

City of Boston

Massachusetts

Comprehensive Annual Financial Report

For the Fiscal Year Ended June 30, 2007

Thomas M. Menino, Mayor

Lisa C. Signori, Chief Financial Officer

Sally D. Glora, City Auditor



Prepared by the City of Boston Auditing Department



Photographs provided by Naveen Chinthakunta

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Cover photo: City of Boston seal

City of Boston, Massachusetts Comprehensive Annual Financial Report For the Fiscal Year Ended June 30, 2007

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Boston Public Garden





City of Boston
Auditing Department

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December 3, 2007

*The Honorable Mayor and
Members of the City Council:*

We are pleased to submit to you the Comprehensive Annual Financial Report (CAFR) of the City of Boston (City) for the fiscal year ended June 30, 2007. The accuracy of the financial statements together with the completeness and fairness of their presentation are the responsibility of the City's management. This report is accurate in all material respects and all disclosures necessary have been included to fairly present the financial position of the City. The financial position and results of operations of the various funds have been prepared in accordance with U.S. generally accepted accounting principles (GAAP), as established by the Governmental Accounting Standards Board (GASB). All requirements of State finance law of the Commonwealth of Massachusetts and the City Charter have also been satisfied.

The City of Boston composes this Letter of Transmittal to provide additional information to the readers of the CAFR. The financial statements are presented utilizing a financial reporting model promulgated by GASB. This financial reporting model focuses on major funds, rather than fund types, and includes government-wide financial statements, which will include all revenues and all costs of providing services each year. These Basic Financial Statements report on all current assets and liabilities and also long-term assets and liabilities, such as capital assets, including infrastructure (roads, bridges and sidewalks). This Letter of Transmittal is for the fiscal year ended June 30, 2007. Readers are encouraged to consider this information in conjunction with the information that is supplied in the Management's Discussion & Analysis (MD&A) Section of the City's Basic Financial Statements.

In addition to the Basic Financial Statements of the City, this report includes information pertaining to component units included in the City's reporting entity because of the significance of their operational and/or financial relationship with the City as required by GASB Statement No. 14. The State-Boston Retirement System (SBRS) has been presented as a blended component unit because it provides services almost exclusively to the primary government.

Discretely presented component units are reported in a separate column to emphasize that they are legally separate from the City, but are included because the City is financially accountable for and is able to impose its will on the organizations. The following component units have been discretely presented in the Basic Financial Statements: the Boston Public Health Commission, the Boston Redevelopment Authority, the Trustees of the Public Library of the City of Boston, and the Economic Development Industrial Corporation.

Thomas M. Menino, Mayor
Sally D. Glora, City Auditor

Profile of the Government

The City of Boston, incorporated as a town in 1630 and as a City in 1822, now exists under Chapter 486 of the Acts of 1909 and Chapter 452 of the Acts of 1948 of the Commonwealth of Massachusetts, which, as amended, constitute the City's Charter. The Mayor is elected to a four-year term and serves as chief executive officer of the City. The Mayor has general supervision of and control over the City's boards, commissions, officers and departments. The legislative body of the City is the City Council, which consists of thirteen elected members serving two-year terms.

Thomas M. Menino, Mayor of the City of Boston, was re-elected in November 2005 to a fourth four-year term, expiring in January 2010. The Mayor remains committed to promoting his initiatives in the areas of public education, public safety, housing and neighborhood development as well as economic development. The City provides a wide range of governmental services in these areas as well as in the areas of social services, public health, transportation, human services, and basic city services.

Economic Conditions and Outlook

The City is the economic hub of both the Commonwealth of Massachusetts and the New England region. Its diverse economy is a center for professional, business, financial, higher education and medical services as well as transportation, communication, export, cultural and entertainment activities. Boston is also the state capital and the host to several federal agency offices. High technology, tourism, research and development, manufacturing, and wholesale distributions also contribute to the economy of the City and its suburbs. As of the summer of 2007, Boston's economy continues to perform reasonably well, recording solid job growth as of that time. The number of payroll jobs has grown in every month of this year. There were 563,739 payroll jobs in Boston in June 2007, compared to 547,687 in January 2007 and 545,295 in June 2006.

The financial markets continue to express their confidence in Boston's fiscal health. In March 2007, the credit rating service bureaus Moody's Investors Service and Fitch Ratings reaffirmed the City's ratings at Aa1 and AA, respectively. During the same period, Standard & Poor upgraded Boston's credit rating from AA to AA+ in conjunction with the City's \$100.0 million general obligation and \$85.4 million refunding bond issues in March 2007. The credit reports of the three rating agencies stated that their ratings reflected the City's: (1) Strong management and demonstrated ability to make budget adjustments as necessary to maintain balance during difficult financial times; (2) Sound financial position with sufficient reserves; (3) Manageable debt burden with prudent debt policies; and (4) A stable, well diversified tax base that has doubled in value since 1996. These factors contribute to the confidence in Boston, along with Boston's dominant role in the New England economy.

Overview of Local Economy

In mid 2007, Boston's economy was steadily growing in some areas but was stationary in others. The City had experienced growth since mid 2004, following a downturn, which began in early 2001. The number of jobs in the City had reached an all-time high in the year 2000 following nine years of growth. Since mid-year 2004, employment in the City had once again been growing at a steady pace. Boston's unemployment rate had been improving since late 2003, but in the last several months the rates have been relatively flat in comparison to the same period last year. In July 2007, Boston's unemployment rate of 5.1% was higher than the U.S. unadjusted rate (4.6%) but lower than the City's July 2006 rate of 5.3%

Boston's diverse economy is made up of financial and professional services, research and development, health care and higher education, and tourism. Boston's housing market, although still considered strong, is no longer experiencing the rapid price gains of the last several years. Home prices have been corrected slightly as the supply has risen and banks have tightened their lending standards following the national trend. The manufacturing, transportation, retail, arts, entertainment, and recreation sectors of the economy have shown general tendencies toward employment losses in the past few years. The finance, professional services, administrative and support services, accommodation and food services, real estate, and information sectors have rebounded and are now growing strongly. Higher education and health care have generally continued to realize growth over the whole 2001-2007 time frame.

Current Economic Outlook

The latest data indicates the City's economy has remained consistent since 2005 – revealing minor fluctuations in unemployment rates and job growth. The Boston economy peaked in the 1999-2000 time period as Boston's office, hotel and housing markets were among the strongest in the nation by mid-year 2000 and into early 2001. From about January of 2001 through mid-2004 Boston's slower economic growth was clear, given existing information. The latest data for 2005 through mid-year 2007, however, shows a much stronger economy. Job levels and the unemployment rate are stable, the hotel occupancy rates and average daily hotel room rates are very strong, and the office market is showing vast improvements.

Long Term Financial Planning

The City of Boston is required to have a balanced budget in accordance with Massachusetts General Laws (M.G.L.) Chapter 59, Section 23. As part of the State Department of Revenue's tax rate certification process, the City 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. Over half of the City's revenues come from the property tax levy, however the increase in the levy from year to year is limited by state law. The current level of the City's second largest source of revenue - state aid – still represents a significant loss since fiscal year 2002. State aid in FY08 is expected to remain fairly level with FY07 aid, when combined with state assessments. The City is seeking ways to diversify its revenue base and has filed legislation to establish local option

taxes. It is within this revenue context that the City plans and appropriates for expenses, especially those that will continue into future years. All multi-year funding commitments, including the most recent collective bargaining agreements, are made after reviewing a forecast for future available revenues. Because a large portion of the City's budget is dedicated to salaries and benefits, the size of the City's workforce is also continuously monitored and the hiring of new employees is controlled centrally.

The cost of health insurance, the major component of employee benefits, has continued to rise at significant rates. In an effort to slow the overall growth in health insurance costs, the City negotiated two changes through collective bargaining – an increase in employee contributions over two years and a new indemnity plan.

The Office of Capital Budgeting (OCB), a program of the Office of Budget Management, is responsible for managing the capital budget of the City. OCB's mission is to evaluate the condition of the City's capital assets, forecast the timing and financial requirements of new construction and rehabilitation and recommend allocation of current and future resources to meet the City's infrastructure and capital requirements through a five year capital plan. Resource availability and capital needs are assessed frequently and appropriate planning responses are taken. The capital planning process is synchronized with the annual operating budget cycle, allowing for the regular assessment of capital needs and projections and their impact on the operating budget (personnel, maintenance, equipment and utilities).

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

The City's management of its finances has resulted in a continuing upward trend in general fund equity. The City strives 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 that is between 5% and 10% of Budgetary Operating Expenses. The FY08 budget assumes the use of \$25 million in Budgetary Fund Balance, \$20 million of which will be transferred to a newly created Health Stabilization Fund. This new fund is the first step in developing a long term strategy for financing the City's liability associated with Other Post-Employment Benefits (OPEB).

Financial Overview

The Reporting Entity and Its Services

Included in the CAFR are governmental activities, business-type activities, each major fund, the aggregate discretely presented component units and aggregate remaining fund information. The City is responsible for the financial reporting prescribed by the GASB. The criteria include legal standing, fiscal dependency and financial accountability. Based on these

criteria, entities reported in the CAFR are considered part of the reporting entity (see Notes 1 and 2 of the Basic Financial Statements).

General Government Results

The City's financial position as shown in its Governmental Funds Balance Sheet as of June 30, 2007 includes overall fund balances of \$1.01 billion represented by liabilities of \$441.2 million and by assets available to liquidate such liabilities of \$1.45 billion.

The General Fund now has an accumulated fund balance of \$732.0 million. The City completed its fiscal year ended June 30, 2007 with a combined Governmental Funds net change in fund balance of \$74.8 million, as compared to the preceding fiscal year net increase of \$80.9 million. The Governmental Funds' 2007 net change in fund balance of \$74.8 million includes a net increase of \$70.7 million in the General Fund, a net increase of \$3.4 million in the Special Revenue Fund, a net decrease of \$2.5 million in the Capital Project Fund and a net increase of \$3.3 million in the Other Governmental Funds.

Cash Management

The City's Collector-Treasurer establishes the investment policies of the City. Portions of M.G.L. Chapter 29 and 41 govern these policies. Generally, the City's investment policy centers on receiving a competitive yield for its investible cash while ensuring safety. The balances held in the City's General Fund for investment are ultimately used to meet liability obligations and, are therefore, not available for what would be considered long-term investing. The duration of time during which funds are available for investment does vary; therefore, the City must carefully select the investment type most suitable for the given time frame to optimize income while maintaining safety and sufficient liquidity requirements. The City requires that repurchase agreements, certificates of deposits and investable accounts be collateralized.

Additionally, the Collector-Treasurer, working with the trustee(s) of the various trust funds, has developed a detailed Investment Guidelines and Policy Statement for an Individual or Common Fund. M.G.L. Chapter 203 (Uniform Common Trust Act) provides that the City of Boston may establish common trust funds. The pooling of individual trust funds into a common trust allows for greater diversification of investment in asset classes, as well as reduced management cost.

Risk Management

The Risk Management Program focuses on a planned strategy of self-insurance, supported by strong prevention and cost reduction efforts, financial reserves and catastrophic insurance. The City is self-insured in most areas of risk including general liability, property and casualty, Workers' Compensation, certain employee health care costs and unemployment compensation.

The City's legal liabilities are capped per M.G.L. Chapter 258, and Corporation Counsel defends the City in any lawsuits that arise from the normal course of operations. For Workers' Compensation, the City is exempt from state insurance requirements per M.G.L. Chapter 152 Section 25B. The City's Workers' Compensation Division, as well as the Police and Fire Departments, manage employee injury claims internally. The City budgets for and funds legal claims and employee injury costs through the General Fund, charging specific departments for their share of costs in order to promote awareness and prevention efforts.

The City purchases health insurance coverage for employees and retirees through a variety of health maintenance organizations (HMO's), in addition to offering three self-insured indemnity plans, which are administered by Blue Cross and Blue Shield of Massachusetts (BC/BS). HMO costs are funded through the General Fund, and the self-insured plans are financially managed through a trust fund established in compliance with M.G.L Chapter 32B Section 3A.

Capital Assets

The Capital Assets of the City are those capital assets used in the performance of governmental functions. They are reported in the Statement of Net Assets. At June 30, 2007, the capital assets of the City amounted to \$1.13 billion. This amount represents the valuation of capital assets in accordance with GAAP and the City's capitalization policy as described in Note 2, "Summary of Significant Accounting Policies."

Fiduciary Operations

The City of Boston participates in the State-Boston Retirement System (SBRS) which is a contributory defined benefit retirement plan. The SBRS, a cost sharing multiple employer public employee plan, is governed by M.G.L. Chapter 32. All retirement allowances are paid from a fund supported by employee, City and state contributions. Employee contributions, in the form of a mandatory deduction from regular compensation, constitute an annuity fund from which the annuity portion of the retirement allowance is paid.

The City is committed to funding based upon a schedule approved by the SBRS and the state actuary, which includes paying the current year's estimated present value of benefits earned during the year (normal cost), and an annual contribution toward reducing the unfunded liability to zero by the year 2023. This schedule is calculated in accordance with the entry age normal actuarial cost method. The schedule is subject to update and approval at least every three years by the state Public Employee Retirement Administration Commission (PERAC), a state agency established to oversee all 106 local Massachusetts public retirement systems. The SBRS most recently received approval for a funding schedule for fiscal 2006, 2007, and 2008. The annual appropriation, based on the funding schedule, is a legal obligation of the City that must be included as part of the tax rate certification by the Commonwealth.

Beginning January 1, 2000, accumulated assets in the plan have been reported using the “asset smoothing” valuation method. Asset smoothing gradually recognizes gains and losses over a period of time (usually 3 – 5 years). This method potentially reduces the volatility in the equity markets.

The SBRS Board, on an annual basis, considers a cost of living adjustment (COLA). As part of the annual review process, the Board considers the fiscal conditions of the City and whether the granting of the COLA would substantially impair the City’s financial well being. Cost of living adjustments are set each year at the Consumer Price Index, or an amount up to but not greater than, 3% on the first \$12,000 of a retiree’s annual payment. The Board approved a 3% COLA for 2007.

Accounting System and Budgetary Control

The accounts of the City are organized on the fund basis. Each fund is considered to be a separate accounting entity. The operations of each fund are accounted for by providing a separate set of self-balancing accounts, which comprise each fund’s assets, liabilities, fund balance, revenues and expenses. An integrated computerized financial accounting system is maintained by the Auditing Department to record transactions within these accounts. This system is an encumbrance accounting system, which monitors the City’s purchase orders for goods, services and other contractual commitments. The City budgets and maintains its books and records on a statutory basis of accounting prescribed by the Commonwealth of Massachusetts. This basis of accounting differs from U.S. GAAP.

The City’s management is responsible for establishing and maintaining internal accounting controls designed to provide reasonable, but not absolute, assurance that the assets of the City are safeguarded from loss, theft or misuse. In addition, the internal control structure reasonably assures that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with U.S. generally accepted accounting principles. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the evaluation of costs and benefits requires estimates and judgments by management. The City Auditor is responsible for evaluating the adequacy and effectiveness of the control structure and the Auditing Department conducts a periodic evaluation of the control structure’s proficiency.

As a part of its internal control structure, the City maintains budgetary controls. The objective of these controls is to ensure compliance with the legally mandated budget adopted by the City Council. Activities of the General Fund are included in the annual budget. The budget within the Special Revenue Fund is established based on specific grant requirements or specific legislation, but is not subject to City Council approval. The Capital budget reflects long-term needs, financed primarily through the issuance of bonds. This multi-year plan is subject to approval by the City Council. Specific budgets are established for each capital project prior to its inception.

The function and activity within the individual fund establishes the level of budgetary control. Budgetary control, in this context, defines the level at which expenditures cannot legally exceed the appropriated amount. In the case of the General Fund, this control is at the department level. In the case of the Special Revenue and Capital Projects Fund, the control is at the grant or project levels, respectively. All of these budgetary controls are integrated within the City's financial system and are monitored by the Office of Budget Management and the Auditing Department to ensure compliance.

The Auditing Department initiates a fiscal year closing process that limits and establishes departmental appropriation reserves through encumbrances and closely monitors the amount of prior year reserves carried forward. The process allows for the year-end closing and accompanying financial statements to be completed in an efficient and timely manner.

The *Single Audit Act and Office of Management and Budget Circular A-133* requires the City to have an annual independent audit conducted on the federal financial assistance it has received. This audit is conducted simultaneously with the City's annual financial statement audit.

A significant portion of the Single Audit is devoted to evaluating the City's internal control structure. The evaluation includes tests of a significant number of the major federal program transactions that occurred during the fiscal year. The Single Audit also requires that the auditors determine whether the organization has complied with laws and regulations that may have a material effect on each of its major federal financial assistance programs. All of the City's major federal programs are evaluated for the adequacy of internal controls and compliance with laws and regulations.

The City's Single Audit report for the year ending June 30, 2007 included no instances of material weaknesses in the internal control structure, nor were any significant violations of the applicable laws and regulations reported. The report is publicly issued under a separate cover.

Other Information

Independent Audit

The Commonwealth of Massachusetts, through Chapter 190 of the Acts of 1982, requires that the City undergo an annual audit performed by a firm of independent public accountants. The City has selected the firm of KPMG LLP to perform the June 30, 2007 audit. This audit is conducted in accordance with generally accepted government auditing standards (GAGAS) issued by the Comptroller General of the United States. The audit provides an independent review to help assure a fair presentation of the City's financial position and results of operations.

The City also undergoes an annual audit of its Federal grant funds as required by the Single Audit Act. KPMG LLP issues separate reports on the City's internal control systems and compliance with applicable laws and regulations that meet the requirements of the *Single Audit Act and Office of Management and Budget Circular A-133*.

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Boston for its CAFR for the fiscal year ended June 30, 2006. This was the twelfth consecutive year that the City of Boston has received this prestigious award. In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized CAFR. This report must satisfy both GAAP and applicable state and local legal requirements.

A Certificate of Achievement is valid for a period of only one year. We believe that our current report continues to meet the Certificate of Achievement program requirements, and we are submitting it to the GFOA to determine its eligibility for a certificate.

In addition, the City of Boston also received the GFOA's Award for Distinguished Budget Presentation for its Annual Budget document for the fiscal year beginning July 1, 2006. The City of Boston's budget document was judged to be proficient in several categories including policy documentation and financial planning.

Acknowledgements

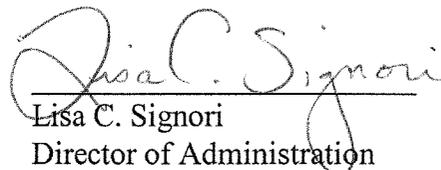
We would like to express our appreciation to the staff of the Accounting and Financial Reporting Program and all the members of the Auditing Department whose professionalism and dedication made the timely preparation of the CAFR possible. We also wish to thank the professional staff of KPMG LLP for their counsel, technical assistance and encouragement in the preparation of this CAFR. Several other City departments and agencies provided additional information and assisted in the CAFR preparation. We gratefully acknowledge their efforts and contributions to this report. Finally, we wish to thank you for your continued interest in the financial operations of the City, and for the planning and support necessary to conduct the City's financial operations in a responsible manner.

The City's Auditing and Management Information Services (MIS) departments have worked to produce the City's annual financial statements on-line. The Basic Financial Statements and the CAFR for FY05, FY06 and FY07 are featured on the City's web page www.cityofboston.gov/auditing.

Respectfully submitted,



Sally D. Glora
City Auditor



Lisa C. Signori
Director of Administration
and Finance

Certificate of
Achievement
for Excellence
in Financial
Reporting

Presented to

City of Boston
Massachusetts

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2006

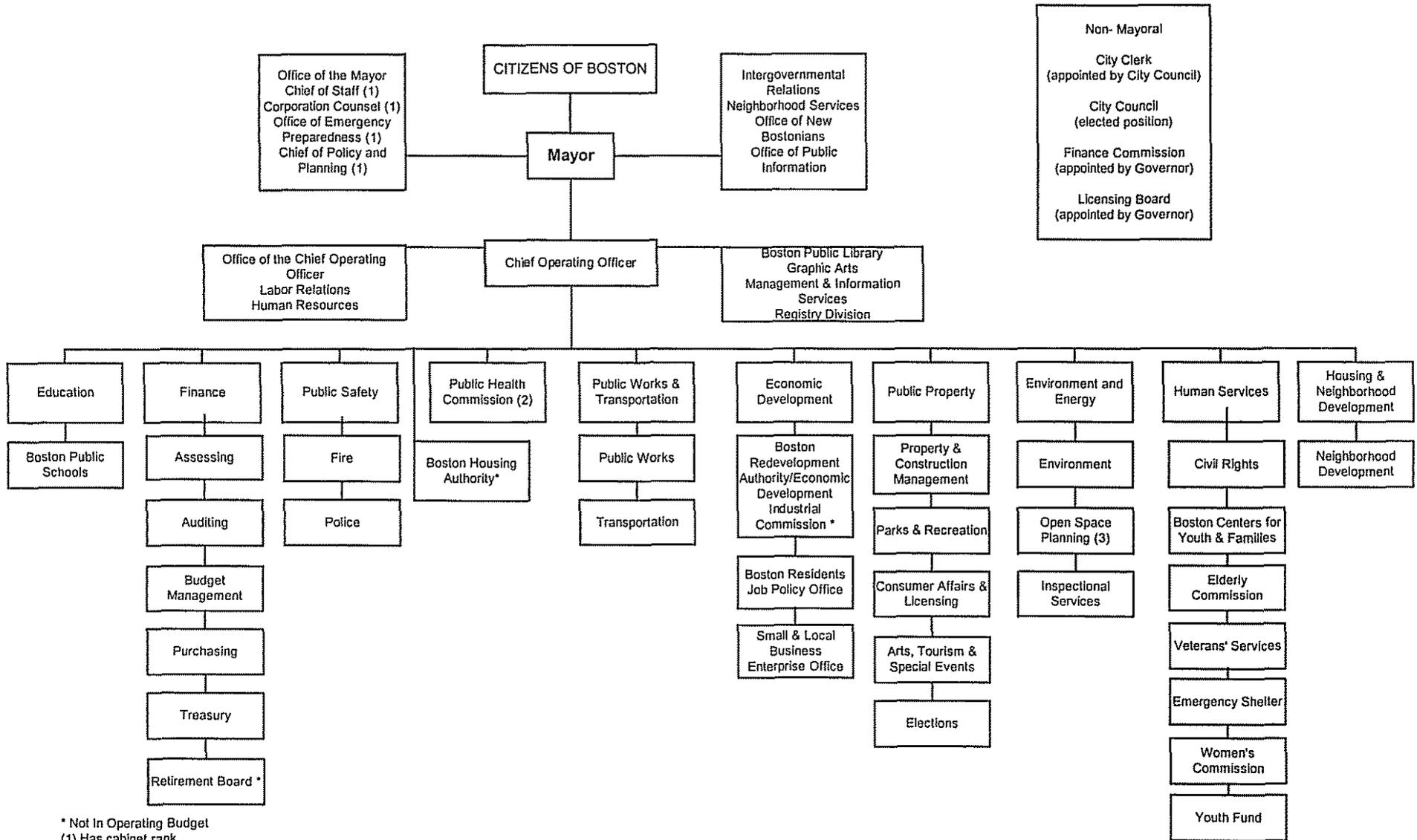
A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director

ORGANIZATION OF CITY GOVERNMENT



Non- Mayoral

- City Clerk
(appointed by City Council)
- City Council
(elected position)
- Finance Commission
(appointed by Governor)
- Licensing Board
(appointed by Governor)

City of Boston, Massachusetts

* Not In Operating Budget
 (1) Has cabinet rank.
 (2) The Boston Public Health Commission is an independent authority created in June 1996.
 (3) Programmatically within this cabinet; financially in Parks & Recreation

ELECTED and APPOINTED OFFICIALS

Mayor

THOMAS M. MENINO

City Council Members

Maureen E. Feeney (President)	District 3
Michael F. Flaherty, Jr.....	At-Large
S.H. Samuel Yoon.....	At-Large
Stephen J. Murphy.....	At-Large
Felix D. Arroyo	At-Large
Salvatore LaMattina	District 1
William Linehan	District 2
Charles C. Yancey	District 4
Robert J. Consalvo.....	District 5
John M. Tobin	District 6
Chuck Turner.....	District 7
Michael P. Ross.....	District 8
Jerome P. McDermott	District 9

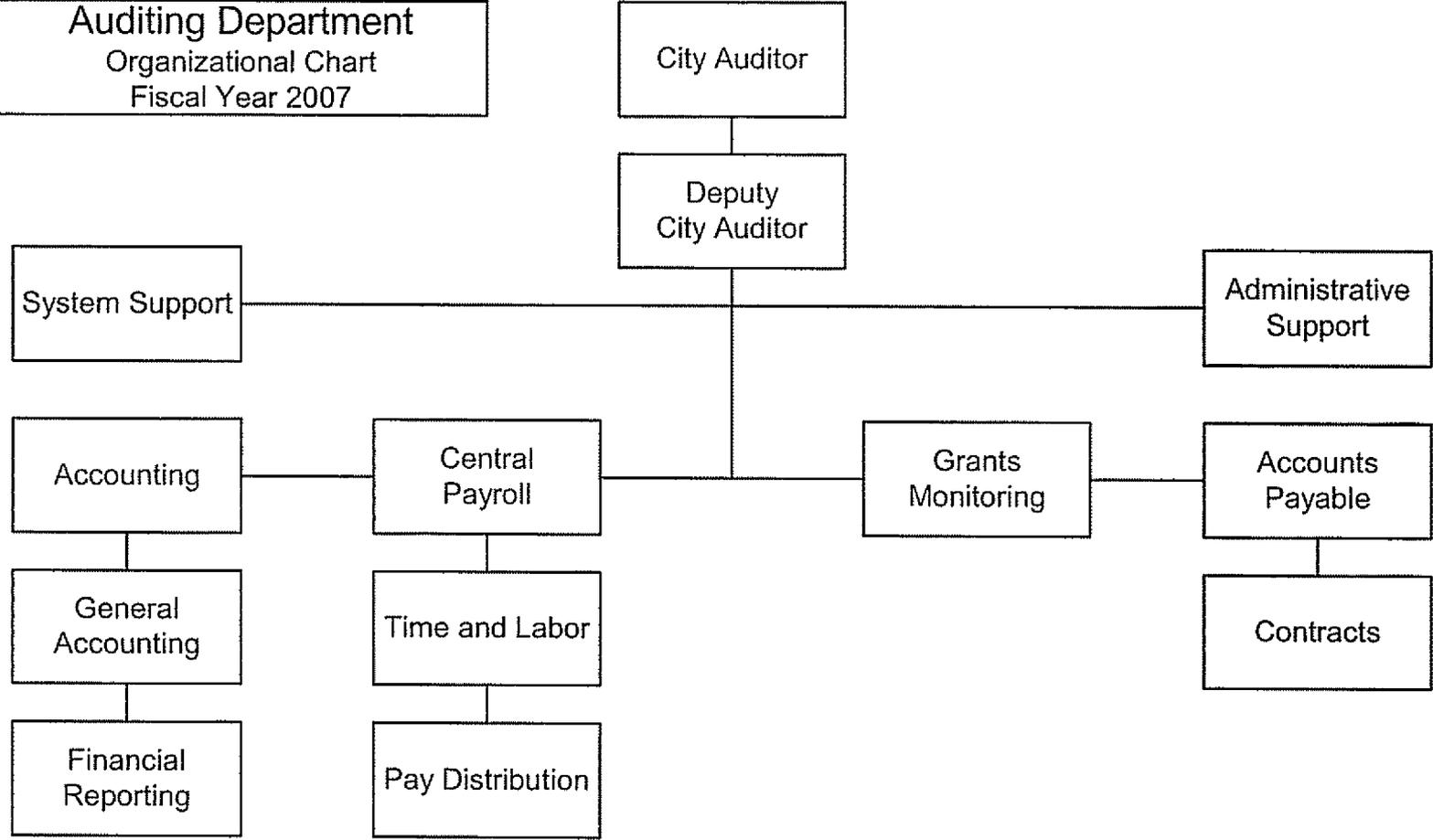
Suffolk County Officials

Andrea Cabral	Sheriff
Daniel F. Conley.....	District Attorney

Appointed City Executive Branch Members

Judith Kurland	Chief of Staff
William F. Sinnott	Corporation Counsel
Dennis DiMarzio	Chief Operating Officer
Lisa C. Signori.....	Chief Financial Officer
Paul McCann	Acting Chief Economic Development Officer
William Oates.....	Chief Information Officer
Michael Contompasis	Chief of Education
J. Larry Mayes	Chief of Human Services
Michael Galvin	Chief of Basic Services
James Hunt	Chief of Environmental Services
Sandra B. Henriquez.....	Chief of Public Housing
Joanne Massaro	Interim Chief of Housing
Edward F. Davis	Chief of Public Safety and Police Commissioner
Roderick J. Frasier.....	Chief of Public Safety and Fire Commissioner
Dr. Nancy Norman	Interim Chief of Public Health
Dennis E. Royer.....	Chief of Public Works and Transportation Department

Auditing Department
Organizational Chart
Fiscal Year 2007



Auditing Department Personnel
Sally D. Glora, City Auditor
Dennis J. Coughlin, Deputy City Auditor

Ruth Agosto	Diane O'Malley
Allan M. Brodsky	Christine M. Opila
Domenica Cabral	Michelle Pacitta
Michelle E. Castillo	Charles T. Panagopoulos
Naveen Chinthakunta	Mary L. Raysor
Mattie Crouse	Carol Rhodey
Stephen Flaherty	Magnolia Rojas
Allen Hurley	Christopher Sargeant
Cynthia Johnson	Lori Schilling
Nelly Lopez	Lisa Stone
Medina Lucien	Ming C. Su
Luis Carlos Martinez	Donna Seel
Mary Ann Mason	Julie A. Tippet
Hazel McAfee	Vandana Toreti
Sheila A. McGonagle	Stanley J. Wallace
Elvira Murphy	Paul F. Waple