to the extent that the liabilities mature (come due for payment).

Operating expenditures are direct costs incurred by the MSBA and are categorized into administrative expenditures, such as payroll related benefits and legal fees, and project related expenditures such as professional consultants and other related costs.

Nonoperating revenues and expenditures, classified as other financing sources (uses), primarily relate to the issuance of long-term debt.

The MSBA reports the following funds:

The Special Revenue Fund is the MSBA's primary operating fund. It accounts for all financial resources of the MSBA, except those required to be accounted for in another fund.

During fiscal year 2010, the MSBA established a Debt Service Fund in the fund financial statements. The Debt Service Fund is a sinking fund related to the 2010 Series A bonds. The amounts in the Debt Service Fund will be used to pay the principal of the 2010 Series A bonds at maturity. Periodically, money is transferred from the Special Revenue Fund to the Debt Service Fund to meet sinking fund requirements. During fiscal year 2011, there was a transfer of $8.9 million from the Special Revenue Fund to the Debt Service Fund. As of June 30, 2011, the total amount in the Debt Service Fund totaled $17.8 million.

Government-Wide Financial Statements – The MSBA utilizes the full accrual basis of accounting, which focuses on changes in total economic resources, in the preparation of government-wide financial statements. Under the full accrual basis of accounting, changes in long-term assets and liabilities are incorporated into the financial statements. Since the fund financial statements are prepared on a different measurement focus and basis of accounting than the government-wide

financial statements, an "Adjustments Column" is presented to convert the fund basis financial statements into the government-wide financial statements. Details supporting amounts in the Adjustments Column are presented in note 7.

Due to its relationship with the Commonwealth, the MSBA is considered a blended component unit for financial statement purposes and is presented as a special revenue fund in the Commonwealth's financial statements. The MSBA has no relationship with other entities that could be considered component units.

(b) Investments

All investments are recorded at fair value. The MSBA has investments in U.S. Treasuries and a Guaranteed Investment Contract. The fair value of the Guaranteed Investment Contract is determined based on contract value.

Fluctuations in the fair value of U.S. Treasuries are recorded as interest income (loss). Interest income (loss) related to fluctuations in value of U.S. Treasuries was ($12.1) million in fiscal year 2011. The MSBA intends to hold these U.S. Treasuries to maturity.

(c) Capital Assets

Capital assets are defined by the MSBA as classes of assets with an initial aggregate cost of more than $100,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed.

Leasehold improvements exceeding $100,000 are capitalized and amortized over the life of the lease which is seven years. The net book value of capitalized leasehold improvements associated with the MSBA's lease for the fiscal year ending June 30, 2011 was approximately $352,000.

(d) Compensated Absences

Employees earn the right to be compensated during absences for vacation and illness. Vested or accumulated vacation and sick leave expected to be liquidated with expendable available financial resources are reported as expenditures and liabilities. Employees are granted vacation and sick leave in varying amounts based on years of service. Upon retirement, termination, or death, certain employees are compensated for unused vacation and sick leave (subject to certain limitations) at their then-current rate of pay. At June 30, 2011, approximately $403,000 of accrued compensated absences has been recorded.

(e) Revenue Recognition

The MSBA's major revenue source is the portion of the Commonwealth's sales tax revenue dedicated to the MSBA. Pursuant to the Act, all moneys received by the Commonwealth raised by a one percent (1%) statewide sales tax (drawn from the existing statewide 6.25% sales tax, excluding sales tax revenues on meals and from certain additional statutorily exempted revenues from sales (Dedicated Sales Tax Revenue)) are deposited into the School Modernization and Reconstruction Trust (SMART) Fund, and are available to the MSBA without further appropriation or allotment. The Dedicated Sales Tax Revenue was phased in annually through fiscal year 2010. In fiscal year

2011 and beyond, 100% of the Dedicated Sales Tax Revenue will be deposited into the SMART Fund. The use of the SMART Fund is exclusively restricted for the purposes of the MSBA. Revenue is recognized and a corresponding "Amount due from Commonwealth" is recorded when the Dedicated Sales Tax Revenue or other funds from the Commonwealth are deposited into the SMART Fund.

The Dedicated Sales Tax Revenues are pledged for repayment of outstanding debt service.

(f) Grants Payable

The MSBA records a liability for its share of total eligible project costs differently depending on the type of project. However, for all projects, the MSBA recognizes a liability for its estimated share of total eligible project costs when the applicable eligibility requirements have been met.

Prior Grants – All of the 728 Prior Grant projects had been receiving an annual payment under the former program. The liability for these projects will be reduced over time through annual payments, and savings from debt refundings by the local communities in which the MSBA recoups a share of the savings based on the reimbursement rate of the project.

Waiting List – The MSBA funds Waiting List projects using two different methods, lump sum and progress payments. Each funding method has different eligibility requirements.

Waiting List projects that will receive a lump sum payment are recognized as a liability once construction has started. The MSBA's share of costs incurred for Waiting List projects that will be funded on a progress payment basis are generally recognized as a liability once a grantee requests reimbursement from the MSBA. Waiting List projects that are not currently recognized as a liability are considered commitments of the MSBA.

Under the Act, the MSBA is committed to paying for its share of projects on the Waiting List once communities meet all applicable eligibility requirements for receiving such grants. The amount of commitments outstanding for the Waiting List projects is $142.6 million and is anticipated to be funded under the progress payment method.

New Program – The MSBA funds New Program projects on a progress payment basis. Under this process, communities submit monthly requests for reimbursement. Upon review, the MSBA processes payment for its share of eligible costs incurred. The MSBA's share of costs incurred for New Program projects are recognized as a liability once a grantee requests reimbursement from the MSBA. The MSBA has recorded a liability of $86.7 million for the reimbursements due for these projects. New Program projects that are not currently recognized as a liability are considered commitments of the MSBA. The amount of commitments outstanding for the New Program projects is $1.1 billion and will be funded under the progress payment method.

For all projects, regardless of the funding mechanism, costs incurred by the grantees are subject to audit by the MSBA. Completion of these audits will allow the MSBA to determine the final approved cost of these projects, and the MSBA will adjust the payments it makes for these projects in accordance with the results of those audits.

(g) Employee Benefits

The Commonwealth is responsible by statute for the pension benefits for members of the State Employees' Retirement System (SERS) including employees of the MSBA. The SERS is a single employer defined benefit public employee retirement system, covering substantially all employees of the Commonwealth and certain employees of independent authorities and agencies. The SERS is administered by the Commonwealth and is part of its reporting entity; no stand-alone financial report is issued. The employee retirement contributions for the year ended June 30, 2011 transferred by the MSBA were approximately $359,000. The MSBA has not recorded any pension costs in these financial statements. The MSBA share of the retiree pension expense is included in the Commonwealth's financial statements. The value of the MSBA's share was not available as of June 30, 2011, and therefore, is not reported in these financial statements. As of June 30, 2011, the MSBA did not have any retirees.

The MSBA provides post employment benefits other than pensions, including health care and life insurance benefits for active and retired employees through participation in the Commonwealth's Group Insurance Commission. MSBA employees may become eligible for those benefits if they reach normal retirement age while working for the MSBA. The MSBA records other post employment benefits (OPEB) as expenses when earned by the employee. The MSBA currently funds OPEB on a pay-as-you-go basis, however, as of June 30, 2011, the MSBA did not have any retired employees.

(h) Use of Estimates

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

(i) Fund Balances

In Fiscal Year 2011, the MSBA adopted GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This new standard requires entities to classify fund balances as restricted, committed, assigned, or unassigned. The MSBA Board of Directors has the ability to commit and un-commit funds while financial management of the MSBA has the ability to assign and un-assign funds. Restricted balances are restricted in their use by bond covenants or statute.

As of June 30, 2011, the MSBA had the following fund balances (in thousands):

		Amount
Fund balance:		
Restricted:		
Grants to cities, towns, and regional school districts	$	118,303
Debt service*		596,606
Subtotal		714,909
Committed:		
Other postemployment benefits		1,422
Assigned:		
Other postemployment benefits		1,989
Arbitrage rebate		14,864
Grants and loans to cities, towns, and regional school districts		360,401
Subtotal		377,254
Total fund balance	$	1,093,585

* $17,765 relates to the debt service fund.

(3) Amount due from Commonwealth

Coincident with the establishment of the MSBA, the Commonwealth established the SMART Fund for the purpose of receiving the transfer of Dedicated Sales Tax Revenue and other funds from the Commonwealth to the MSBA. Amounts held in this Fund are for the exclusive purpose of the MSBA. In fiscal year 2011, $654.6 million of Dedicated Sales Tax Revenue was earned and recorded as revenue. Of that amount, $55.9 million was received subsequent to year-end and is recorded as a receivable on the MSBA's financial statements.

Pursuant to the Act, in fiscal year 2010, the SMART Fund received 95% of the total Dedicated Sales Tax Revenue. In fiscal years 2011 and beyond, 100% of the Dedicated Sales Tax Revenue will be deposited into the SMART Fund.

(4) Deposits and Investments

Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*, requires that entities disclose essential risk information about deposits and investments.

(a) Investment Policy

Pursuant to the Act, the MSBA is authorized to invest in obligations of the U.S. Treasury, its agencies and instrumentalities, bonds, or notes of public agencies or municipalities, bank time deposits, guaranteed investment contracts, money market accounts, and repurchase agreements. These investments are recorded at fair value. The MSBA has an investment policy that establishes minimum credit quality for certain instruments, outlines investment procedures and provides for

periodic reporting. The MSBA's investment policy does not specifically limit the amount the MSBA may invest in any one issuer.

(b) Custodial Credit Risk

Custodial credit risk is the risk that in the event of bank failure, the MSBA's deposits may not be returned. The MSBA does not have a formal investment policy for custodial credit risk. The MSBA carries deposits that are fully insured by the Federal Deposit Insurance Corporation (FDIC) as well as deposits that are fully collateralized. As of June 30, 2011, all MSBA bank balances were fully protected against loss.

(c) Interest Rate Risk

The MSBA's investment policy does not specifically limit investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

As of June 30, 2011, the MSBA had $226.5 million invested in a collaterized guaranteed investment contract (GIC) and $200.7 million invested in U.S. Treasury Bonds. These investments are included in restricted cash and investments on the balance sheet. The GIC matures August 15, 2030 while the U.S. Treasury Bonds mature from 2019 to 2039. Both investments exceed 5% of the MSBA's total investments.

(d) Credit Risk

The MSBA's investment policy generally limits investments in fixed income products with institutions that have an investment grade rating as determined by one of the nationally recognized rating agencies. The MSBA's policy requires issuers of investment contracts to be rated AA or above by at least two of the nationally recognized rating agencies or A with pledged collateral equal to 102% of the principal balance.

As of June 30, 2011, the GIC was not rated, however, the issuer was rated AA+ or equivalent.

(5) Long and Short-Term Obligations

Following is a summary of the long-term obligations of the MSBA as of June 30, 2011 (amounts in thousands):

	Outstanding, beginning of year	Additions	Reductions*	Outstanding, end of year	Due within one year
Grants payable:					
Prior Grant projects	$ 2,325,336	—	392,480	1,932,856	257,225
Waiting List projects	362,282	—	56,890	305,392	66,433
New Program projects	26,515	86,669	26,515	86,669	86,669
	2,714,133	86,669	475,885	2,324,917	410,327
Long-term debt:					
Dedicated Sales Tax Bonds (2005)	2,291,040	—	57,795	2,233,245	60,405
Dedicated Sales Tax Bonds (2007)	1,466,595	—	15,350	1,451,245	16,100
Dedicated Sales Tax Bonds (2009A)	129,900	—	20,000	109,900	18,000
Dedicated Sales Tax Bonds (2009B)	450,000	—	—	450,000	—
Dedicated Sales Tax Bonds (2010A)	151,000	—	—	151,000	—
	4,488,535	—	93,145	4,395,390	94,505
Other liabilities:					
Other postemployment benefits	2,933	478	—	3,411	—
Compensated absences	410	—	7	403	240
Arbitrage rebate	20,404	2,989	8,529	14,864	10,355
	23,747	3,467	8,536	18,678	10,595
Total long-term obligations	$ 7,226,415	90,136	577,566	6,738,985	515,427

* Includes reductions due to MSBA audits and debt refundings by the local communities of $19.7 million and $24.7 million for Prior Grant projects and Waiting List projects, respectively.

Maturity of Bond Indebtedness

Bond indebtedness outstanding at June 30, 2011 matures as follows (amounts in thousands):

	Principal	Interest	Interest subsidy	Total
Year ending June 30:				
2012	$ 94,505	217,486	(17,258)	294,733
2013	98,110	213,162	(17,258)	294,014
2014	98,865	208,546	(17,258)	290,153
2015	120,575	203,792	(17,258)	307,109
2016	96,375	197,941	(17,258)	277,058
2017 – 2021	563,230	910,404	(86,289)	1,387,345
2022 – 2026	689,420	755,782	(86,289)	1,358,913
2027 – 2031	1,260,640	524,288	(53,262)	1,731,666
2032 – 2036	770,760	258,239	(33,780)	995,219
2037 – 2040	602,910	48,186	(8,950)	642,146
	$ 4,395,390	3,537,826	(354,860)	7,578,356

In Fiscal Year 2010, the MSBA issued $450.0 million of Dedicated Sales Tax Bonds (2009 Series B Bonds) and $151.0 million of Subordinated Dedicated Sales Tax Bonds (the 2010 Series A Bonds) for the purpose of funding school construction and renovation projects. The MSBA elected to issue the 2009 Series B Bonds as "Build America Bonds" pursuant to the American Recovery and Reinvestment Act of 2009 (ARRA). As a result, the MSBA is eligible to receive interest subsidy payments from the United States Treasury equal to 35% of the interest payable on the 2009 Series B Bonds. The MSBA elected to issue the 2010 Series A Bonds as "Qualified School Construction Bonds". As a result, the MSBA is eligible to receive interest subsidy payments from the United States Treasury equal to 100% of the interest payable on the 2010 Series A Bonds.

(6) Grants Payable

As of June 30, 2011, future payments related to the Prior Grant projects are as follows (amounts in thousands):

Year ending June 30:	
2012	$ 257,225
2013	248,178
2014	236,609
2015	224,642
2016	212,521
2017 – 2021	705,586
2022 – 2023	48,095
Total	$ 1,932,856

The amounts to be reimbursed may decrease as a result of debt refundings by the local communities and the MSBA may recalculate the final eligible grant amount pursuant to M.G.L. Chapter 70B, Section 19.

As of June 30, 2011, the MSBA's liability related to Waiting List projects totaled $305.4 million. The MSBA expects to fund its remaining share of approved eligible project costs for these Waiting List projects over the next several years upon completion of an audit of each project.

The MSBA will also fund its share of eligible project costs for projects on the Waiting List that are not currently recognized as a liability. For these projects, which will be funded on a reimbursement basis, a liability will be recognized as costs are incurred and submitted to the MSBA for reimbursement.

The total value of Waiting List projects that the MSBA inherited was approximately $5.5 billion. During fiscal years 2005 through 2011, payments and adjustments due to MSBA audits reduced the total value of the outstanding Waiting List projects to $448.0 million, composed of the Waiting List Liability of $305.4 million and commitments of $142.6 million.

Upon completion of the projects, all costs incurred by the grantees are subject to audit by the MSBA and, based on the results of the audits, the estimated approved eligible costs and the related liability may either increase or decrease.

(7) Adjustments Column

(a) Explanation of Certain Differences between the Governmental Fund Balance Sheet and the Statement of Net Assets (Deficit)

Long-term liabilities of the MSBA's activities are not due and payable in the current period and therefore are not reported as fund liabilities. Also, some assets used in governmental activities are not financial resources and therefore are not reported as fund assets. All assets and liabilities, both current and long-term, are reported in the statement of net assets (deficit). The difference between the governmental fund balances and governmental activities net deficit at June 30, 2011 were as follows (amounts in thousands):

Total fund balance – governmental funds	$	1,093,585
Amounts reported for governmental activities in the statement of net assets (deficit) are different because:		
Bond issuance costs are capitalized in the government-wide statement of net assets (deficit)		30,300
Leasehold improvements are capitalized in the government-wide statement of net assets (deficit)		352
Grant receivable is capitalized in the government-wide statements		3,702
Some liabilities are not due and payable in the current period and therefore are not reported in the governmental funds. Those liabilities consist of:		
Dedicated sales tax bonds		(4,395,390)
Grants payable to local communities		(2,253,345)
Bond premiums		(195,522)
Accrued interest		(78,225)
Other liabilities		(18,275)
Compensated absences		(403)
Net deficit of governmental activities	$	(5,813,221)

(b) Explanation of Certain Differences between the Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balance and the Statement of Activities

In the statement of activities prepared on the full accrual basis all revenues and expenses are recognized in the year they are earned or incurred regardless of when they are paid and will therefore be reflected in the statement of activities. Additionally, in the Governmental Funds, payments and receipts contribute to the change in fund balance while the same payments and receipts decrease and increase liabilities in the statement of net assets (deficit). These differences in measurement recognition affect both the reported fund balance and the reported net assets. Adjustments required to be made to the reported Governmental Funds to arrive at the statement of activities are as follows (amounts in thousands):

Net change in fund balances – governmental funds	$	(441,444)
Amounts reported for governmental activities in the statement of activities are different because:		
Payments of grants decrease long-term liabilities in the statement of net assets (deficit) but are included as expenditures in the governmental funds.		425,727
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds. This amount represents the change in compensated absences, other assets, OPEB expense and interest payable.		6,069
Bond issuance costs, net are capitalized in the government-wide statement of net assets (deficit)		(1,231)
Repayment of Bond Principal are expenditures in the the governmental funds, but reduce long-term liabilities on the statement of net assets (deficit).		93,145
Bond premiums, net increase the long-term liabilities in the statement of net assets (deficit), but are included in the operating statement of the governmental funds.		15,235
Certain revenues reported in the statement of activities can not be recognized as revenue in the governmental funds.		326
Change in net assets of governmental activities	$	97,827

(8) Commitments and Contingencies

(a) Grant Commitments

The MSBA has estimated the amount of outstanding Waiting List commitments and New Program commitments at June 30, 2011 to be $142.6 million and $1.1 billion, respectively.

(b) Related Parties

The MSBA enters into various related party transactions with the Commonwealth. All significant or material transactions have been properly disclosed in the accompanying financial statements.

(c) Operating Lease

The MSBA leases its office space. The lease terminates on March 31, 2015 with future minimum lease payments totaling $2,685,122 as follows:

Fiscal year		Amount
2012	$	726,921
2013		744,578
2014		762,235
2015		451,388
Total	$	2,685,122

Rent expense recorded during fiscal year 2011 was approximately $706,000.

(9) Intergovernmental Loans

The MSBA has entered into various loan agreements with certain school districts at a 2% interest rate to be received in equal installments through 2041. This program is designed to assist school districts with unanticipated inflationary construction costs over the districts' original amount budgeted for a Waiting List project. The loans outstanding as of June 30, 2011 total $121.2 million, of which $5.9 million is due within one year. The loans outstanding are included in Loan Receivable on the Balance Sheet and statement of net assets. During fiscal year 2011, the MSBA executed $36.0 million of new loans and collected $6.0 million of scheduled principal and interest payments.

(10) Other Post-Employment Benefits

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, requires governments to account for other postemployment benefits, primarily healthcare, on an accrual basis rather than on a pay-as-you-go basis. The effect is the recognition of an actuarially required contribution as an expense on the statement of revenues, expenses, and changes in net assets when a future retiree earns their postemployment benefit rather than when they use their postemployment benefit. To the extent that an entity does not fund their actuarially required contribution, a postemployment benefit liability is recognized on the balance sheet over time.

(a) Plan Description

The MSBA will provide post-employment health care and life insurance benefits (OPEB) for employees who retire directly from the MSBA through the Group Insurance Commission (GIC). The GIC is a state agency that administers an agent multi-employer defined benefit OPEB plan. As of January 1, 2009, the actuarial valuation date, the MSBA had no retirees and 38 active plan members, of which 14 plan members met the eligibility requirements as of January 1, 2009. The plan does not issue a separate financial report.

(b) Benefits Provided

As part of the MSBA employee benefits package administered by the GIC, the MSBA provides health and life insurance to employees who retire from the MSBA and their covered dependents. All

active employees who retire from the MSBA, meet the eligibility criteria, and opt for the plan will receive these benefits.

(c) Funding Policy

Subject to statutory requirement, future retirees will contribute 20% to 25% of the cost of the premium of the health plan, as determined by the GIC, and the MSBA will contribute the remainder of the health plan costs.

(d) Annual OPEB Costs and Net OPEB Obligation

The MSBA's fiscal year 2011 OPEB expense is calculated based on the value of benefits earned during the year (Normal Cost) and an amortization of the Unfunded Actuarial Accrued Liability (UAAL), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The Annual Required Contribution (ARC) in the table below is based on full recognition of this liability as of June 30, 2011. For future years, the ARC will be limited to changes in membership, the benefit plans and inflation rates, and is expected to decrease significantly. The following table shows the components of the MSBA's OPEB cost for the year ending June 30, 2011, the amount actually contributed to the plan, and the change in the MSBA's net OPEB obligation based on an actuarial valuation as of January 1, 2009 (amounts in thousands):

Annual required contribution (ARC)	$	3,411
Adjustment to ARC*		(2,933)
Annual OPEB cost		478
Contributions made		—
Change in net OPEB obligation		478
Net OPEB obligation – beginning of year		2,933
Net OPEB obligation – end of year	$	3,411

* Includes interest on net OPEB obligation.

The MSBA's OPEB cost, the percentage of OPEB cost contributed to the plan, and the net OPEB obligation were as follows (amounts in thousands):

Fiscal year ended		OPEB cost	Percentage of OPEB cost contributed		Net OPEB obligation
2011	$	478	—	$	3,411
2010		53	—		2,933
2009		1,150	—		2,880

During fiscal year 2010, the MSBA Board voted to establish an irrevocable trust to fund the MSBA's outstanding OPEB liability and to transfer to such trust an amount not to exceed $1,422,000 to fully

fund the Authority's outstanding OPEB liability. As of September 30, 2011, the MSBA has not yet established the irrevocable trust, but has set aside $1,422,000 in a separate account to contribute to the trust. The MSBA is currently working with the Commonwealth to develop a process whereby the MSBA could invest these funds in the State Retiree Benefits Trust Fund.

(e) Funded Status and Funding Progress

The funded status of the plan as of June 30, 2011, based on an actuarial valuation as of January 1, 2009, was as follows (amounts in thousands):

Actuarial accrued liability (AAL)	$	2,491
Actuarial value of plan assets		—
Unfunded actuarial accrued liability (UAAL)	$	2,491
Funded ratio (actuarial value of plan assets/AAL)		—%
Covered payroll (active plan members)	$	3,013
UAAL as a percentage of covered payroll		82.7%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the MSBA are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

(f) Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the plan as understood by the MSBA and the plan members and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the MSBA and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the January 1, 2009 actuarial valuation, the projected unit credit cost method was used. The actuarial value of assets was not determined as the MSBA has not advance funded its obligation. The actuarial assumptions included a 4.5% investment rate of return and an initial annual healthcare cost trend rate of 9.0% which decreases to a 5% long-term trend rate for all healthcare benefits after eight years. The MSBA has chosen to amortize its AAL over 1 year.

(11) Subsequent Event

On July 20, 2011, the MSBA issued $142.4 million of Subordinated Dedicated Sales Tax Bonds (the 2011 Series A Bonds). The Bonds mature on July 15, 2028. The MSBA elected to issue the 2011 Series A Bonds as "Qualified School Construction Bonds". As a result, the MSBA is eligible to receive interest subsidy payments from the United States Treasury equal to 100% of the interest payable on the 2011 Series A Bonds.

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Schedule of Funding Progress

Required Supplementary Information

June 30, 2011

(Unaudited)

(Dollars in thousands)

Other postemployment benefits

Actuarial valuation	Assets (a)	Actuarial accrued liability (AAL) – (b)	Unfunded AAL (UAAL) (b-a)	Funded ratio (a/b)	Covered payroll (c)	UAAL as a percentage of covered payroll ((b-a)/(c))
January 1, 2009	$ —	2,491	2,491	—%	$ 3,013	82.7%
January 1, 2008	—	2,471	2,471	—%	2,633	93.8%
January 1, 2007	—	1,448	1,448	—	1,990	72.8

See accompanying independent auditors' report.

KPMG LLP
Two Financial Center
60 South Street
Boston, MA 02111

Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Board Members
The Massachusetts School Building Authority:

We have audited the financial statements of the governmental activities and major funds of the Massachusetts School Building Authority (the MSBA), a blended component unit of the Commonwealth of Massachusetts, as of and for the year ended June 30, 2011, which collectively comprise the MSBA's basic financial statements, and have issued our report thereon dated October 14, 2011. The MSBA, in 2011, implemented Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the MSBA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The

results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the MSBA's Board and management, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

October 14, 2011

KPMG

cutting through complexity