

Minutes of the Advisory Board to the Comptroller

Meeting Date: Thursday, February 15, 2024
Time: 3:00 p.m.
Location: Virtually via ZOOM, and consistent with Section 40 of Chapter 2 of the Acts of 2023.

MEMBERS AND OTHER ATTENDEES

Members Present

Matthew Gorzkowicz (Chair), Secretary for Administration and Finance
William Kaplita (Designee), Director of State Audits, Office of the State Auditor
Thomas G. Ambrosino, Court Administrator of Massachusetts Trial Court
Kathleen McNamara (Designee), Internal Auditor, Office of the State Treasurer
Michael Esmond (Gubernatorial Appointment), Chief Financial Officer, Massachusetts Convention Center Authority
Natalie Monroe (Gubernatorial Appointment), Chief Magistrate, Massachusetts Division of Administrative Law Appeals

Members Absent

M. Patrick Moore, Jr. (Designee), First Assistant Attorney General, Office of the Attorney General

Office of the Comptroller Attendees

Tryntje Bumgardner, Assistant Comptroller for Payroll and Payments
Kristine Hill-Jones, Assistant Comptroller for Contracts, Vendors, and Non-Tax Revenue
Kristin Lacroix, Assistant Comptroller and Chief Accounting Officer
Pauline Lieu, Assistant Comptroller and Chief Financial Reporting Officer
Rosemary Navarro, Executive Assistant to the Comptroller
William McNamara, Comptroller
Howard Merkowitz, Senior Advisor
Amy Nable, Assistant Comptroller and General Counsel
Rosemary Navarro, Executive Assistant to the Comptroller
Darian Roberts, Assistant General Counsel/Records Access Officer
Michael Sangalang, Communications Manager
Peter Scavotto, Assistant Comptroller for Risk
Thomas Smith-Vaughn, Chief Operating Officer
Andrea Wadsworth, Chief Financial Officer

Clifton Larson Allen (CLA) Attendees

Chris Rogers, Managing Principal of Industry, State and Local Government

Shana Doiron, Director

Mathew Goulet, Manager

Jim Piotrowski, Principal

AGENDA

1. CALL TO ORDER

1.1 Recording Announcement by the Chair

The Chair announced that, pursuant to the Commonwealth's Open Meeting Law, Massachusetts General Laws, Chapter 30A, Section 20, any person may make a video or audio recording of this open meeting.

The Chair noted that the Office of the Comptroller ("CTR") was recording for the purpose of keeping the minutes and asked anyone else making a recording to please identify themselves. Chris Lisinski from the Statehouse News Service stated that he was recording the meeting as well.

1.2 Statement on Remote Participation

The Chair announced that on March 29, 2023, Governor Healey signed into law a supplemental budget bill which, among other things, extends certain temporary provisions pertaining to the Open Meeting Law until March 31, 2025. Specifically, this further extension allows public bodies to continue holding meetings remotely without a quorum of the public body physically present at a meeting location, and to provide "adequate, alternative" access to remote meetings. In accordance with that law, all members of the Advisory Board and members of the public are participating remotely in today's meeting.

Because members of the Board are participating remotely, all votes will be taken by roll call.

2. REVIEW AND APPROVAL OF OCTOBER 25, 2023, ADVISORY BOARD MEETING MINUTES

On a motion by Mike Esmond, seconded by Natalie Monroe, the Board approved by roll call vote the October 25, 2023, Advisory Board meeting minutes.

- Secretary Gorzkowicz – Yes
- William Kaplita – Yes
- Thomas Ambrosino – Yes
- Kathleen McNamara – Yes
- Michael Esmond – Yes
- Natalie Monroe – Yes

3. REMARKS FROM THE CHAIR

The Chair welcomed participants and observers to the meeting. He stated that the purpose of this meeting is to review the Fiscal Year (“FY”) 2023 Statutory Basis Financial Report (“SBFR”). He stated that the SBFR shows the Commonwealth’s financial condition is sound. Even though there has been a revenue slowdown through FY23 and FY24, the Stabilization Fund currently sits at an all-time high of more than \$8 billion and the goal is to preserve it and continue to let it grow.

One challenge encountered in FY23 was a significant underperformance of revenue compared to benchmarks. However, thanks to statutory mechanisms that use capital gains above a set threshold to grow the Stabilization Fund, the Commonwealth’s budget is somewhat insulated from the swings in capital gains experienced last April, and that is one of the reasons why the fund is as large as it is. The Commonwealth was able to manage through the decline in revenue without impacting budget or spending on programs and services. The tax collection pattern has continued through FY24, with January 2024 marking seven consecutive months of missed revenue targets. As a response to this decline, Governor Healey acted in January to bring the FY24 budget back into balance. She used her statutory authority, through a process called “9C Reductions,” to cut \$375 million in spending. The administration has also downgraded revenue projections for FY24 by nearly \$1 billion. There is still risk for the rest of FY24, particularly in the month of April, as seen in April of FY23. January revenues came in \$263

million lower than the revised benchmark, and the Commonwealth has now collected about \$212 million less than it did at this same point in FY23. The administration will continue to monitor the trend closely and there currently are no plans for additional 9C cuts. There are a variety of tools that can be used to get the budget into balance, and the Office of Administration and Finance is working on preparing to use those tools if necessary. Tax revenues make up about 60% of the total budget, so the administration can rely on the other 40% and other tools to keep the budget in balance.

The Chair stated that, despite these declines, the economy of the Commonwealth remains strong. Unemployment remains low and experts continue to call for a “soft landing.” Interest rates, which are driving a drop in sales tax in some sectors, could start to come down later in the fiscal year. This bodes well for a potential “soft landing” and an eventual rise in revenues, hopefully by mid-FY25. The administration believes it can navigate through these issues, while maintaining programs and services.

The administration recently filed its FY25 budget. It is a \$56.1 billion proposal that limited growth, excluding Fair Share tax, to 2.9%. This was done based on the slow growth and lower than expected revenues in the past fiscal year. The bill has already been filed in the House and a hearing held by the House Ways and Means Committee with officials from the Healey administration has already taken place. The next step is action by the House.

The Chair thanked the Comptroller and his office for their efforts to complete the SBFR. He then turned the presentation over to the Comptroller.

4. REMARKS AND REPORTING PROCESS OVERVIEW FROM THE COMPTROLLER

The Comptroller stated that the financial condition of the Commonwealth remains sound, which is reflected in the SBFR. Based on conversations with other state comptrollers, he believes Massachusetts has done better than any other state reacting to volatile conditions over the past few years. This is thanks in large part to good budgeting and forecasting by elected officials over that time.

The Comptroller provided high-level remarks regarding the SBFR. It shows total balances in budgeted funds stood at \$15.338 billion and the amount in the Stabilization Fund rose from \$6.938 billion to \$8.036 billion at the end of FY23. The SBFR results show compliance with the FY23 General Appropriations Act, supplementary budgets, and state finance law. The timing of this year's financial reports remains an issue due largely to:

- Timing of the closing supplemental budget, which effects the timing of SBFR and ACFR; and
- Ability of component units and delegated financial entities to produce reports, which affects the ACFR.

The Comptroller discussed his hope that the process will improve moving forward. He identified the three major financial reports: the SBFR, the ACFR, and the Single Audit. He clarified that CLA, the Commonwealth's independent CPA firm, only reviews the SBFR, rather than conducting a full audit like they do with the ACFR. The Comptroller then turned the presentation over to Assistant Comptroller and Chief Financial Reporting Officer Pauline Lieu and CTR Senior Advisor Howard Merkwitz to provide a detailed update of the SBFR.

5. REVIEW OF THE STATUTORY BASIS FINANCIAL REPORT (SBFR)

Ms. Lieu first provided a high-level overview of the SBFR. The SBFR is presented on a budgetary or statutory basis. The budgetary view includes cash receipts and expenditures, including the two month accounts payable and receivable period. By statute, it excludes trust funds and most so-called "business-type activities," such as unemployment and the institutions of higher education. The SBFR also excludes component units, such as the Massachusetts Bay Transportation Authority. It determines whether the budget is balanced according to state finance law and determines the calculation of the consolidated net surplus at the end of year to transfer to the Stabilization Fund. Consolidated net surplus is the undesignated or unreserved balance in certain budgetary funds (funds subject to the Commonwealth's annual budget process) as of the end of the fiscal year, June 30. The General Fund and the Commonwealth Transportation Fund account for the bulk of spending activity, at about 87.5% and 3.5% respectively.

Ms. Lieu next provided a detailed overview of the FY23 SBFR. FY23 ended with a balanced budget, meaning that there was a consolidated net surplus of \$0 in the budgeted funds, after enactment of legislation that reserved \$4.578 billion in unexpended balances for re-appropriation in FY24. There was a FY23 operating loss of \$2.862 billion in the budgeted funds, compared to a \$6.101 billion operating gain in FY22. This was due primarily to changes in tax laws or triggering of adjustments to the Commonwealth's personal income tax, which reduced FY23 revenue by a total of \$4.708 billion, as well as a drop in capital gains taxes, which declined by \$2.048 billion compared to FY22. The operating loss represents the excess of yearly expenditures over revenue received, resulting in a lower year-end balance in budgeted funds. It does not represent deficit spending or an increase in debt.

Ms. Lieu provided a summary of the budgeted fund ending balance of approximately \$15.338 billion:

- \$8.036 billion held in the Stabilization Fund (\$1.098 billion was deposited in FY23);
- \$1.891 billion in the Transitional Escrow Fund, from FY21 and FY22 surpluses; and
- \$4.578 billion designated for FY24 appropriations and for debt service.

Mr. Merkowicz provided an overview of revenue collections for FY23. Total budgeted fund revenue totaled \$57.414 billion, a decrease of \$4.670 billion (7.5%) from FY22. Budgeted fund tax revenue (not including sales tax revenue allocated to the MBTA or MSBA) totaled \$33.704 billion, down \$4.883 billion (12.7%) from FY22. This was due to the triggering of certain laws that resulted in an increase in personal income tax refunds, and a decline in capital gains tax revenue. Adjusting for the three tax law changes only, tax revenue was down \$417 million (1.1%). This was due to a drop in capital gains taxes, partially offset by growth in other tax types.

Total personal income tax collection totaled \$18.995 billion, down \$5.341 billion (21.9%) from FY22. Personal income tax withholding was up \$732 million (4.6%), as employment continued to grow steadily. Non-withheld personal income tax decreased by \$6.074 billion (72.1%). This was due to Chapter 62F refunds of \$2.879 billion (triggered by the statutory maximum), non-recurring pass-through entity tax revenues of \$1.829 billion, and a decline in capital gains tax revenues of \$2.048 billion. This was partially offset by \$199 million in new

non-withheld revenues generated from the implementation of a 4% surtax on taxable incomes of more than \$1 million and growth in other non-withheld income tax.

Sales and use tax increased by \$480 million (7.7%), including a \$161 million (12.1%) increase in meals taxes. Corporate and business taxes totaled \$5.108 billion, which is virtually identical to FY22. Other notable changes in tax collections include an increase in the estate and inheritance tax of \$105 million (12.1%) and a decline in the deeds excise tax of \$135 million (28.7%).

Federal reimbursements totaled \$15.225 billion, down \$554 million (3.5%) from FY22. This was largely due to non-recurring FY22 revenue of \$1.023 billion for pandemic relief funds received by the Massachusetts Emergency Management Agency. This was partially offset by reimbursements for the Commonwealth's Medicaid program, which increased by \$418 million (3%) to \$14.312 billion.

Departmental revenue increased \$669 million (12.4%), mainly due to interest earnings, which increased from \$44 million in FY22 to \$698 million, as a result of higher interest rates on large cash balances. Lottery profits totaled \$1.188 billion, an increase of \$87 million (7.9%) from FY22.

Ms. Lieu then discussed budgetary expenditures. Budgeted fund expenditures and other uses (prior to transfers between budgeted funds) total \$60.276 billion, an increase of \$4.293 billion (7.7%) from FY22. The increase was due to several items. Medicaid expenditures totaled \$21.700 billion, an increase of \$1.855 billion (9.3%), due to normal growth and a shift in the timing of some payments to providers. Direct local aid spending was \$7.295 billion, up \$552 million (8.2%). The transfer to the state pension fund was \$3.743 billion, an increase of \$328 million (9.6%). Additional pension contributions included a \$200 million appropriation from the General Fund and a \$42 million transfer of capital gains taxes. Budgeted fund debt service totaled \$2.420 billion, virtually identical to FY22.

Interfund transfers from budgeted to non-budgeted funds totaled \$1.239 billion, a decrease of \$2.132 billion (63.2%) from FY22. This decline was due mainly to several large FY22 non-recurring transfers, including funding to repay Unemployment Insurance loans from

the federal governments that were taken out during the pandemic, transfers to finance local hospitals that treat Medicaid patients, and for COVID-related expenses.

Transfers among the budgeted funds totaled \$5.555 billion, a decrease of \$2.674 billion (32.5%) from FY22. This was largely due to a decrease of \$4.812 billion for one-time FY22 surplus transfers to the Transitional Escrow Fund and a decrease of \$1.691 billion in capital gains tax revenue transferred to the Stabilization Fund, State Retiree Benefits Trust, and State Pension Funds. This decrease in budgeted funds was partially offset by a transfer of \$2.879 billion from the Transitional Escrow Fund to the General Fund to finance the FY22 Chapter 62F refunds and several new statutory transfers from the General Fund to finance new programs.

Mr. Merkowicz then reviewed Stabilization Fund activity. The Commonwealth added more than \$1 billion to the Fund, increasing its balance from \$6.938 billion to \$8.036 billion. This was largely due to \$750 million in capital gains tax revenue transfers, \$56 million in abandoned property transfer, and \$271 million in interest earnings. As of the end of FY23, the Commonwealth Stabilization Fund is the third largest in the United States. It represents 19.3% of “General Fund own-source expenditures,” well above the reported projected national median of 12.1% and up 3.6% from FY22. As of December 2023, the balance has risen to \$8.2 billion from additional interest earnings.

Ms. Lieu next reviewed non-budgeted special revenue fund revenue and expenditures. FY23 revenues and other sources totaled \$20.659 billion, down \$367 million (1.7%) from FY22. There was \$6.495 billion in federal revenues, virtually identical to FY22. Assessment revenue increased by \$237 million (18.1%) and departmental revenue increased by \$376 million (4.9%). This was offset by decreased transfers of \$1.288 billion (77.9%), mostly due to COVID-related non-recurring transfers:

- COVID-19 Massachusetts Emergency Fund - \$84 million.
- COVID-19 Public Health Emergency Hospital - \$250 million.
- COVID-10 Essential Employee Premium Pay - \$500 million.
- Medical Assistance Fund - decreased by \$667 million (88.7%).

FY23 expenditures and other uses totaled \$20.568 billion, down \$187 million (0.9%) from FY22. Notable changes included a reduction of almost \$1.3 billion in COVID-19 related

spending, an increase of \$893 million in new spending from the Hospital Investment and Performance Trust Fund, and an increase of \$269 million in Lottery prize money distributed.

Ms. Lieu reviewed capital projects spending and revenue. FY23 spending on capital projects totaled \$3.711 billion, virtually identical to FY22. Significant categories of spending included \$2.064 billion (more than half of total capital spending) on transportation-related projects, \$612 million on non-transportation state infrastructure, \$258 million on housing, \$247 million on environmental projects, \$224 million on education, and \$177 million on information technology. To fund the capital budget, the Commonwealth borrowed by issuing general obligation debt with proceeds of \$1.776 billion. No new special obligation debt was issued in FY23. The Commonwealth received \$769 million in federal reimbursement for capital spending, mostly for transportation projects. At the end of FY23, the capital projects funds had a \$3.326 billion negative balance, as the Commonwealth had not yet reimbursed itself for capital spending that it typically funds in arrears through subsequent bond issues. The capital projects funds normally have a negative balance at the close of each fiscal year.

The Chair thanked Ms. Lieu and Mr. Merkwitz for their thorough presentation. He asked if any Board members had questions regarding the information reviewed. No questions were asked, but Mr. Esmond expressed thanks for the thorough slides and presentation.

6. CLIFTONLARSONALLEN (CLA) REPORT TO THE BAORD

The Comptroller turned the presentation over to Chris Rogers from CLA. He gave brief introductions and turned the presentation over to Mathew Goulet to discuss CLA's review of the SBFR. He stated that the objective of CLA's SBFR review is to obtain limited assurance as a basis for reporting whether material modifications should be made to the financial statements for the SBFR to comply with statutory requirements. The review is substantially less in scope than an audit. It does not assess fraud risk and there is no testing of accounting records through inspection, observation, confirmation, or examination of source documents.

The scope of CLA's review includes:

- Budgeted funds (General Fund, Commonwealth Transportation Fund, Stabilization Fund, Federal COVID-19 Response Fund, Transitional Escrow Fund, and 19 other nonmajor funds).
- Non-budgeted special revenue funds. These are revenue sources that support specific governmental activities (such as federal grants, Lottery, gaming, etc.).
- Capital projects funds, which include acquisition and construction of major capital assets financed primarily through the issuance of bonds.

The Commonwealth and CLA each have different responsibilities regarding review of the SBFR. The Commonwealth is responsible for preparation and fair presentation of the SBFR in accordance with the Commonwealth statutory basis of accounting. They must design, implement, and maintain internal controls relevant to preparation and fair presentation of the SBFR that are free from material misstatement (whether by fraud or error). They must provide unrestricted access to information and personnel requested, and a representation letter at the conclusion of the review. CLA is responsible for concluding whether or not material modifications should be made to the combined financial statements, the combined individual fund statements, and supplemental information. They conduct engagement in accordance with Statements on Standards for Accounting and Review Services, published by the American Institute of Certified Public Accountants (“AICPA”). They must comply with the AICPA’s Code of Professional Conduct, including ethical principles of integrity, objectivity, professional competence, and due care.

Board Member Ambrosino noted at this point that he had to leave the meeting early and stated that he had no issues with the SBFR.

Mr. Rogers then continued, saying that CLA performs analytical procedures and inquiries of management during their review. CLA looks at balances reported in the SBFR to identify any odd or unusual relationships that are contrary to expectations. If identified, such relationships require further inquiry, to determine if it makes sense due to factors affecting the Commonwealth during the fiscal year.

Mr. Rogers concluded by saying that, for FY23, CLA is not aware of any material modification that should be made for the SBFR to comply with the statutory basis of accounting. There were no disagreements with management during the review.

Mr. Goulet of CLA then provided a status update regarding the ACFR and the Single Audit. CLA has been working diligently in preparation for their roles regarding both financial reports while the SBFR review occurred. Now that the SBFR has been released, their attention will focus almost entirely on their audit of the upcoming ACFR.

7. ITEMS NOT REASONABLY ANTICIPATED BY THE CHAIR

The Chair asked if there were any other items not reasonably anticipated by the Board to be discussed. None were raised.

8. TIMING OUTLOOK FOR NEXT MEETING

The Chair stated that the next meeting will focus on reviewing the ACFR. Board members will be notified when the timing is closer. The Comptroller said that CTR is working to get it done and will notify the Board when the next meeting is ready to schedule. He told the Board that they can send any questions to him or others at CTR regarding the SBFR and said the current plan to issue the report tomorrow afternoon.

9. MEETING ADJOURNMENT

The Chair adjourned the meeting.