



# The Commonwealth of Massachusetts

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**INDEPENDENT STATE AUDITOR'S REPORT ON  
CERTAIN ACTIVITIES OF THE  
MASSACHUSETTS STATE COLLEGE BUILDING  
AUTHORITY  
JULY 1, 2006 TO DECEMBER 31, 2007**

**OFFICIAL AUDIT  
REPORT  
JULY 18, 2008**

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### **INTRODUCTION**

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The Massachusetts State College Building Authority (MSCBA) was established under Chapter 703 of the Acts of 1963, as amended by Chapter 290 of the Acts of 1998 and Chapter 193, Section 30, of the Acts of 2004. The MSCBA is authorized by statute to finance and oversee the design and construction of dormitories, dining facilities, and certain other building at the Commonwealth's nine state colleges.

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, the Office of the State Auditor (OSA) conducted a review to analyze MSCBA's financial and program activities for the period July 1, 2006 to December 31, 2007 to determine if they are operating efficiently and effectively and in compliance with applicable laws, rules and regulations. The audit included a review of 1) administrative expenses; 2) contract administration and project oversight; 3) revenue management; 4) debt service; 5) the MSCBA's most recent Independent Public Accountant's report and management letter. We also determined whether appropriate corrective action had been taken regarding the issue disclosed in our previous audit report (No. 2004-0209-3A).

Based on our review, we have concluded that MSCBA has taken appropriate action to address the prior audit issue, and has maintained adequate controls and complied with applicable laws and regulations for the areas tested.

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Our prior audit report disclosed that in 1998, the MSCBA executed a forward bond purchase option agreement with an investment banking firm on a portion of its funded debt in order to raise cash to reduce the amount of debt service on its bonds. The MSCBA was paid \$567,376 by the investment banking firm at that time in return for an option to refund this debt in the future, if interest rate were favorable to them. The investment banking firm exercised this option in 2004 when market rates were lower, requiring the MSCBA to refund the debt at the higher 1998 rate. This transaction allowed the investment banker to keep the \$3,255,478 net bond premium generated from the refunding, and resulted in a net profit of \$2,688,102 for the investment banker.

Our follow-up audit revealed that the MSCBA's current management team has discontinued this speculative practice, and that the Authority has not executed a forward bond purchase option since 1998.

## INTRODUCTION

### *Background*

The Massachusetts State College Building Authority (MSCBA) was established under Chapter 703 of the Acts of 1963, as amended by Chapter 290 of the Acts of 1998, and Chapter 193, Section 30, of the Acts of 2004. It is not subject to the supervision or regulation of the Department of Education or any other department, bureau, or agency of the Commonwealth, except as specifically provided in the Act. The enabling legislation as amended prohibits MSCBA from initiating projects without written approval from the Secretary of Administration and Finance and the Chancellor of the System of Public Higher Education. The Secretary of Administration and Finance and the State Treasurer and Receiver General must also approve all sales of bonds and notes by the MSCBA. The Authority is governed by a nine-member Board of Trustees, which currently has two vacant positions. An Executive Director, appointed by the Board, is responsible for operations.

MSCBA's mission is to aid and contribute to the performance of the state colleges located in Bridgewater, Fitchburg, Framingham, Salem, Westfield, and Worcester; the Massachusetts College of Art; the Massachusetts Maritime Academy; and the Massachusetts College of Liberal Arts. MSCBA aids and contributes to performance of the state colleges by developing and providing dormitories, dining facilities, common areas, and other buildings for use primarily by students and staff.

MSCBA is authorized by statute to issue bonds to finance development, buy and sell real property, oversee design and construction of facilities, and set and collect student rents and fees for the operation of student living facilities at the nine state college campuses. The rent and fee income is then used to service debt issued to finance the facility improvements within the state college system. The financial powers and functions of MSCBA are governed by statutes, the trust agreements for each of its bond issues, and the contract for financial assistance between MSCBA and the Board of Higher Education, which acts on behalf of the nine state colleges.

As of June 30, 2007, the total investment in buildings by MSCBA was \$354 million.

MSCBA has assembled a new management team, including a new Executive Director, Assistant Director and Controller, and has strengthened its internal controls and project oversight activity by the development and use of a database that captures relevant information and metrics to track the

timing and selection of new projects, renovations and maintenance. A new financial and project management software system, which is intended to provide broad-based, flexible access to real-time financial data, is currently being installed.

***Audit Scope, Objectives, and Methodology***

Our audit, which covered the period July 1, 2006 to December 31, 2007, was conducted in accordance with applicable generally accepted government auditing standards for performance audits, as issued by the Comptroller General of the United States, and included procedures and tests that we considered necessary to meet those standards. The objectives of our audit were to analyze MSCBA's financial and program activities for the period July 1, 2006 to December 31, 2007 to determine if they are operating efficiently and effectively and in compliance with applicable laws, rules and regulations. The audit included a review of 1) administrative expenses; 2) contract administration and project oversight; 3) revenue management; 4) debt service; and 5) the MSCBA's most recent Independent Public Accountant's report and management letter, to determine whether the report identified any issues requiring further review. We also determined whether appropriate corrective action had been taken regarding the issue disclosed in our previous audit report.

To achieve our objectives, we reviewed (1) the Authority's enabling legislation, Chapter 703 of the Acts of 1963, as amended by Chapter 290 of the Acts of 1998 and Chapter 193, Section 30, of the Acts of 2004; (2) official bond documents; (3) the report of a private accounting firm, (4) contract and bid documents; (5) construction pay estimates and invoices; (6) college revenue and assessment data; and (7) minutes of Board of Trustees meetings.

Based on our review, we have concluded that MSCBA has taken appropriate action on our prior audit issue, and has maintained adequate controls and complied with applicable laws, rules, and regulations for the areas tested.

## AUDIT RESULTS

### **PRIOR AUDIT RESULTS RESOLVED – FORWARD BOND PURCHASE OPTION ARRANGEMENTS DISCONTINUED**

Our prior audit report disclosed that in 1998, the Massachusetts State College Building Authority (MSCBA) executed a forward bond purchase option agreement (option contract) with an investment banking firm on \$15,150,000 of its funded debt in order to raise cash needed to reduce the amount of debt service on its bonds. Under the terms of this agreement, the MSCBA received an option premium of \$567,376 for the promise to issue refunding bonds in the future at a predetermined coupon rate of 6.7%, while the investment banker acquired an option to refund the debt in the future if market interest rates were favorable.

The investment-banking firm exercised this option in 2004, thus requiring the MSCBA to refund the debt at the predetermined rate. This transaction allowed the investment banker to retain the \$3,255,478 net bond premium generated from the refunding, resulting in a net profit of \$2,688,102 for the investment banker. In addition, because the option contract prohibited MSCBA from calling the re-issued bonds prior to 2015, the MSCBA could not take advantage of any future declining interest rates.

Our follow-up audit revealed that MSCBA's current management team has discontinued this speculative practice, and that the Authority has not executed a forward bond purchase option since 1998.