MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Financial Statements and Required
Supplementary Information

June 30, 2012

(With Independent Auditors' Report Thereon)

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

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KPMG LLP
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Independent Auditors' Report

The 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), each major fund and the aggregate remaining fund information 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, 2012, 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, each major fund and the aggregate remaining fund information of the MSBA, as of June 30, 2012, and the respective changes in financial position for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 15, 2012 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.

U.S. generally accepted accounting principles require that the management's discussion and analysis and schedule of funding progress on pages 3 through 9 and 29 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

October 15, 2012

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, 2012. 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 of Massachusetts (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 is pledged for payment of outstanding debt service.

Under the former program, the Commonwealth was reimbursing cities, towns and regional school districts for 728 previously approved projects (Prior Grant projects). 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. The Commonwealth's share ranged from 50% to 90% of approved, eligible costs for each project. As of June 30, 2012, the MSBA had paid in full its share of 376 of the 428 Waiting List projects and 390 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 by statute 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. The aggregate grant limit for fiscal years 2008 through 2012 totals approximately $2.4 billion.

Financial Highlights

- The government-wide net deficit at June 30, 2012 was $5.9 billion. The MSBA's government-wide net deficit increased by $56.4 million in fiscal year 2012 primarily due to an increase in debt for the purposes of funding school construction and renovation projects.
- Total government-wide liabilities at June 30, 2012 were approximately $7.7 billion, an increase of $699.5 million from the prior year. Total liabilities include grants payable to municipalities totaling approximately $1.9 billion to fund school construction and renovation projects. The grants payable liability

decreased by $431.3 million in fiscal year 2012 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 shares in the savings based on the reimbursement rate of the project. In addition, total liabilities include $5.4 billion of outstanding Dedicated Sales Tax Bonds to fund school construction and renovation projects.

- During the year, the MSBA had general revenues of $770.9 million, comprised of $670.5 million of sales tax revenue, $76.7 million of interest income, and $23.7 million of grant income as compared to general revenues of $680.3 million in fiscal year 2011. Total revenues increased by $90.6 million primarily due to an increase in interest income of $68.4 million, an increase of $15.9 million in dedicated sales tax revenue, and an increase in grant income of $6.3 million. The increase in interest income of $68.4 million is primarily related to the MSBA investments in U.S. Treasuries and municipal bonds which are recorded at fair value. Fluctuations in the market value of these investments are recorded as interest income (loss). In fiscal year 2012, interest income related to the fair value of these investments was $54.7 million versus an interest loss of $12.1 million in fiscal year 2011. The MSBA intends to hold these U.S. Treasuries and municipal bonds to maturity. The increase in sales tax revenue in fiscal year 2012 versus fiscal year 2011 is due to an increase in sales tax collections. The increase in grant income is related to the interest subsidy payments from the federal government in connection with the 2011A Series A Bonds.
- As of June 30, 2012, the value of the grants payable liability totaled $1.9 billion, consisting of Prior Grant projects of $1.5 billion, Waiting List projects of $244.7 million, and $137.4 million of New Program projects. 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 New Program liability of $137.4 million represents costs incurred in the New Program prior to June 30, 2012 but paid after June 30, 2012. The MSBA has approximately $1.4 billion of commitments related to the New Program, which are not reflected in the MSBA's financial statements.
- As of June 30, 2012, the value of the outstanding Waiting List projects totaled approximately $328.8 million, composed of the Waiting List liability of $244.7 million and commitments of $84.1 million. The $84.1 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 8).
- Total assets of the Special Revenue Fund at June 30, 2012 were $1.8 billion compared to $1.1 billion at June 30, 2011. Cash and cash equivalents increased by $459.7 million due to the issuance of bonds. The MSBA issued $1.1 billion of debt during fiscal year 2012 which will primarily be used to fund grant payments.
- Special Revenue Fund operations expenditures for the year ended June 30, 2012 were approximately $14.7 million. Operations expenditures consisted of two major categories. Administrative expenditures totaling $7.4 million consisted primarily of payroll and employee related benefits, including an OPEB expense of $1.8 million, and rent and utilities. Project related expenditures totaling $7.3 million consisted primarily of expenses relating to commissioning consultants.

- The Special Revenue Fund reported a fund balance of $1.7 billion at June 30, 2012 as compared to a fund balance of $1.1 billion at June 30, 2011 primarily because cash and investments increased by $635.7 million. Cash and investments increased because the MSBA issued $1.1 billion of debt during FY 2012. Expenditures consisted of grant payments of $975.5 million, debt service of $337.3 million, operations expenditures of $14.7 million and bond issuance costs of $6.4 million.
- Assets of the Special Revenue Fund included cash and cash equivalents of $843.7 million; restricted cash and investments of $737.5 million; an amount due from the Commonwealth related to the 2012 Dedicated Sales Tax Revenue totaling $58.3 million, 100% of which was collected subsequent to year-end; loans receivable of $121.3 million in connection with the MSBA's intergovernmental loan program for cities and towns; and, an interest receivable of $9.4 million.
- In Fiscal Year 2012, the MSBA established an OPEB Trust Fund for the purposes of accumulating assets to pay for future other post-employment benefits. During Fiscal Year 2012, the MSBA transferred $1.8 million from the Special Revenue Fund to the OPEB Trust Fund. As of June 30, 2012, the OPEB Trust Fund was fully funded.

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 six financial statements presented on three pages. The first two financial statements are the Governmental Fund Balance Sheet/Statement of Net Assets (Deficit) found on page 10. The second two financial statements are the Statement of Revenues, Expenditures and Changes in Fund Balance/Statement of Activities found on page 11. The final two financial statements are the Statement of Fiduciary Net Assets and the Statement of Changes in Fiduciary Net Assets found on page 12. The OPEB Trust Fund is an irrevocable trust fund established for the purpose of accumulating assets to pay for future other post-employment benefits. The assets are funded from operations and accumulate to reduce the unfunded actuarial liability of health care and other related post-employment benefits. Currently, the MSBA has no retired employees; thus, the assets of the trust are currently not used for direct payment of benefits.

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* 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, 2012.

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)

		2012	2011
Cash and investments	$	1,616,179	980,520
Receivables		192,407	189,626
Other assets		35,325	30,652
Total assets		1,843,911	1,200,798
Current liabilities		629,700	609,805
Noncurrent liabilities		7,083,835	6,404,214
Total liabilities		7,713,535	7,014,019
Net deficit	$	(5,869,624)	(5,813,221)

Summary of Activities

(In thousands)

		2012	2011
Dedicated sales tax	$	670,494	654,643
Interest income		76,746	8,292
Grant income		23,672	17,377
Total general revenues		770,912	680,312
Grant payments and operations		588,432	375,966
Debt Service		238,883	206,519
Total expenses		827,315	582,485
Change in net deficit		(56,403)	97,827
Net deficit, beginning of year		(5,813,221)	(5,911,048)
Net deficit, end of year	$	(5,869,624)	(5,813,221)

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 primarily due to the fact that the MSBA has $5.4 billion of Dedicated Sales Tax Bonds outstanding for the purposes of funding school construction and renovation projects. The MSBA also assumed responsibility for funding the Commonwealth's share of the 428 Waiting List and 728 Prior Grant school construction and renovation projects. As of June 30, 2012, the MSBA had paid in full its share of 376 of the 428 Waiting List projects and 390 of the 728 Prior Grant projects. This net deficit of $5.9 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 10 and 11). 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 $5.9 billion of Dedicated Sales Tax Bonds for the purpose of funding school construction and renovation projects. As of June 30, 2012, the MSBA had $5.4 billion of Dedicated Sales Tax Bonds outstanding plus approximately $276.7 million of unamortized premiums for the purpose of funding school construction and renovation projects. Coupons on the bonds range from 2.00% to 5.715% and each series is payable semiannually with the latest maturity occurring in fiscal year 2042. The $5.4 billion of debt outstanding includes $293.4 million of Subordinated Dedicated Sales Tax Bonds. The Dedicated Sales Tax Revenue is pledged for payment of outstanding debt service.

On July 28, 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 and the interest on the bonds is payable semi-annually each July 15th and January 15th. 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.

On November 3, 2011, the MSBA issued $1.0 billion of Senior Sales Tax Bonds (2011 Series B Bonds). The Bonds mature at various dates through October 15, 2041 and interest on the bonds is due semi-annually each October 15th and April 15th. The coupons on the bonds range from 2.000% through 5.250%.

A portion of the interest on the Dedicated Sales Tax Bonds is reimbursed by the federal government. Of the $5.4 billion of debt outstanding as of June 30, 2012, $450.0 million is taxable Build America Bonds for which the MSBA is eligible to receive a 35% interest subsidy directly from the United States Treasury. In addition, the Subordinated Dedicated Sales Tax Bonds, including the 2011 Series A Bonds, were issued as "Qualified School Construction Bonds" for which the MSBA is eligible to receive a 100% interest subsidy payment directly from the United States Treasury.

On August 16, 2012, the MSBA refunded $808.2 million of 2005 Dedicated Sales Tax Bonds by issuing $766.1 million of Senior Sales Tax Refunding Bonds (2012 Series A Bonds). The Bonds mature at various dates through August 15, 2030 and the interest on the bonds is payable semi-annually each August 15th and February 15th. The interest rates on the bonds range from 3.000% to 5.000%. The refunding resulted in reduced debt service of $77.1 million and a present value savings of $56.6 million over the life of the debt.

As of June 30, 2012, 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, 2012, 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, 2012

(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)	$	843,653	—	—	843,653
Restricted cash and investments (note 4)		737,504	35,022	—	772,526
Amount due from Commonwealth (note 3)		58,289	—	—	58,289
Interest receivable		9,449	—	—	9,449
Grant receivable		—	—	3,412	3,412
Loan receivable (note 9)		6,464	—	—	6,464
Noncurrent assets:					
Other assets		—	—	35,325	35,325
Loan receivable (note 9)		114,793	—	—	114,793
Total assets	$	1,770,152	35,022	38,737	1,843,911
Liabilities					
Current liabilities:					
Accounts payable	$	1,635	—	—	1,635
Accrued interest		—	—	90,229	90,229
Current portion of grants payable (notes 5 and 6)		38,873	—	371,863	410,736
Current portion of long-term debt (note 5)		—	—	108,165	108,165
Current portion of compensated absences (note 5)		—	—	300	300
Current portion of bond premium		—	—	18,635	18,635
Long-term liabilities:					
Long-term debt (note 5)		—	—	5,335,100	5,335,100
Grants payable (notes 5 and 6)		—	—	1,482,910	1,482,910
Bond premium		—	—	258,035	258,035
Compensated absences (note 5)		—	—	195	195
Arbitrage rebate (note 5)		—	—	7,595	7,595
Total liabilities		40,508	—	7,673,027	7,713,535
Fund Balance/Net Assets (Deficit)					
Restricted		1,320,331	35,022	(1,355,353)	—
Assigned		409,313	—	(409,313)	—
Total fund balance		1,729,644	35,022	(1,764,666)	—
Total liabilities and fund balance	$	1,770,152	35,022		
Restricted for debt service					772,526
Unrestricted					(6,642,150)
Commitments and contingencies (notes 8 and 10)					
Net deficit				$ (5,869,624)	(5,869,624)

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, 2012

(Dollars in thousands)

	Special Revenue Fund	Debt Service Fund	Adjustments (note 7)	Statement of activities
General revenues:				
Dedicated sales tax (note 3)	$ 670,494	—	—	670,494
Interest income	79,770	62	(3,086)	76,746
Grant income	23,962	—	(290)	23,672
Total revenues	774,226	62	(3,376)	770,912
Expenditures/expenses:				
Grant payments (note 6)	975,473	—	(398,567)	576,906
Operations	14,729	—	(3,203)	11,526
Bond issuance costs	6,412	—	(6,412)	—
Debt service	337,252	—	(98,369)	238,883
Total expenditures/expenses	1,333,866	—	(506,551)	827,315
Other financing sources (uses):				
Arbitrage rebate payment (note 5)	(10,355)	—	10,355	—
Bond Proceeds (note 5)	1,142,380	—	(1,142,380)	—
Bond Premium	98,634	—	(98,634)	—
Transfer to (from) funds (note 2)	(17,195)	17,195	—	—
Total other financing sources (uses)	1,213,464	17,195	(1,230,659)	—
Change in fund balance/net deficit	653,824	17,257	(727,484)	(56,403)
Fund balance/net deficit, beginning of year	1,075,820	17,765	(6,906,806)	(5,813,221)
Fund balance/net deficit, end of year	$ 1,729,644	35,022	(7,634,290)	(5,869,624)

See accompanying notes to financial statements.

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Fiduciary Fund

June 30, 2012

(Dollars in thousands)

Statement of Fiduciary Net Assets

(for the period ended June 30, 2012)

		OPEB Trust Fund
Assets:		
Cash and cash equivalents (note 4)	$	1,778
Total assets		1,778
Net assets – held in trust for OPEB benefits	$	1,778

Statement of Changes in Fiduciary Net Assets

(for the period June 25, 2012 to June 30, 2012)

Additions:		
Contributions:		
Employer	$	1,778
Total contributions		1,778
Net assets, beginning of period		—
Net assets, end of period	$	1,778

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). 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. The Commonwealth's share ranged from 50% to 90% of approved eligible costs. As of June 30, 2012, the MSBA had paid in full its share of 376 of the 428 Waiting List projects and 390 of the 728 Prior Grant 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 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*.

(Continued)

(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.

The Debt Service Fund is a sinking fund related to the 2010 Series A Bonds and 2011 Series A Bonds. The amounts in the Debt Service Fund will be used to pay the principal of the 2010 Series A Bonds and 2011 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 2012, there was a transfer of $17.2 million from the Special Revenue Fund to the Debt Service Fund. As of June 30, 2012, the total amount in the Debt Service Fund totaled $35.0 million.

Fiduciary Fund – During fiscal year 2012, the MSBA established the OPEB Trust Fund, an irrevocable trust fund established to accumulate assets for the purpose of paying for future other post-employment benefits. The assets are funded from operations and accumulate to reduce the unfunded actuarial liability of health care and other related post-employment benefits. Currently, the MSBA has no retirees; thus, the assets of the trust are currently not used for direct payment of benefits.

(Continued)

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 and fiduciary 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, municipal bonds, an external investment pool and a Guaranteed Investment Contract. The fair value of the Guaranteed Investment Contract is determined based on contract value.

The MSBA invests in the Massachusetts Municipal Depository Trust (MMDT), which is an external investment pool and is not SEC-registered. The fund is state regulated and is valued at current share price.

Fluctuations in the fair value of U.S. Treasuries and municipal bonds are recorded as interest income (loss). Interest income (loss) related to fluctuations in value of these investments was $57.4 million in fiscal year 2012. The MSBA intends to hold these investments 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 at June 30, 2012 was approximately $234,000.

(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, 2012, approximately $495,000 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 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 Revenue is pledged for repayment of outstanding debt service.

100% of the interest on the $293.0 million of Subordinated Dedicated Sales Tax Bonds and 35% of the interest on the $450.0 million of Build America Bonds is eligible to be reimbursed by the federal government and recorded as grant income.

(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 shares in 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 lump sum payments are recognized as a liability once construction has started. 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 shares in the savings based on the reimbursement rate of the project.

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. As of June 30, 2012, the amount of commitments outstanding for the Waiting List projects is $84.1 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

(Continued)

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 $137.4 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. As of June 30, 2012, the amount of commitments outstanding for the New Program projects is $1.4 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, as necessary, 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, 2012 transferred by the MSBA were approximately $377,000. 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, 2012, and therefore, is not reported in these financial statements.

The MSBA provides 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 post-employment benefits if they reach normal retirement age while working for the MSBA and retire from the MSBA. The MSBA records other post-employment benefits (OPEB) as expenses when earned by the employee. The MSBA currently funds OPEB based on an actuarial funding schedule. As of June 30, 2012, the MSBA did not have any retirees.

(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

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* 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, 2012, the MSBA had the following fund balances (in thousands):

		Amount
Fund balance:		
Restricted:		
Grants to cities, towns, and regional school districts	$	582,827
Debt service*		772,526
Subtotal		1,355,353
Assigned:		
Arbitrage rebate		7,595
Grants and loans to cities, towns, and regional school districts		401,718
Subtotal		409,313
Total fund balance	$	1,764,666

* $35.0 million 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 2012, $670.5 million of Dedicated Sales Tax Revenue was earned and recorded as revenue. Of that amount, $58.3 million was received subsequent to year-end and is recorded as a receivable on the MSBA's financial statements. The Dedicated Sales Tax Revenue is pledged for repayment of outstanding debt service.

(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.

The assets of the MSBA's OPEB Trust Fund are invested in the State Retiree Benefits Trust Fund, which is part of the Massachusetts Pension Reserves Investment Trust Fund and follows the investment policy of the Massachusetts Pension Reserves Investment Management Board.

(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, 2012, 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, 2012, the MSBA had $226.5 million invested in a collaterized guaranteed investment contract (GIC) and $343.5 million invested in U.S. Treasury Bonds and municipal 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 and municipal bonds mature from 2019 to 2040. These 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, 2012, the GIC was not rated; however, the issuer was rated AA+ or equivalent. As of June 30, 2012, the MSBA's investments in municipal bonds were rated AA+ or above.

(5) Long and Short-Term Obligations

Following is a summary of the long-term obligations of the MSBA as of June 30, 2012 (amounts in thousands):

		Outstanding, beginning of year	Additions	Reductions*	Outstanding, end of year	Due within one year
Grants payable:						
Prior Grant projects	$	1,932,856	—	421,346	1,511,510	229,913
Waiting List projects		305,392	—	60,703	244,689	43,375
New Program projects		86,669	137,447	86,669	137,447	137,448
		2,324,917	137,447	568,718	1,893,646	410,736
Long-term debt:						
Dedicated Sales Tax Bonds (2005)		2,233,245	—	60,405	2,172,840	63,285
Dedicated Sales Tax Bonds (2007)		1,451,245	—	16,100	1,435,145	16,825
Dedicated Sales Tax Bonds (2009A)		109,900	—	18,000	91,900	18,000
Dedicated Sales Tax Bonds (2009B) – Build America Bonds		450,000	—	—	450,000	—
Subordinated Dedicated Sales Tax Bonds (2010A) – Qualified School Construction Bonds		151,000	—	—	151,000	—
Subordinated Dedicated Sales Tax Bonds (2011A) – Qualified School Construction Bonds		—	142,380	—	142,380	—
Dedicated Sales Tax Bonds (2011B)		—	1,000,000	—	1,000,000	10,055
		4,395,390	1,142,380	94,505	5,443,265	108,165
Other liabilities:						
Other postemployment benefits		3,411	—	3,411	—	—
Compensated absences		403	92	—	495	300
Arbitrage rebate		14,864	3,086	10,355	7,595	—
		18,678	3,178	13,766	8,090	300
Total long-term obligations	$	6,738,985	1,283,005	676,989	7,345,001	519,201

* Includes reductions in grants payable due to MSBA audits and debt refundings by the local communities of $27.4 million and $1.4 million for Prior Grant projects and Waiting List projects, respectively.

Maturity of Bond Indebtedness

Bond indebtedness outstanding at June 30, 2012 matures as follows (amounts in thousands):

		Principal	Interest	Interest subsidy	Total
Year ending June 30:					
2013	$	108,165	268,982	(24,213)	352,934
2014		118,490	263,923	(24,213)	358,200
2015		131,140	258,579	(24,213)	365,506
2016		115,375	252,040	(24,213)	343,202
2017		133,920	246,254	(24,213)	355,961
2018 – 2022		746,845	1,125,529	(121,065)	1,751,309
2023 – 2027		915,460	935,470	(121,065)	1,729,865
2028 – 2032		1,320,740	639,587	(55,009)	1,905,318
2033 – 2037		1,077,260	341,607	(29,065)	1,389,802
2038 – 2040		775,870	66,389	(5,093)	837,166
	$	5,443,265	4,398,360	(452,362)	9,389,263

As of June 30, 2012, the MSBA had outstanding approximately $5.4 billion of Dedicated Sales Tax bonds, plus approximately $276.7 million of unamortized premiums, for the purpose of funding school construction and renovation projects. Coupons on the bonds range from 2.000% to 5.715% and each series is payable semi-annually with the latest maturity occurring in fiscal year 2042. The $5.4 billion of debt outstanding includes $293.4 million of Subordinated Dedicated Sales Tax Bonds.

On July 28, 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 and the interest on the bonds is payable semi-annually each July 15th and January 15th. 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.

On November 3, 2011, the MSBA issued $1.0 billion of Senior Sales Tax Bonds (2011 Series B Bonds). The Bonds mature at various dates through October 15, 2041 and interest on the bonds is due semi-annually each October 15th and April 15th. The coupons on the bonds range from 2.000% through 5.250%.

A portion of the interest on the Dedicated Sales Tax Bonds is reimbursed by the federal government. Of the $5.4 billion of debt outstanding as of June 30, 2012, $450.0 million is taxable Build America Bonds for which the MSBA is eligible to receive a 35% interest subsidy directly from the United States Treasury. In addition, the Subordinated Dedicated Sales Tax Bonds, including the 2011 Series A Bonds, were issued as "Qualified School Construction Bonds" for which the MSBA is eligible to receive a 100% interest subsidy payment directly from the United States Treasury.

(6) Grants Payable

As of June 30, 2012, future payments related to the Prior Grant and Waiting List projects are as follows (amounts in thousands):

		Prior Grants	Waiting List	Total
Year ending June 30:				
2013	$	229,913	43,375	273,288
2014		217,218	20,946	238,164
2015		206,633	20,946	227,579
2016		194,185	20,946	215,131
2017		180,550	20,324	200,874
2018 – 2022		472,005	94,652	566,657
2023 – 2024		11,006	23,500	34,506
Total	$	1,511,510	244,689	1,756,199

The amounts to be reimbursed for the Prior Grant and Waiting List projects may decrease as a result of debt refundings by the local communities in which the MSBA shares in the savings based on the reimbursement rate of the project.

The MSBA will also fund its share of eligible project costs for Waiting List projects and New Program projects that are not currently recognized as a liability. For these projects, which will be funded on a progress payment basis, a liability will be recognized as costs are incurred and submitted to the MSBA for reimbursement. The MSBA has estimated the amount of outstanding Waiting List commitments and New Program commitments at June 30, 2012 to be approximately $84.1 million and $1.4 billion, respectively.

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, 2012 were as follows (amounts in thousands):

Total fund balance – governmental funds	$	1,764,666
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)		35,091
Leasehold improvements are capitalized in the government-wide statement of net assets (deficit)		234
Grant receivable is capitalized in the government-wide statements		3,412
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		(5,443,265)
Grants payable to local communities		(1,854,773)
Bond premiums		(276,670)
Accrued interest		(90,229)
Other liabilities		(7,595)
Compensated absences		(495)
Net deficit of governmental activities	$	(5,869,624)

(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	$	671,081
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.		398,567
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 post-employment benefits, other assets, and interest payable.		(1,531)
Bond issuance costs, net are capitalized in the government-wide statement of net assets (deficit)		4,792
Proceeds of long-term increase long-term liabilities in the statement of net assets (deficit) but are included in the operating statement of the governmental funds.		(1,142,380)
Repayment of Bond Principal are expenditures in the governmental funds, but reduce long-term liabilities on the statement of net assets (deficit).		94,505
Proceeds from bond premiums increase long-term liabilities in the statement of net assets (deficit)		(98,634)
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.		17,487
Certain revenues reported in the statement of activities can not be recognized as revenue in the governmental funds.		(290)
Change in net assets of governmental activities	$	(56,403)

(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, 2012 to be $84.1 million and $1.4 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 January 31, 2015 with future minimum lease payments totaling $1,958,201 as follows:

Fiscal year		Amount
2013	$	744,578
2014		762,235
2015		451,388
Total	$	1,958,201

Rent expense recorded during fiscal year 2012 was approximately $726,921.

(9) Intergovernmental Loans

The MSBA has entered into various loan agreements with municipalities at a 2% interest rate with principal to be paid in equal installments for varying terms. Currently, the longest repayment schedule has a final payment in fiscal year 2041. This program is designed to assist a limited number of school districts with unanticipated inflationary construction costs over the districts' original project budget. The loans outstanding as of June 30, 2012 were $121.3 million, of which $6.5 million is due in FY13. During FY12, the MSBA executed $5.9 million of new loans and collected $5.9 million of scheduled principal payments.

(10) Other Post-Employment Benefits

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions*, requires governments to account for other post-employment 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 post-employment benefit rather than when they use their post-employment benefit. To the extent that an entity does not fund their actuarially required contribution, a post-employment benefit liability is recognized on the balance sheet over time.

(a) Plan Description

The MSBA will provide post-employment health care, life insurance and other post-employment benefits (OPEB) for employees who meet the eligibility criteria and 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. The MSBA plans to keep the plan fully funded on an annual basis.

(d) Annual OPEB Costs and Net OPEB Obligation

The MSBA's fiscal year 2012 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, 2012. 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, 2012, 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, and updated June 30, 2012 (amounts in thousands):

Annual required contribution (ARC)	$	1,778
Adjustment to ARC*		(3,411)
Annual OPEB cost		(1,633)
Contributions made		(1,778)
Change in net OPEB obligation		(3,411)
Net OPEB obligation – beginning of year		3,411
Net OPEB obligation – end of year	$	—

* 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
2012	$	(1,633)	100%	—
2011		478	—	3,411
2010		53	—	2,933

During fiscal year 2012, the MSBA established an irrevocable trust to accumulate assets to pay for future other post-employment benefits. In June, 2012, the MSBA transferred $1,778,000 to the Trust to fully fund it.

(e) Funded Status and Funding Progress

The funded status of the plan as of June 30, 2012, based on an actuarial valuation as of January 1, 2009, and updated June 30, 2012, was as follows (amounts in thousands):

Actuarial accrued liability (AAL)	$	1,778
Actuarial value of plan assets		1,778
Unfunded actuarial accrued liability (UAAL)	$	—
Funded ratio (actuarial value of plan assets/AAL)		100%
Covered payroll (active plan members)	$	3,880
UAAL as a percentage of covered payroll		—%

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, which was updated as of June 30, 2012, the projected unit credit cost method was used. The actuarial value of assets was determined to be $1.8 million based on the fair market value of the assets. The actuarial assumptions included an 8.25% 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 August 16, 2012, the MSBA refunded $808.2 million of 2005 Dedicated Sales Tax Bonds by issuing $766.1 million of Senior Sales Tax Refunding Bonds (2012 Series A Bonds). The Bonds mature at various dates through August 15, 2030 and the interest on the bonds is due semi-annually each August 15th and February 15th. The interest rates on the bonds range from 3.000% to 5.000%. The refunding resulted in reduced debt service of $77.1 million and a present value savings of $56.6 million over the life of the debt.

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Schedule of Funding Progress – Required Supplementary Information

June 30, 2012

(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*	$ 1,778	1,778	—	100%	$ 3,880	—%
January 1, 2009	—	2,491	2,491	—	3,013	82.7
January 1, 2008	—	2,471	2,471	—	2,633	93.8

* Updated as of June 30, 2012

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*

The Board Members
The Massachusetts School Building Authority:

We have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information 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, 2012, which collectively comprise the MSBA's basic financial statements, and have issued our report thereon dated October 15, 2012. 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

Management of the MSBA is responsible for establishing and maintaining effective 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 opinions 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 15, 2012