

Financial Management of the City

Managing the City's finances involves both a strategic and operational component. Strategically, the finances must be managed to accommodate fluctuations in the economy and the resulting changes in costs and revenues. Operationally, the City must put in place clear financial goals, policies, and tools to implement its strategic plan.

The Mayor ultimately directs all of Boston's financial operations. The Mayor is the chief executive officer of the City and has general supervision of and control over the City's boards, commissions, officers, and departments.

Mayor Menino established a cabinet form of government to recognize the major functional responsibilities of city government and to facilitate improvements in conducting the executive and administrative business of the City.

The following departments are included in the Administration and Finance Cabinet and have major roles in the financial management of the City.

- The Treasury Department collects revenues due to the City and pays all amounts due for payrolls and outside vendors. The Treasury Department also manages the investment of City funds and supervises City borrowings.
- The Auditing Department prepares the City's annual financial statements, implements fiscal controls over departmental spending, provides technical assistance to departments and agencies, and reviews and processes all financial transactions for accuracy, completeness and compliance.
- The Assessing Department is responsible for the valuation and assessment of all real and personal property in the City for the purpose of taxation.
- The Office of Budget Management coordinates the analysis and presentation of

the Mayor's operating budget and capital plan, assembles, analyzes, and presents data with respect to revenue and debt management and evaluates programs to establish and use performance measures.

- The Purchasing Department procures all supplies, materials, and equipment, selects vendors through public bidding and processes purchase orders and contracts.
- The Retirement Board administers the State-Boston Retirement System, which provides pension benefits to retired City employees under a state contributory retirement statute.

STRATEGIC FINANCIAL MANAGEMENT

Maintaining a healthy financial base that fully supports City services according to mayoral priorities requires constant vigilance. This work is reflected in restructuring and reshaping City services, implementing new financial management systems, securing sound recurring revenues, and making responsible spending adjustments in light of revenue growth limitations in order to achieve a balanced budget.

A balanced budget is required by Massachusetts General Laws Chapter 59, Section 23. As part of the State Department of Revenue's tax rate certification process, municipalities must balance all appropriations, fixed costs and prior year deficits with the approved property tax levy, estimated local revenues, and available prior year surpluses in order to obtain authorization to issue property tax bills.

The overall success of the City's adhering to its financial policies and building its image in the capital markets has contributed to steady bond rating upgrades. In March 2007, Standard & Poor's Rating Services upgraded Boston's credit rating to AA+. Both Moody's Investors Service and Fitch Ratings affirmed the City's credit ratings of Aa1 and AA respectively. These are the highest ratings

in Boston's history, a clear recognition by the credit markets of the City's strong proactive management.

Investors are willing to invest in bonds with higher credit quality, thereby lowering the interest rate the City must pay to service its debt. Solid credit ratings have allowed the City to borrow money more affordably. The City has also refinanced existing debt during favorable market conditions to achieve significant savings.

Maximizing Return on Investment

The City works to improve service delivery by constantly reassessing the management, organization, and distribution of financial resources toward those priority goals that maximize return. The Office of Budget Management (OBM) supports departments in their work by providing analysis and technical assistance.

Ongoing investment in the city's resources - people, property, and systems - is critical to guaranteeing solid service delivery for the future. Capital investments weigh changing service needs with the need for adequate building maintenance and upgrades. Human resource training has included specialized management training and a performance appraisal system.

The City's technology needs are continually assessed and updated. The City recently completed an analysis of strategies to strengthen its Citizen Relationship Management systems that may result in operational efficiencies and improved customer service. An implementation plan has been identified to improve the handling of citizen service calls and implement supporting technology in select front-line agencies.

Reducing Over Reliance on Property Tax

Nearly 80% of total general fund revenue comes from just two sources, the property tax and state aid from the Commonwealth. The City continues to support the dual goals of diversifying its revenue base while more closely matching revenues with its economic strengths. While always a concern, recently, controlling the growth in property taxes for residents and businesses has become top priority for the Mayor.

Recent events in the property tax highlight the dangers of the City relying too heavily on one

source of revenue. The average single-family tax bill has increased 78% since FY02, and the percentage of the total tax levy being born by residents versus businesses has increased from 30% to nearly 42% during the same period

The Mayor has repeatedly filed legislation to diversify the City's revenue stream and to relieve pressure on the property tax. Specifically, the Mayor has filed legislation in recent years to establish local option taxes on restaurant meals and parking. These small, broad-based taxes would serve to export some tax burden to non-residents who use and enjoy City services.

The Mayor has also filed legislation to close property tax loopholes that allow exemptions for certain equipment or corporate structures in the telecommunications industry. These exemptions have the effect of shifting tax burden to other businesses and residents.

This year, the new Governor has supported the Mayor in his efforts by filing the Municipal Partnership Act which would expand municipal resources through local option taxes, among other smaller initiatives.

A meals tax is a good fit with the strong tourist and travel economy in Boston. It would provide revenue growth at a nominal rate without placing a heavy burden on residents, tourists or travelers as the total rate of taxation would continue to remain the lowest of any major city. Revenue from this tax would also help offset the related costs the City incurs when large public events are held in the Boston.

A local option tax on parking in commercial parking lots would benefit the City in a similar way to the meals tax. The City, like other regional employment centers, expends considerable resources on traffic control and street maintenance to support local and regional commutes. But unlike other cities, Boston does not have any taxing authority to recover those costs.

INTERNAL MANAGEMENT CONTROLS

Pursuant to state law mandates and policy initiatives, the City has established a system of internal management controls to manage its financial operations effectively. These controls are designed to maximize revenue collections,

monitor operating and capital spending, evaluate infrastructure needs, and enhance the City's internal control of business procedures. The major components of the City's system of financial management controls are discussed below.

Capital Planning

The Office of Budget Management's Capital Budgeting Program is responsible for managing the capital budget of the City. It evaluates the condition of the City's infrastructure, forecasts the timing and financial requirements of new construction and rehabilitation, and makes recommendations on the allocation of current and future resources. The Capital Budgeting Program plays an ongoing supervisory role during the project implementation phase by reviewing and approving all capital contracts and monitoring project costs and schedules to ensure the adequacy of available funding sources.

The capital planning process is synchronized with the annual operating budget cycle, allowing for the regular reassessment of capital needs and projections, as well as the update of a rolling five-year capital plan.

The City funds its capital plan primarily through the issuance of general obligation bonds. The size of the City's bond issues is consistent with the City's financial management policies regarding its level of debt and debt service.

Performance Management and Program Evaluation

Boston About Results (BAR) is the City's performance management and evaluation program. BAR aims to create a sustainable and reliable performance management system which captures the core functions of City departments and tracks progress on citywide strategic goals. BAR provides information that assists in the decision making process, identifies areas of improvement, and communicates performance results to a broad range of stakeholders.

Using performance management as its foundation, BAR encourages organizational changes and operational improvements that increase the effectiveness and productivity of City departments.

The Office of Budget Management (OBM) plays a central role in the collection and analysis of performance data, by ensuring proper documentation of results, and assisting

departments in pursuing opportunities for improvements. All financial commitments by departments are first reviewed by OBM for conformance with service priorities and funding availability.

Debt Management

The Treasury Department manages all City borrowings. The City's cash flow is carefully managed and anchored by quarterly billing of the property tax and quarterly receipt of state aid distributions, eliminating the need for short-term borrowings. Guidelines established by the Treasury set forth the City's management policies toward rapidity of debt repayment, debt affordability, the limitation on the level of variable rate debt the City will issue, and the target savings amount on debt to be refinanced.

Two mainstays of the City's positive debt service position have been the relative stability of the annual debt cost to remain below 7% of total general fund expenditures and the adherence to rapid debt retirement, ensuring that at least 40 percent of outstanding principal be retired in five years, and 70 percent in ten years.

The City has taken maximum advantage of the low interest rate environment and has refunded approximately \$537.6 million since FY01 for a net present value savings of \$29.6 million. The City also utilizes lease-purchase financing of equipment with a three to seven year useful life. Annual lease-purchase financing has totaled \$10 to \$15 million to replace front line equipment such as vehicles and upgrade technology and telecommunications equipment.

Pension Management

The State-Boston Retirement System (SBRS), of which the City is the largest member, performs a full valuation every two years to determine the total system liability and the annual funding requirement. As of January 1, 2006, the SBRS pension liability was 64.4% funded. The SBRS hires an investment manager who oversees the various fund managers of the SBRS pension assets. The long-term investment performance of the SBRS has exceeded the long-term investment assumption of 8% upon which the funding schedule is partly based. The average annualized return from January 1, 1985 through December 31,

2005 was 10.21%. Its intermediate five-year (ending December 31, 2005) average annualized return was 4.96% and short-term (2005 only) return was 8.56%. In 2005 the composite short-term rate of return for all Massachusetts' public pension funds was 11.41%. Over the years, the City has worked with the SBRS to maintain a conservative and responsible pension-funding schedule. This has included maintaining a conservative investment rate of return assumption and a funding schedule that fully funds the system several years earlier than the statute requires.

Other Post Employment Benefits (OPEB)

The City's actuarial consultants provided an actuarial valuation of the City's OPEB obligations as of June 30, 2005. That valuation estimates that the City's total OPEB actuarial accrued liability as of that date was \$5.2 billion if the City continued to provide for its OPEB obligations on a pay-as-you-go basis. The report further estimated that the City's liability would be reduced to \$2.5 billion if the City adopted a policy of prefunding its unfunded actuarial accrued OPEB liability over a 30-year period. Based on these estimates, the City's annual actuarially required contribution toward its OPEB obligations on account of then current and estimated future retirees was projected at approximately \$286 million on a pay-as-you-go basis, and approximately \$176 million on an actuarially prefunded policy.

Massachusetts General Laws currently do not provide cities and towns with general legal authority to establish a trust fund for the purpose of prefunding this liability in the same manner as traditional pension benefits. However, the City will take the first step in FY08 in acknowledging this real, yet unfunded cost of providing health insurance to retirees by allocating \$20 million in reserves to a stabilization fund set up specifically for this purpose

Risk Management

Several City departments work to limit and manage risk related costs including third party legal liability claims, property losses, workplace injuries, employee healthcare and unemployment compensation. The Office of Budget Management works to maximize the effectiveness of these intradepartmental efforts by reviewing cost trends, assisting in improvements, and implementing the

City's risk financing strategy. This strategy provides a planned self-insurance program which protects both individual departments' budgets and the citywide budget through central accounts, reserves and catastrophic commercial insurance.

The City budgets and funds for the costs described above through the general fund, except for self-insured healthcare costs, which are managed by Blue Cross Blue Shield, and financed through an employee/employer trust fund established in compliance with Section 3A of Chapter 32B of the General Laws.

To protect City assets from adverse loss, commercial insurance is purchased strategically for certain exposures. A catastrophic property insurance policy provides \$65 million all risk protection after a \$10 million deductible; boiler and machinery losses are insured up to \$2.5 million; and, 70% of the City's healthcare costs are insured through HMOs. For unexpected large losses, the City continues to build a catastrophic risk reserve, the available balance of which will reach \$11.5 million at the end of fiscal 2007.

Energy Management

The Mayor established an Energy Management Board in late 2002 and charged it with the mission to make decisions regarding the City's procurement, use, and conservation of energy to reduce costs and minimize the impact of fossil fuel consumption on public health. The Energy Management Board, comprised of the Chief Financial Officer, Chief of Environment and Energy, Chief of Public Property, and Chief of Public Health, commissioned an Integrated Energy Management Plan to assure progress toward the fulfillment of its mission. Since 2005, the City has independently contracted with third party electricity suppliers to meet all of the City's electricity supply requirements. To date, supply rates the City has paid to its third party electricity supplier have been less than the default basic supply rates offered by the City's local electricity distribution company, NSTAR - Boston Edison.

Property Tax Collections

The City's aggressive enforcement program continues to reduce the number of tax accounts that are delinquent and to discourage new delinquencies. The City achieved a property tax

collection rate of 98.7% of the FY06 gross levy as of June 30, 2006. The City's program includes a variety of collection remedies authorized by state statute.

The Taxpayer Referral and Assistance Center provides "one-stop" service to Boston taxpayers on tax-related matters. An on-line bill payment option is offered for taxpayer convenience. Parcel-specific information as well as payment history is also available on-line.

Expenditure Controls

In addition to the management systems described above, the City operates under several statutory financial control systems. Certain controls established in the 1982 Funding Loan Act and its 1986 amendments set limits on flexibility in financial administration. For example, under the 1982 Funding Loan Act, until April 15 of each year, the Mayor is authorized to reallocate no more than \$3 million.

Several other financial controls were enacted by state law and implemented during the 1980s. An expenditure allotment system prevents departmental overspending of personnel appropriations. Additional state law provisions are directed at the control of School Department spending. These controls, teamed with conservative and cautious estimates of annual revenue, have aided the City in avoiding operating budget deficits every year since FY85, and have aided the School Department in avoiding operating budget deficits every year since FY90.

Reserve Fund

As required by law since 1986, the City has maintained a reserve fund equal to 2 1/2% of the preceding year's appropriations for all City departments except the School Department. The fund may be applied to extraordinary and unforeseen expenditures after June 1 in any fiscal year with the approval of the Mayor and the City Council. To date, this budgetary reserve has not been utilized. As of June 30, 2006, the reserve fund had a balance of \$24.1 million. The City fulfilled the FY07 reserve requirement by adding \$1.5 million to the reserve before the close of FY06. The City expects to fulfill any FY08 requirement prior to the close of FY07.

Accounting System

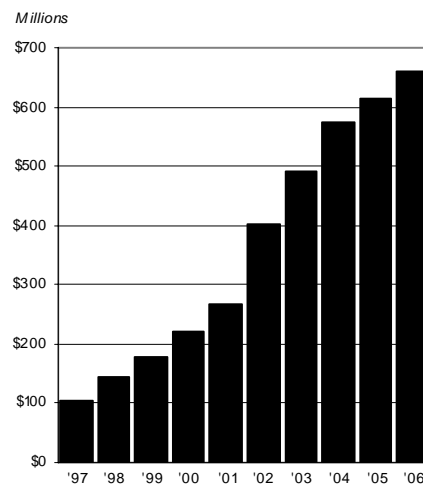
Financial management is supported through the City's PeopleSoft System. This integrated financial and human resources management system is designed to track and control daily activities and report the financial position of the City. This system supports the rigorous monitoring and reporting requirements enforced by the City.

Management Letters

Following the completion of the financial statements, the City's independent auditors deliver a management letter containing comments and recommendations on internal financial controls. The current management letter indicated no material weaknesses in the City's management.

Contracting Procedures

The Uniform Procurement Act, Massachusetts General Laws Chapter 30B, enacted by the Commonwealth in 1990 (the UPA), creates uniform procedures for the contracting of services and supplies by all municipalities in the



**General Fund Equity (GAAP Basis)
FY97- FY06**

Figure 1

Commonwealth. The City has implemented internal processes to conform its contracting procedures to the requirements of the UPA.

General Fund Equity

The City's management of its finances has resulted in a continuing upward trend in general fund equity. This trend was interrupted by merger of the City's two public hospitals with a private

hospital to form a new private entity in 1996. This improved the City's future financial outlook by shielding the City from the likely growth in hospital subsidies that would have been required without the merger. (Figure 1)

General Fund equities for FY02 through FY04 appear artificially high as compared to prior years due to the required implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*. GASB No. 34 fundamentally changed the treatment of liabilities and receivables in the General Fund.

It is expected that the actual results at the close of FY07 will not add significantly to the upward trend in general fund equity that the City has experienced since FY96. The City hopes to preserve its policy of maintaining a GAAP Undesignated Fund Balance in the General Fund that is 10% or higher than the current fiscal year's GAAP General Fund Operating Expenditures, while maintaining a Budgetary Undesignated Fund Balance between 5% and 10% of Budgetary Operating Expenses.

Auditing and Budgeting Practices

The City prepares its comprehensive financial

reports in accordance with generally accepted accounting principles (GAAP). However, accounting practices established by the Commonwealth's Department of Revenue, the so-called budgetary basis method of accounting, are used in the annual general fund budget and property tax certification process. Budgetary basis departs from GAAP in the following ways:

(a) Real and personal property taxes are recorded as revenue when levied (budgetary), as opposed to when susceptible to accrual (GAAP).

(b) Encumbrances and continuing appropriations are recorded as the equivalent of expenditures (budgetary), as opposed to a reservation of fund balance (GAAP).

(c) Certain activities and transactions are presented as components of the general fund (budgetary), rather than as separate funds (GAAP).

(d) Prior years' deficits and utilized available funds from prior years' surpluses are recorded as expenditure and revenue items (budgetary), but have no effect on GAAP expenditures and revenues.

In addition, there are certain differences in classifications between revenues, expenditures

**Adjustments Between Budgetary Basis and
GAAP Basis of Accounting for FY06**

(in thousands)

	Revenue	Expenditures	Other Financing Sources (Uses), Net	Excess (Deficiency) of Revenue and Other Financing Sources
As reported on a budgetary basis	2,104,252	2,090,391	-	13,861
<u>Adjustments:</u>				
Revenues to modified accrual basis	16,614	-	-	16,614
Expenditures, encumbrances and accruals, net	-	(17,898)	-	17,898
Free Cash Used	-	-	-	-
<u>Reclassifications:</u>				
State-funded teachers' retirement costs	(85,164)	(85,164)	-	-
Convention Center Fund Revenue	(18,000)	-	18,000	-
Transfers	90,580	-	(90,580)	-
As reported on a GAAP basis	<u>2,108,282</u>	<u>1,987,329</u>	<u>(72,580)</u>	<u>48,373</u>

and transfers. The reconciliation summarizes the differences between budgetary and GAAP basis accounting principles for the year ended June 30, 2006.

Financial statements for the fiscal year ended June 30, 2007 are expected to be available in late fall.

Budgetary Support

Budgetary Fund Balance can be appropriated for use during the fiscal year. Budgetary Fund Balance, is more commonly referred to as "Free Cash" when used this way. This item is most simply described as the portion of available reserves, generated to a considerable degree by annual operating surpluses, which the City can responsibly appropriate for spending.

The law governing the calculation and availability of budgetary fund balance for cities and towns is Chapter 59, section 23 of Massachusetts General Law, and is administered by the Massachusetts Department of Revenue. On March 1, 2006, the Director of Accounts certified that the amount of funds available for appropriation ("free cash"), as of July 1, 2005, was \$54,416,841. The FY06 Budget employed the use of a \$6.7 million appropriation from that amount. The FY07 Budget assumes the use of \$11.65 million from that amount.

On January 22, 2007, the Director of Accounts certified that free cash, as of July 1, 2006, was \$63,077,000. The FY08 Budget assumes the use \$25 million in Budgetary Fund Balance, \$20 million of which will be transferred to a newly created Health Insurance Stabilization Fund. This new fund will reserve for Other Post-Retirement Benefits (OPEB), or the liability associated with retiree health insurance costs.

**Statement of Revenues, Expenditures, and Changes in Fund Balances -
General Fund
Years ended June 30 2006 and 2005
(in Thousands)**

	\$	<u>2006</u>	\$	<u>2005</u>
Revenues:				
Real and personal property taxes		1,190,347		1,138,254
Excises		107,361		93,906
Payments in lieu of taxes		60,584		42,218
Fines		67,876		65,280
Investment income		32,351		17,970
Licenses and permits		40,353		33,491
Departmental and other		51,992		60,704
Intergovernmental		557,418		460,898
		<u>2,108,282</u>		<u>1,912,721</u>
Expenditures:				
Current:				
General government		57,262		57,471
Human services		24,875		23,821
Public safety		446,784		457,541
Public works		101,441		106,749
Property and development		33,322		29,836
Parks and recreation		15,723		15,708
Library		28,365		27,594
Schools		719,715		673,009
Public health programs		61,282		60,586
County		-		-
Judgements and claims		11,590		6,620
Retirement costs		96,853		59,419
Other employee benefits		157,885		142,721
State and district assessments		118,817		115,894
Capital outlays		815		2,683
Debt Service		112,600		115,769
		<u>1,987,329</u>		<u>1,895,421</u>
		Excess(deficiency) of revenues		
		over expenditures		
		120,953		17,300
Other financing sources (uses):				
Operating transfers in (out)		(72,580)		23,529
Payments to escrow agent to refund debt		-		(1,025)
Transfers from component units		-		-
Transfers to component units		-		-
		<u>(72,580)</u>		<u>22,504</u>
		Net change in fund balance		
		48,373		39,804
Fund balance - beginning		613,024		573,220
Fund balance - ending	\$	<u>661,397</u>	\$	<u>613,024</u>

Fund Structure and Use

The accounts of the City are organized on a fund basis. Each fund is considered to be a separate accounting entity and complies with finance-related legal requirements. All of the funds of the City can be divided into three categories: Governmental Funds, Proprietary Funds and Fiduciary Funds.

The City has four governmental funds. The General Fund, the Special Revenue Fund, the Capital Projects Fund and all non-major governmental funds in an “Other” category.

The General Fund is the only fund for which a budget is legally adopted and is used to account for all revenues, expenditures and other financial resources except those required to be accounted for in other funds.

The Special Revenue Fund is used to account for the proceeds of specific revenue sources that are legally restricted for specific purposes. This fund accounts for a number of federal and state grants that provide additional support to department programs. It also accounts for money that has been set aside by state statute and can also be used to support the City’s general fund operations.

The Capital Projects Fund accounts for financial resources, primarily from the issuance of bonds, used for the acquisition or construction of major capital facilities.

Proprietary Funds are used to show activities that operate more like those of commercial enterprises (Enterprise Funds). Both the Convention Center Fund and the Hospital Bond Fund were established for activities related to bonds for which revenue streams have been pledged as security repayment.

Fiduciary Funds are used to account for resources held for the benefit of parties outside City government and are not available to support the City’s own programs. The City’s fiduciary funds are the Employee Retirement Funds and Private Purpose Trust Funds.

The City’s operating budget is also supported by available governmental funds transferred and appropriated from three available funds. The City appropriates yearly parking meter revenues (Special Revenue Fund) to support the Transportation Department, cemetery trust monies (Other Governmental Funds) to support

the City’s maintenance of its public cemeteries, and surplus property disposition proceeds (Capital Projects Fund) to fund a risk retention reserve and the City’s “Leading the Way” affordable housing initiative. Figure 2 provides a history, as well as projected changes in fund balances for the available funds used to support the City’s operating budget.

Additional discussion of these revenue sources used to support the operating budget can be found in the Summary Budget section.

Parking Meter Fund				
Fiscal Year	Beginning Year Balance	Funds Out	Funds In	Ending Year Balance
FY01	22.582	(6.677)	7.923	23.828
FY02	23.828	(2.790)	8.821	29.859
FY03	29.859	(10.000)	5.905	25.764
FY04	25.764	(1.000)	12.227	36.991
FY05	36.991	(3.500)	9.314	42.805
FY06	42.805	(1.000)	10.390	52.194
*FY07	52.194	(10.000)	9.500	51.694
*FY08	51.694	(10.000)	9.500	51.194

Notes: (\$millions), *projected

Cemetery Trust Fund				
Fiscal Year	Beginning Year Balance	Funds Out	Funds In**	Ending Year Balance
FY01	13.618	(1.678)	1.301	13.240
FY02	13.240	(1.778)	-0.678	10.784
FY03	10.784	(1.849)	1.541	10.476
FY04	10.476	(1.932)	2.728	11.271
FY05	11.271	(2.029)	1.139	10.381
FY06	10.381	(2.110)	2.478	10.749
*FY07	10.749	(2.221)	2.000	10.529
*FY08	10.529	(2.141)	2.000	10.388

Notes: (\$millions), *projected, **Includes appreciation

Surplus Property Disposition Fund				
Fiscal Year	Beginning Year Balance	Funds Out	Funds In	Ending Year Balance
FY01	34.100	0.000	8.474	42.574
FY02	42.574	0.000	13.300	55.874
FY03	55.874	(13.000)	0.000	42.874
FY04	42.874	0.000	7.500	50.374
FY05	50.374	(6.618)	0.000	43.756
FY06	43.756	0.000	0.000	43.756
*FY07	43.756	(5.331)	0.000	38.425
*FY08	38.425	(6.669)	0.000	31.756

Notes: (\$millions), *projected

Figure 2