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Commonwealth of Massachusetts

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March 25, 2021

To the citizens of the Commonwealth of Massachusetts *and*

His Excellency Charles D. Baker
Governor
Commonwealth of Massachusetts
State House, Room 360
Boston, MA 02133

Secretary Michael J. Heffernan
Executive Office for Administration & Finance
State House, Room 373
Boston, MA 02133

Honorable Aaron Michlewitz, Chair
House Ways and Means Committee
State House, Room 243
Boston, MA 02133

Secretary Michael J. Rodrigues, Chair
Senate Ways and Means Committee
State House, Room 212
Boston, MA 02133

Mr. Steven T. James
Clerk of the House of Representatives
State House, Room 145
Boston, MA 02133

Mr. Michael D. Hurley
Clerk of the Senate
State House, Room 335
Boston, MA 02133

The Office of the Comptroller is pleased to provide this Letter of Transmittal for the Commonwealth's fiscal year 2020 (FY20) Comprehensive Annual Financial Report (Annual Report) prepared in accordance with Generally Accepted Accounting Principles (GAAP) in the United States of America. The objective of this report is to provide a clear financial picture of our government as a single, unified entity.

This document presents the Commonwealth's financial information on three bases of accounting, each serving a different purpose. The report includes "required supplementary information" in the form of budgetary basis statements, which are prepared in accordance with the Commonwealth's budgetary or statutory basis of accounting and is summarized by Commonwealth branch and agency. This information is aggregated from FY20 line item appropriations, the legal level of budgetary control -- i.e., the amount up to which state departments can spend without approval of additional appropriations (in a so-called "supplemental budget") by the Massachusetts Legislature. Line items specify a dollar amount that can be legally spent on specified programs or activities; for example, separate line items are authorized in the state's annual budget for general administrative expenses (including personnel expenses) and for benefit payments in the Commonwealth's Medicaid program. More detailed information on the statutory basis of accounting and the results of operations on that basis from FY20 are found in the Statutory Basis Financial Report (SBFR) issued separately on December 18, 2020. The SBFR documents compliance with the legislatively adopted budget at a fund level. Further documentation is found within the Commonwealth's accounting system, the Massachusetts Management Accounting and Reporting System (MMARS). Each state maintains different rules for budgetary reporting and therefore the SBFR should not be used for comparisons across states.

The Annual Report "fund perspective" statements present the governmental operations on a modified accrual basis of accounting. The fund perspective is designed to measure inter-period equity, the extent to which current resources (available within one year) fully fund all current services provided by the government. Long-term

liabilities are excluded with the implicit assumption that future tax revenues will fund these liabilities as they come due. This fund perspective provides results similar to the SBFR.

In addition to the fund perspective, this Annual Report presents a "government-wide" perspective. This perspective combines all governmental and business-type activities in a statement of net position and a statement of activities, presenting all functions on a full accrual basis of accounting. All capital assets are added to the government-wide statements, as are most long-term liabilities. Funds that are shown as fiduciary under the fund perspective are not portrayed in the government-wide statements, as the assets do not belong to the Commonwealth.

In the government-wide statements, the balance sheet has been organized into a "net position format." This format classifies all assets and liabilities as either short-term or long-term and then subtracts liabilities and deferred inflows of resources from assets and deferred outflows of resources to arrive at net position.

The Commonwealth's government-wide revenues, expenses and activities are included in the statement of activities. The expenses of the Commonwealth, organized by function, are netted against fees, fines, grant revenues, and assessments generated to fund each function in an attempt to derive the net cost to the taxpayer of each function. This format allows the reader of the financial statements to discern the net cost of a particular function of government funded by taxation and other general revenues.

This Annual Report is presented in three sections: **Introductory**, **Financial**, and **Statistical**. The **Introductory Section** contains an overview of current initiatives and summary financial data. The **Financial Section** contains the Management's Discussion and Analysis (MD&A) and the Commonwealth's Basic Financial Statements. GAAP requires that management provide a narrative overview and analysis in the form of an MD&A to accompany the basic financial statements.

This letter of transmittal is designed to complement the MD&A, where the financial analysis is presented. The Commonwealth's MD&A can be found immediately following the Independent Auditors' Report. The **Statistical Section** contains selected financial and demographic information; it also contains background information on the Commonwealth.

PROFILE OF THE COMMONWEALTH

The Commonwealth of Massachusetts was the sixth of the original 13 colonies to ratify the United States Constitution, joining the United States on February 6, 1788. Boston, the capital of the Commonwealth since its founding, dates from 1630. The Commonwealth has an area of 8,257 square miles. Geographically, the Commonwealth includes 351 cities and towns. The largest city is the capital, Boston. Employment is largely in the education, health services, wholesale and retail trade, financial, technology, and public sectors. Due to the Commonwealth's high levels of basic and advanced education and the presence of world-class educational institutions, the Commonwealth's economy is driven in large part by innovation in technology, life sciences, health care, and business services.

The Massachusetts Constitution was ratified in 1780 while the Revolutionary War was still in progress, nine years before the United States Constitution was adopted, and is the oldest written Constitution now in use. It specified three branches of Government: Legislative, Executive, and Judicial. "The Great and General Court," elected every two years, is made up of a Senate of 40 members and a House of Representatives of 160 members. It is the second oldest democratic deliberative body in the world.

The table on page 3 reconciles the fund balances on three bases of accounting: the statutory basis as presented in the separately issued financial statements on December 18, 2020; the fund basis; and the entity-wide basis statements, the latter two of which are included in this report.

Governmental Funds - Statutory to GAAP - Fund Perspective and to Governmental Activities Net Position
(Amounts in millions)

Governmental Funds - Statutory Basis, June 30, 2020	
Budgeted fund balance	\$ 4,295.2
Non-budgeted special revenue fund balance	4,506.5
Capital projects fund balance	<u>(762.1)</u>
Governmental Fund Balance - Statutory Basis, June 30, 2020	\$ 8,039.6
Plus: Expendable Trust and Similar Fund Statutory balances that are considered Governmental Funds for GAAP reporting purposes	628.1
Less: Massachusetts Department of Transportation Funds	<u>(1,501.1)</u>
Adjusted Statutory Governmental fund balance	7,166.6
Reclassification of funds due to implementation of GASB Statement No. 84	61.7
Short term accruals, net of allowances and deferrals for increases /(decreases):	
Taxes, net of refunds and abatements	2,265.5
Tobacco settlement agreement receivable	125.7
Medicaid	<u>(232.2)</u>
Other short term accruals:	
Assessments and other receivables	452.6
Amounts due to authorities and municipalities, net	<u>(532.2)</u>
Claims, judgments and other risks	(14.1)
Amounts due to health care providers and insurers	(23.1)
Workers' compensation and group insurance	(180.2)
Other accruals, net	<u>(1,750.1)</u>
Net increase to governmental fund balances	173.6
Massachusetts School Building Authority fund balance	<u>1,717.3</u>
Total changes to governmental funds	<u>1,890.9</u>
Governmental fund balance (fund perspective)	9,057.5
Plus: Capital assets including infrastructure, net of accumulated depreciation	4,922.8
Deferred revenue, net of other eliminations	820.6
Long-term receivables	28.0
Long term accruals:	
Net pension liability	(40,836.7)
Net deferred (inflows)/outflows of resources related to pension	5,779.3
Net OPEB liability	(15,972.2)
Net deferred (inflows)/outflows of resources related to OPEB	(1,370.0)
Environmental remediation liability	(560.4)
Massachusetts School Building Authority debt and school construction payables	(6,753.4)
Long term debt, unamortized premiums and net deferrals on debt refundings	(31,359.2)
Compensated absences	(688.3)
Capital leases	(17.1)
Accrued interest on bonds	(447.3)
Other long term liabilities	<u>(281.0)</u>
Total governmental activities net position	<u>\$ (77,677.4)</u>

The deficit of \$77.677 billion in governmental activities net position is largely attributable to several factors. First, the Commonwealth has made a policy decision to finance construction of assets owned by other government entities, particularly Commonwealth roads and bridges, school buildings, and assets of cities and towns and local authorities. As a result of transportation reform implemented during FY10, the Commonwealth shifted virtually all

its road and bridge assets from its books to the newly created Massachusetts Department of Transportation (MassDOT), a component unit of the Commonwealth. Second, starting in FY15, the Commonwealth's net (or unfunded) pension liability, was placed on the Commonwealth's books in accordance with [GASB Statement No. 68, Accounting and Financial Reporting for Pensions](#). Third, the Commonwealth's net (or unfunded) OPEB, or other post-employment benefits (mainly health insurance), liability, was placed on the Commonwealth's books starting in FY18 in accordance with [GASB Statement No. 75, Accounting and Financial Reporting for Post Employment Benefits Other than Pensions](#).

At the end of FY20, MassDOT held \$25.629 billion in road, bridge, and other transportation-related assets (excluding assets of the Massachusetts Bay Transportation Authority) net of related depreciation, the vast majority of which were formerly held by the Commonwealth. The Commonwealth also has financed significant transportation and non-transportation assets currently held by Massachusetts Institutions of Higher Education, Massachusetts cities and towns, and quasi-public authorities. While the exact amount of Commonwealth-funded assets held by these entities is difficult to determine, between FY05 and FY20 the Commonwealth's capital spending on Higher Education capital projects totaled approximately \$2.272 billion, capital spending for transportation-related financial assistance to local governments totaled approximately \$4.211 billion, and other grants and financial assistance for non-Commonwealth entities such as cities and towns and quasi-public authorities funded through the Commonwealth's capital budget totaled \$6.981 billion, including \$1 billion to fund the Massachusetts School Building Authority (MSBA) in FY05 and FY06. In addition, the Commonwealth has a net liability of \$4.918 billion for debt and grant obligations for the School Building Assistance Program that finances construction of schools for the Commonwealth's cities and towns. As almost all of this capital spending was financed by Commonwealth debt, the liabilities are retained by the Commonwealth while the assets are held by the Institutions of Higher Education, Massachusetts cities and towns, and entities such as local housing and other quasi-governmental authorities.

Since MassDOT ended FY20 with a positive net position of \$27.588 billion, it is more informative to view the Commonwealth's financial statements in combination with MassDOT than to analyze the two separately, while also keeping in mind that significant assets owned by the Institutions of Higher Education and local governments and authorities were financed by liabilities still on the Commonwealth's books.

As of June 30, 2020, the net pension liability in governmental activities totaled \$40.837 billion, offset by GASB 68 related adjustments (in the form of deferred inflows and outflows of resources) of \$5.779 billion; resulting in a reduction in governmental activities net position of \$35.057 billion. Governmental activities' net OPEB liability totaled \$15.972 billion.

The net deficit in governmental activities (which excludes "business-type activities" of Unemployment Insurance, the Family and Employment Security Trust and Higher Education) increased by \$3.100 billion on between June 30, 2019 and June 30, 2020, as increases in assets were approximately offset by increases in liabilities. The most significant changes were as follows:

- The Commonwealth's current assets increased by \$2.077 billion, primarily as a result of increased cash on hand due to the federal government provision of financial aid under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which provided the state with \$2.461 billion in aid to offset costs of the COVID-19 pandemic. Of that amount, \$1.862 billion in cash remained as of June 30.
- The Commonwealth's other net post employment benefits (OPEB) liability, after taking into account deferrals of the liability decrease caused by lower than projected retiree medical costs and a change in the discount rate by which OPEB liabilities are calculated, increased by \$246 million between FY19 and FY20. As further explained in Footnote 1T, the OPEB actuarial valuation was also corrected due to errors discovered in calculations underlying the amounts reported in the GASB 75 report as of the June 30, 2018 measurement date, which was reported in the FY2019 Annual Report.
- The Commonwealth's net pension liability, after taking into account deferrals of FY20 investment gains and other adjustments that will be recognized over the next several years, increased by \$4.313 billion, primarily due to a reduction, from 7.25%, to 7.15%, in the rate used to discount liabilities.
- As noted on page 3, the Commonwealth continues to fund, through its own debt, transportation-related assets owned by the Massachusetts Department of Transportation (MassDOT), Institutions of Higher

Education, cities and towns and quasi-public authorities. In FY20, approximately \$1.999 billion of the more than \$2.497 billion in state-funded capital spending generated assets not owned by the Commonwealth, including \$1.358 billion in transportation spending (more than \$326 million of which were grants and other financial assistance to cities and towns), \$146 million for Institutions of Higher Education (which are attributed to the Commonwealth's business-type activities), and approximately \$474 million in other capital grants and financial assistance to local governments and quasi-public entities. As a result of this capital spending on assets owned by entities other than the Commonwealth, the amount of debt outstanding increased by \$1.560 billion while the Commonwealth's governmental activities capital assets net of depreciation increased by only \$169 million.

The net deficit in the primary government, in addition to governmental activities, includes the Commonwealth's business-type activities of the Unemployment Insurance system, Family and Employment Security Trust and Higher Education institutions, increased by \$4.019 billion from FY19, due primarily to increased liabilities for pension and post-employment (health insurance) benefits for state employees, which together increased by a total of \$1.612 billion, and decrease in net position of business-type activities of \$919 million, caused by a reduction of \$1.795 billion in the Unemployment Insurance fund balance, partially offset by an increase of \$830 million in Family and Employment Security Trust and smaller surpluses in Higher Education. These changes are explained in more detail on pages 23 through 32 of this report.

The Commonwealth engages in multi-year financial planning in several areas, including the adoption of a statutorily required triennial pension funding schedule (which is funded prior to the adoption of each year's annual budget), a five-year capital spending plan, and a multi-year debt issuance planning process via a Debt Affordability Committee established in statute, comprised of Massachusetts government and non-government financial experts. The Commonwealth's short and long-term goal is to achieve annual statutory structural budget balance, i.e., where annual revenues equal or exceed annual expenditures, thus minimizing the use of one-time resources. A related goal is to limit the growth in state expenditures to increases in budgeted revenues. The current Administration has also committed to a policy of annual increases in unrestricted aid to cities and towns equal to the growth in projected budgetary fund tax revenues.

REPORTING ENTITY

The financial statements incorporate activity from over 150 departments. These departments include the various agencies, boards, and commissions, the 25 Institutions of Higher Education, the judicial and legislative branches of government, and constitutional offices. The departments record their daily financial operations in the state accounting system, MMARS, operated by the Office of the Comptroller.

In addition, the financial statements include 41 independent public authorities. These entities are defined as component units and meet the criteria for inclusion in the Commonwealth's reporting entity in accordance with GAAP. They are further described in [Note 14](#) to the basic financial statements. The Massachusetts School Building Authority (MSBA) is blended into the Commonwealth's operations.

INDEPENDENT AUDIT

The Commonwealth's independent auditors, KPMG LLP, have performed an independent audit of the Commonwealth for the fiscal year ended June 30, 2020. The [Independent Auditors' Report](#) is presented in the Financial Section.

The Office of the Comptroller prepares these financial statements and is responsible for the completeness and reliability of the information presented in this report. To provide a reasonable basis for making these representations, the Office of the Comptroller, working in conjunction with the State Auditor, has established a comprehensive internal control framework that is designed to protect the Commonwealth's assets from loss, theft, or misuse and to compile sufficient reliable information for the preparation of the Commonwealth's financial statements in conformity with GAAP. Because of the cost, internal controls should not outweigh their benefits. The Commonwealth's comprehensive framework of internal controls has been designed to provide reasonable, rather than absolute assurance that the financial statements will be free from material misstatement.

All fifty states produce a Comprehensive Annual Financial Report but I believe that the accuracy and information value of the Commonwealth's report is unsurpassed. Particularly in the year of the pandemic, I greatly appreciate the skill and hard work of the state's financial professionals. I thank the dedicated employees of the Office of the Comptroller, and in particular First Deputy Comptroller Jeffrey Shapiro, Deputy Comptroller Howard Merkowitz, and Assistant Comptrollers Kristine Hill-Jones, Kevin McHugh, Amy Nable, Peter Scavotto, and Peter Murphy. They and their teams, as well as the financial professionals across state government with whom they collaborate, have served the Commonwealth extremely well in a challenging time.

Respectfully submitted,

A handwritten signature in blue ink that reads "William McNamara". The signature is written in a cursive style.

William McNamara
Comptroller of the Commonwealth