

**OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES**  
**AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL**  
**AREA DE ARCHIVO DIGITAL**

**MUNICIPIO DE SALINAS**  
**AUDITORIA 2003-2004**  
**30 DE JUNIO DE 2004**

SECRETARÍA DE ECONOMÍA  
RECEBIDO  
15 APT. 12. P. R. 10-16  
UNIDAD DE CUERPO

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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF SALINAS**  
**SINGLE AUDIT REPORT**  
**YEAR ENDED JUNE 30, 2004**

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2004

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COMMONWEALTH OF PUERTO RICO  
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*López-Vega, CPA, PSC*

Certified Public Accountants / Management Advisors

Member of:

- American Institute of Certified Public Accountants
- Puerto Rico Society of Certified Public Accountants

## **INDEPENDENT AUDITORS' REPORT**

**To the Honorable Mayor and  
the Municipal Legislature  
Municipality of Salinas  
Salinas, Puerto Rico**

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Salinas, Puerto Rico**, as of and for the year ended June 30, 2004, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the provisions of the Office of Management and Budget Circular A-133, "*Audits of States, Local Governments, and Non-Profit Organizations*". Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinions.

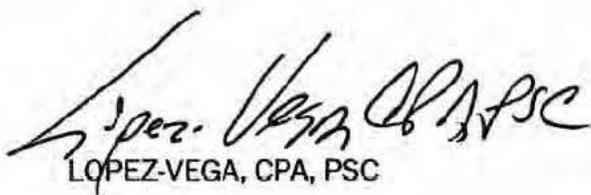
In our opinion, the financial statements referred to above present fairly, in all material respects the financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Salinas, Puerto Rico** as of June 30, 2004, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 12, 2004 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

INDEPENDENT AUDITORS' REPORT (Continued)

Our audit was performed for the purpose of forming an opinion on the basic financial statements of the **Municipality of Salinas, Puerto Rico** taken as whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the respective financial statements. The information in that schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented, in all material respects, in relation to the basic financial statements taken as a whole.

The Management's Discussion and Analysis on pages 3 through 13 and the Budgetary Comparison Schedule-General Fund on pages 46 and 47 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

  
LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico  
December 12, 2004

Stamp No. 2019421 of the Puerto Rico  
Society of Certified Public Accountants  
was affixed to the record copy of this report.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**YEAR ENDED JUNE 30, 2004**

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This discussion and analysis of the Municipality of Salinas (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2004. The Management Discussion and Analysis (MD&A) should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements. The discussion and analysis includes comparative data for prior year as this information is available for the fiscal year ended on June 30, 2003, first year of implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, "*Basic Financial Statements - and Management's Discussion and Analysis-for State and Local Governments.*" This MD & A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

1. a broader basis in focusing important issues;
2. acknowledgement of an overview of the Municipality's financial activities;
3. provide for an evaluation of its financial condition as of the end of the indicated fiscal year, compared with prior year results;
4. identification of uses of funds in the financing of the Municipality's variety of activities and;
5. asses management's ability to handle budgetary functions.

**FINANCIAL HIGHLIGHTS**

The following comments about the financial condition and results of operations as reflected in the financial statements prepared for fiscal year 2004 deserve special mention:

1. Total assets of the Municipality amounted to \$19,014,400 which represents an increase of 59% compared to prior fiscal year;
2. At the end of fiscal year 2004, total liabilities amounted to \$21,233,539. of the said amount, \$18,485,356 corresponded to long-term liabilities of which \$8,736,879 represented the outstanding balance of bonds and notes issued. The Municipality continued to meet all debt service requirements, most of which was paid from self generated revenues;
3. Total deficit of the Municipality amounted to \$2,219,139 which represents a decrease of 63% compared to prior fiscal year;
4. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$16,654,482, derived from the following sources: \$298,604 charges for services; \$3,335,865 from operating grants and contributions; \$3,467,464 from capital grants and contributions obtained from other sources, and \$9,552,549 from general revenues available;

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**FINANCIAL HIGHLIGHTS (CONTINUED)**

5. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to \$12,816,566;
6. As reflected in the Statement of Activities, the current fiscal year operations contributed to an increase in the Net Assets figure by \$3,837,916;
7. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$3,764,779;
8. As the end of the current fiscal year the Municipality's General Fund balance amounted to \$3,129,356, compared to a fund deficit of \$1,382,053 in the prior fiscal year;
9. The actual General Fund budgetary activities resulted in an unfavorable balance of \$704,683.

**FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION**

The new approach used in the presentation of the financial statements of the Municipality is based on a government-wide view of such statements as well as a presentation of individual funds behavior during fiscal year 2004. The combination of these two perspectives provide the user the opportunity to address significant questions concerning the content of said financial statements, and provide the basis for a comparable analysis of future years performance. The comparative analysis is a meaningful and useful management tool for municipal management in the decision making process.

Under the aforementioned approach, assets and liabilities are recognized using the accrual basis of accounting which is similar to the method used by most private enterprises. This means that current year's revenues and expenses are accounted for regardless of when cash is received or paid.

**FINANCIAL STATEMENTS COMPONENTS**

The basic financial statements consist of the government wide financial statements, the major funds financial statements and the notes to the financial statements which provide details, disclosure and description of the most important items included in said statements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**FINANCIAL STATEMENTS COMPONENTS (CONTINUED)**

The Statement of Net Assets reflects information of the Municipality as a whole of a consolidated basis and provides relevant information about its financial strength as reflected at the end of the fiscal year. Such financial level is measured as the difference between total assets and liabilities, with the difference between both items reported as net assets. It is important to note that although municipalities as governmental public entities were not created to operate under a profit motive framework, the return on assets performance plays an important role in their financial operations. The higher the increments achieved in net revenues, the higher the capacity to increase the net assets figure either thru additional borrowings or thru internally generated funds.

The Statement of Activities is focused on both gross and net cost of the various activities of the Municipality. It presents information which shows the changes in the Municipality's net assets at the most recent fiscal year. Based on the use of the accrual basis of accounting, changes are reported as soon as the underlying event occurs, regardless of the timing of the related cash flows. Under said approach, revenues and expenses are reported in the Statement of Activities based on the theory that it will result in cash flows to be realized in future periods.

A brief review of The Statements of Activities of the Municipality at June 30, 2004, shows total expenses incurred to afford the cost of all functions and programs amounted to \$12,816,566. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$7,101,933 was derived from the following sources: \$298,604 charges for services; \$3,335,865 from operating grants and contributions; and \$3,467,464 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$9,552,549. When such figure is added to the \$7,101,933 previously mentioned, total revenues available for the financing of activities amounted to \$16,654,482. There was an excess of revenues over expenses in the amount of \$3,837,916 which contributed with a decrease to the figure of deficit attained at the end of the fiscal year.

The Fund Financial Statement is another important component of the Municipality's financial statements. A fund is a grouping of related accounts that are used to maintain accountability and controls over economic resources of the Municipality that have been segregated for specific activities. The Municipal fund type of accounting is used to demonstrate compliance with related legal requirements. Information offered thru this Statement is limited to the Municipality most significant funds and is particularly related to the local government only, instead of the government as a whole. Government funds are used to account for essentially the same functions as those reported as governmental activities. The funds are reported using an accounting method known as modified accrual accounting which measures cash and all other financial assets that can be readily converted into cash.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**FINANCIAL STATEMENTS COMPONENTS (CONTINUED)**

The fund statement approach gives the user a short term view of the Municipality's government operations and the basic services it provides. Since the focus of government funds is narrower than that of the financial statements as a whole, it also helps the user with comparable information presented in the governmental activities report. By doing so, readers of the basic financial statements may understand better the long-term effect of the Municipality's short-term financial decisions.

**INFRASTRUCTURE ASSETS**

Historically, a significant group of infrastructure assets such as roads, bridges, traffic signals, underground pipes not associated with utilities, have not been recognized nor depreciated in the accounting records of the Municipality. GASB 34 requires that such type of assets be inventoried, valued and reported under the governmental column of the Government-Wide Statement. As of July 1, 2002, the Municipality commenced the prospective reporting of infrastructure assets. The Municipality expects to retroactively report historical costs of infrastructure assets during the fiscal year beginning on July 1, 2006.

According to the requirements of GASB 34, the government must elect to either (a) depreciate the aforementioned assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery to near perpetuity. If the government develops the asset management system, (the modified approach) which periodically (at least every three years), by category, measures and demonstrate its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. In this particular respect, the Municipality has elected the use of recognizing depreciation under the useful life method and it contemplates to continue this treatment on said basis.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)**

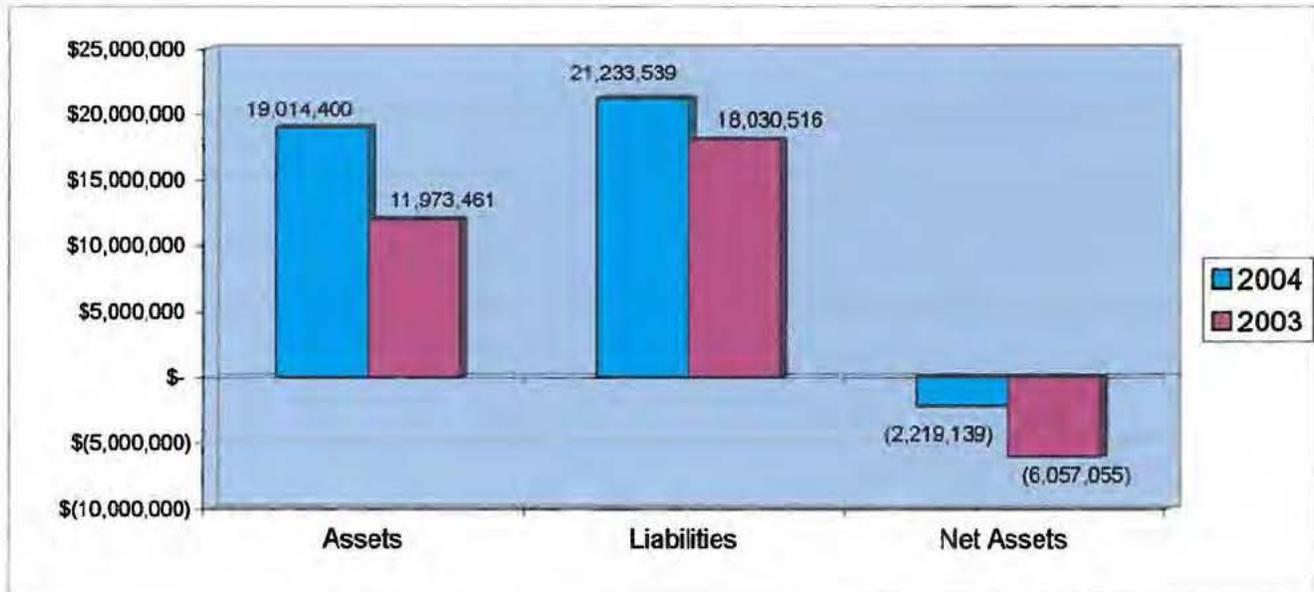
**YEAR ENDED JUNE 30, 2004**

**FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE**

**Net Assets**

The Statement of Net Assets serves as an indicator of the Municipality's financial position at the end of the fiscal year. In the case of the Municipality of Salinas, primary government liabilities exceeded total assets by \$2,219,139 at the end of 2004, compared to \$6,057,055 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

| <b>Condensed Statement of Net Assets</b>        | <b>2004</b>           | <b>2003</b>           | <b>Change</b>       | <b>%</b>     |
|---|-----------------------|-----------------------|---------------------|--------------|
| Current and other assets                        | \$ 6,504,027          | \$ 5,168,324          | \$ 1,335,703        | 26%          |
| Capital assets                                  | 12,510,373            | 6,805,137             | 5,705,236           | 84%          |
| <b>Total assets</b>                             | <b>19,014,400</b>     | <b>11,973,461</b>     | <b>7,040,939</b>    | <b>59%</b>   |
| Current and other liabilities                   | 2,748,183             | 2,149,196             | 598,987             | 28%          |
| Long-term liabilities                           | 18,485,356            | 15,881,320            | 2,604,036           | 16%          |
| <b>Total liabilities</b>                        | <b>21,233,539</b>     | <b>18,030,516</b>     | <b>3,203,023</b>    | <b>18%</b>   |
| Invested in capital assets, net of related debt | 9,863,494             | 3,929,258             | 5,934,236           | 151%         |
| Restricted                                      | 5,098,091             | 4,048,062             | 1,050,029           | 26%          |
| Unrestricted deficit                            | (17,180,724)          | (14,034,375)          | (3,146,349)         | 22%          |
| <b>Total net assets</b>                         | <b>\$ (2,219,139)</b> | <b>\$ (6,057,055)</b> | <b>\$ 3,837,916</b> | <b>(63%)</b> |



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

**FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)**

**Changes in Net Assets**

The Statement of Activities reflects that for fiscal year 2004, the net effect of revenues derived from several programs plus current operating revenues compared to the total expenses, amounted to \$3,837,916 decrease in the Municipality's deficit. Approximately 28 percent of the Municipality's total revenue came from taxes, while 69 percent resulted from grants and contributions, including federal aid. The Municipality's expenses cover a range of services. The largest expenses were for public works, community development, general government and health and welfare. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

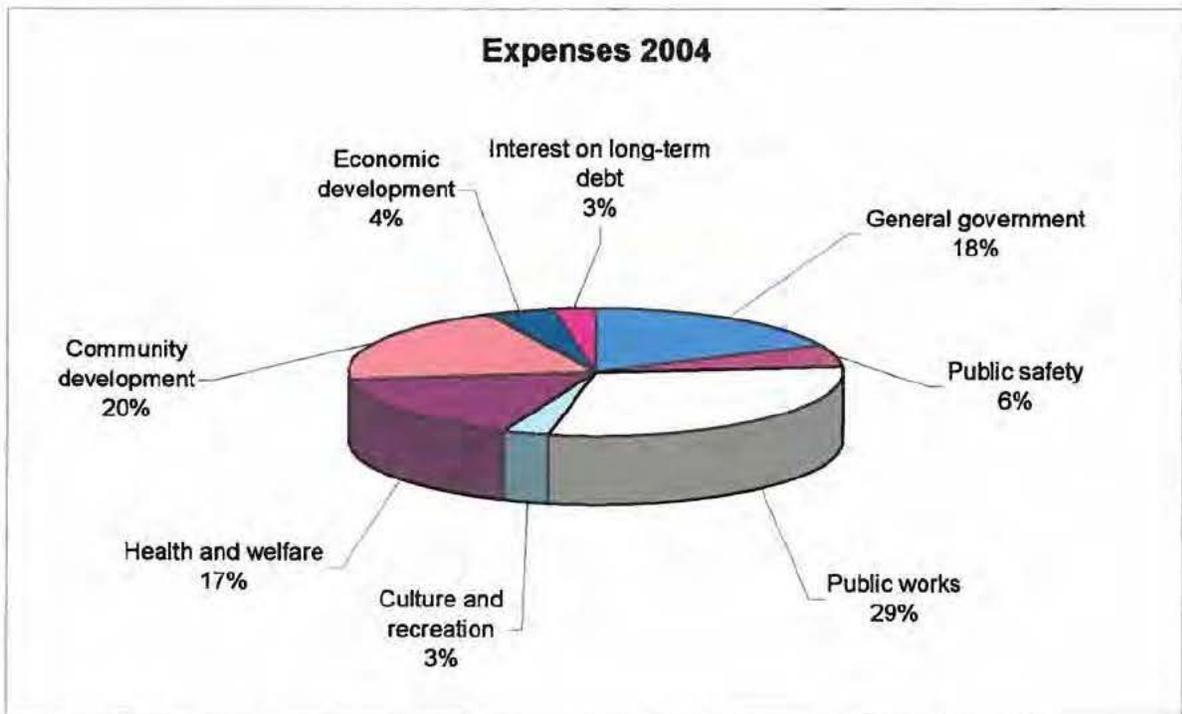
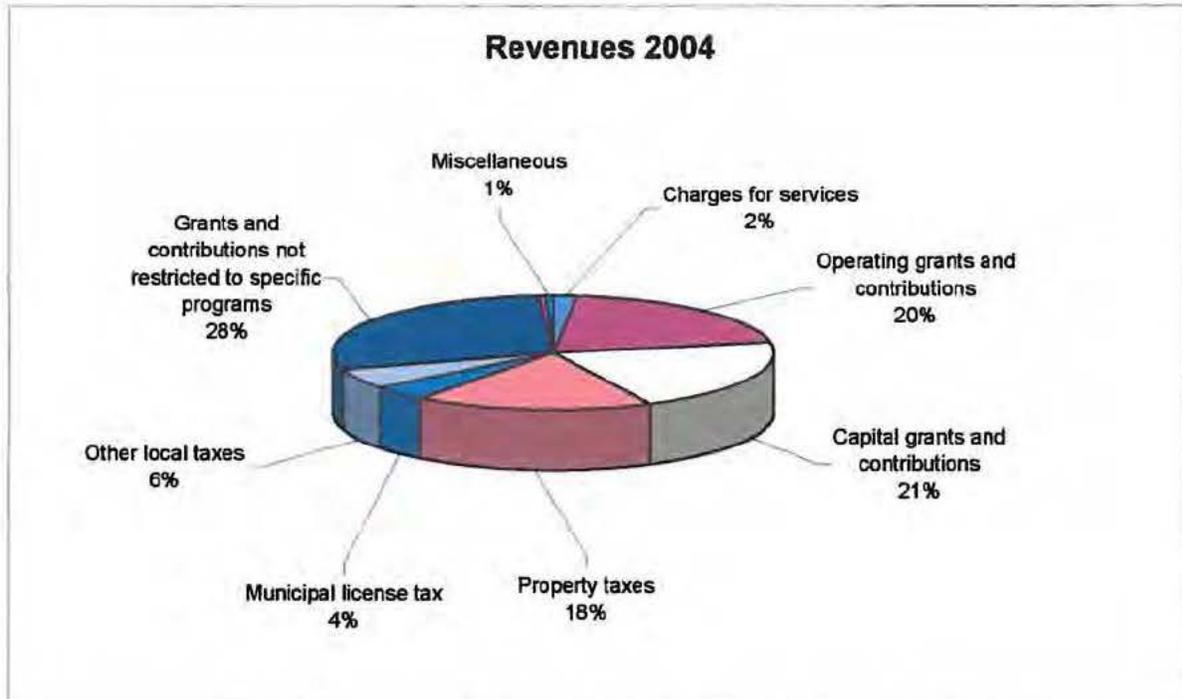
| <b>Condensed Statement of Activities</b>                     | <b>2004</b>           | <b>2003</b>           | <b>Change</b>       | <b>%</b>      |
|--|-----------------------|-----------------------|---------------------|---------------|
| <b>Program revenues:</b>                                     |                       |                       |                     |               |
| Charges for services   | \$ 298,604            | \$ 358,260            | \$ (59,656)         | (17%)         |
| Operating grants and contributions                           | 3,335,865             | 2,571,932             | 763,933             | 30%           |
| Capital grants and contributions                             | 3,467,464             | 651,161               | 2,816,303           | 433%          |
| <b>General revenues:</b>                                     |                       |                       |                     |               |
| Property taxes   | 2,931,364             | 2,717,697             | 213,667             | 8%            |
| Municipal license tax  | 687,950               | 1,062,747             | (374,797)           | (35%)         |
| Other local taxes  | 969,553               | 1,413,691             | (444,138)           | (31%)         |
| Grants and contributions not restricted to specific programs | 4,790,333             | 4,321,643             | 468,690             | 11%           |
| Interest and investment earnings                             | 81,747                | 68,403                | 13,344              | 20%           |
| Gain (loss) on retirement of capital assets                  | -                     | -                     | -                   | -             |
| Miscellaneous  | 91,602                | 99,737                | (8,135)             | (8%)          |
| <b>Total revenues</b>  | <b>16,654,482</b>     | <b>13,265,271</b>     | <b>3,389,211</b>    | <b>26%</b>    |
| <b>Expenses:</b>   |                       |                       |                     |               |
| General government   | 2,326,942             | 6,123,913             | (3,796,971)         | (62%)         |
| Public safety  | 709,919               | 796,492               | (86,573)            | (11%)         |
| Public works   | 3,766,519             | 2,366,445             | 1,400,074           | 59%           |
| Culture and recreation                                       | 383,641               | 530,303               | (146,662)           | (28%)         |
| Health and welfare   | 2,178,722             | 1,721,037             | 457,685             | 27%           |
| Community development  | 2,540,725             | 1,550,897             | 989,828             | 64%           |
| Education  | -                     | 35,725                | (35,725)            | (100%)        |
| Urban development  | 31,691                | 16,875                | 14,816              | 88%           |
| Economic development   | 537,811               | 467,462               | 70,349              | 15%           |
| Interest on long-term debt                                   | 340,596               | 380,043               | (39,447)            | (10%)         |
| <b>Total expenses</b>  | <b>12,816,566</b>     | <b>13,989,192</b>     | <b>(1,172,626)</b>  | <b>(8%)</b>   |
| <b>Change in net assets</b>                                  | <b>3,837,916</b>      | <b>(723,921)</b>      | <b>4,561,837</b>    | <b>(630%)</b> |
| Net assets (Deficit), beginning of year, as restated         | (6,057,055)           | (5,333,134)           | (723,921)           | 14%           |
| <b>Net assets (Deficit), end of year</b>                     | <b>\$ (2,219,139)</b> | <b>\$ (6,057,055)</b> | <b>\$ 3,837,916</b> | <b>(63%)</b>  |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS**

**Governmental Funds**

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$3,764,779, an increase of \$902,509 in comparison with the prior year. There are reservations of fund balance amounting to \$6,116,863. This is the fund balance that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$913,809), 2) to pay debt service (\$1,238,867), 3) to pay for capital projects (\$698,152) and 4) for other purposes (\$3,266,035).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2004, the general fund has an undesignated fund deficit of \$2,352,084.

**GENERAL FUND BUDGETARY HIGHLIGHTS**

Over the course of the year, the Municipality Council revised the Municipality's budget in order to include increases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. Increases in budgeted expenditures were also made since the law mandates a balanced budget.

The actual General Fund budgetary activities resulted in an unfavorable balance of \$704,683.

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

The Municipality has not maintained complete and adequate records related to the Capital Assets acquired and constructed in the past years, but the Municipality expects to compile documents and other information in the next fiscal years in order to attain complete and accurate records of its Capital Assets, and then, comply with such requirement. The Municipal Administration expects to develop a broad and comprehensive identification and assessments project of all fixed assets owned by the local government in order to capitalize them in its Statement of Net Assets, and then, reflects the correct net assets figure of the Municipality as a whole.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)**

The Municipality's investment in capital assets as of June 30, 2004, amounts to \$15,854,283, net of accumulated depreciation of \$3,343,910 (including depreciation charges for the year totaled \$406,350), leaving a net book value of \$12,510,373. This investment in capital assets includes land, construction in progress, buildings, improvements, equipment, infrastructure and vehicles. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2004, the Municipality has \$541,885 of unexpended proceeds mainly from bond and notes issuances that are committed to future construction activities.

**Debt Administration**

The Puerto Rico Legislature has established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged.

The applicable law also requires that in order for a Municipality to be able to issue additional general obligation bonds and notes such Municipality must have sufficient "payment capacity". Act No. 64 provides that a Municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in such municipality's Redemption Fund and the annual amounts collected with respect to such Municipality's Special Additional Tax (as defined below), as projected by GDB, will be sufficient to service to maturity the Municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

The Municipality is required under applicable law to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES**

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may vary if new grants are available but the revenue also is very predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2004-2005.

**FINAL COMMENTS**

The Municipality is an autonomous governmental entity whose powers and authority vested on its Executive and Legislative Branches are specifically established in the Municipal Autonomous Act approved in August 1991. By virtue of such powers, it provides a wide range of services to its constituents which includes, among others, public works, education, public safety, public housing, health, community development, recreation, waste disposal, welfare and others. The Municipality's principal sources of revenues are derived from property taxes, municipal license taxes, subsidies from the Commonwealth of Puerto Rico's General Fund and contributions from the Traditional and Electronic Lottery sponsored by said Government.

On September 7, 2004, Public Law 255 was enacted to amend Section 22 of the Public Law 83 of May 2, 1941, known as the Puerto Rico Electric Power Authority ("PREPA") Act. This Law stipulates a new formula to determine the contribution in lieu of taxes to be distributed to the Municipalities of the Commonwealth of Puerto Rico. From fiscal year 2002-2003 the PREPA is required by law to distribute as contribution in lieu of taxes a twenty percentage of its net revenues, after deduction of subsidies granted, or an amount equal to the actual cost of electric power consumed by each Municipality, or an average of the contribution in lieu of taxes paid to each Municipality in the last most recent five fiscal years, whichever is greater.

The Municipality's management is committed to a continued improvement in the confection of a budget that will respond to the needs of the public and private sectors in accordance with its permissible revenues levels. Such has been the case of the financial operation corresponding to fiscal year 2004. It further contemplates to improve its current figure of net assets, which has been identified as one of the main short and long-term objectives of the Municipality.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**FINANCIAL CONTACT**

The Municipality's financial statements are designed to present users (citizens, taxpayer, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer at P.O. Box 1149, Salinas, Puerto Rico 00751, or call (787) 824-2883.

**Commonwealth of Puerto Rico**  
**Municipality of Salinas**  
**Statement of Net Assets**  
**June 30, 2004**

|  | <b>Governmental<br/>Activities</b> |
|--|------------------------------------|
| <b>Assets</b>                                    |                                    |
| Cash and cash equivalents                        | \$ 1,255,455                       |
| Cash with fiscal agent                           | 4,257,386                          |
| Accounts receivable:                             |                                    |
| Municipal license tax                            | 1,065                              |
| Intergovernmental                                | 434,409                            |
| Federal grant                                    | 385,821                            |
| Other  | 169,891                            |
| Capital assets                                   |                                    |
| Land, improvements, and construction in progress | 8,181,412                          |
| Other capital assets, net of depreciation        | 4,328,961                          |
| Total capital assets                             | <u>12,510,373</u>                  |
| <b>Total assets</b>                              | <u><b>19,014,400</b></u>           |
| <br><b>Liabilities</b>                           |                                    |
| Accounts payable and accrued liabilities         | 1,642,437                          |
| Interest payable                                 | 104,963                            |
| Due to other governmental entities               | 276,705                            |
| Deferred revenues:                               |                                    |
| Municipal license tax                            | 451,421                            |
| Federal grant revenues                           | 272,657                            |
| Other  |                                    |
| Noncurrent liabilities:                          |                                    |
| Due within one year                              | 749,930                            |
| Due in more than one year                        | <u>17,735,426</u>                  |
| <b>Total liabilities</b>                         | <u><b>21,233,539</b></u>           |
| <br><b>Net Assets</b>                            |                                    |
| Invested in capital assets, net of related debt  | 9,863,494                          |
| Restricted for:                                  |                                    |
| Capital projects                                 | 698,152                            |
| Debt service                                     | 1,133,904                          |
| Other purposes                                   | 3,266,035                          |
| Unrestricted (deficit)                           | <u>(17,180,724)</u>                |
| <b>Total net assets (deficit)</b>                | <u><b>\$ (2,219,139)</b></u>       |

The notes to the financial statements are an integral part of this statement.

Commonwealth of Puerto Rico  
Municipality of Salinas  
Statement of Activities  
For the Year Ended June 30, 2004

| Functions/Programs   | Expenses             | Program Revenues        |  |  | Net (Expense) Revenue and<br>Changes in Net Assets |
|--|----------------------|-------------------------|--|--|--|
|  |                      | Charges for<br>Services | Operating<br>Grants and<br>Contributions | Capital<br>Grants and<br>Contributions | Governmental<br>Activities                         |
| General government   | \$ 2,326,942         | \$ 78,808               | \$ 103,478                               |  | \$ (2,144,656)                                     |
| Public safety  | 709,919              | 62,599                  | 123,949                                  |  | (523,371)  |
| Public works   | 3,766,519            | 106,802                 | 24,180                                   | 3,267,464                              | (368,073)  |
| Health and welfare   | 2,178,722            |                         | 1,164,827                                |  | (1,013,895)  |
| Culture and recreation                                       | 383,641              | 50,395                  |  |  | (333,246)  |
| Economic development   | 537,811              |                         | 1,919,431                                |  | 1,381,620  |
| Community development  | 2,540,725            |                         |  | 200,000                                | (2,340,725)  |
| Urban development  | 31,691               |                         |  |  | (31,691)   |
| Education  |                      |                         |  |  | -  |
| Interest on long-term debt                                   | 340,596              |                         |  |  | (340,596)  |
| <b>Total governmental activities</b>                         | <b>\$ 12,816,566</b> | <b>\$ 298,604</b>       | <b>\$ 3,335,865</b>                      | <b>\$ 3,467,464</b>                    | <b>(5,714,633)</b>                                 |
| General revenues:  |                      |                         |  |  |  |
| Property taxes   |                      |                         |  |  | 2,931,364  |
| Municipal license tax  |                      |                         |  |  | 687,950  |
| Other local taxes  |                      |                         |  |  | 969,553  |
| Grants and contributions not restricted to specific programs |                      |                         |  |  | 4,790,333  |
| Interest and investment earnings                             |                      |                         |  |  | 81,747   |
| Miscellaneous  |                      |                         |  |  | 91,602   |
| <b>Total general revenues</b>                                |                      |                         |  |  | <b>9,552,549</b>                                   |
| Change in net assets   |                      |                         |  |  | 3,837,916  |
| Net assets (deficit) - beginning, as restated                |                      |                         |  |  | (6,057,055)  |
| Net assets (deficit) - ending                                |                      |                         |  |  | <b>\$ (2,219,139)</b>                              |

Commonwealth of Puerto Rico  
Municipality of Salinas  
Balance Sheet  
Governmental Funds  
June 30, 2004

|  | General Fund        | Special Revenue Fund<br>Local and State Grants | Special Revenue Fund<br>Other Federal Grants | Capital Projects Fund<br>Local and State Grants | Debt Service Fund   | Other Governmental Funds | Total Governmental Funds |
|--|---------------------|--|--|---|---------------------|--------------------------|--------------------------|
| <b>Assets</b>                              |                     |  |  |   |                     |                          |                          |
| Cash and cash equivalents                  | \$ 12,362           | \$ 652,229                                     | \$ 253,145                                   | \$ 233,746                                      | \$ -                | \$ 103,973               | \$ 1,255,455             |
| Cash with fiscal agent                     | 2,508,697           |  | 2,202  | 541,885   | 1,204,602           |                          | 4,257,386                |
| Accounts receivable:                       |                     |  |  |   |                     |                          |                          |
| Municipal license tax                      | 1,065               |  |  |   |                     |                          | 1,065                    |
| Intergovernmental                          | 50,399              | 348,279  |  |   | 35,731              |                          | 434,409                  |
| Federal Grant                              |                     |  | 385,821                                      |   |                     |                          | 385,821                  |
| Due from other funds                       | 483,741             | 97,494   |  | 684,699   |                     |                          | 1,265,934                |
| Other                                      | 73,092              |  |  |   | 771                 |                          | 73,863                   |
| <b>Total assets</b>                        | <b>3,129,356</b>    | <b>1,098,002</b>                               | <b>641,168</b>                               | <b>1,460,330</b>                                | <b>1,241,104</b>    | <b>103,973</b>           | <b>7,673,933</b>         |
| <b>Liabilities and Fund Balances</b>       |                     |  |  |   |                     |                          |                          |
| <b>Liabilities:</b>                        |                     |  |  |   |                     |                          |                          |
| Accounts payable and accrued liabilities   | 548,615             | 62,858   | 295,695                                      | 735,269   | -                   | -                        | 1,642,437                |
| Due to other governmental entities         | 276,705             |  |  |   |                     |                          | 276,705                  |
| Due to other funds                         | 782,193             | 325,642  | 119,183                                      | 26,909  | 2,237               | 9,770                    | 1,265,934                |
| Deferred revenues:                         |                     |  |  |   |                     |                          |                          |
| Municipal license tax                      | 451,421             |  |  |   |                     |                          | 451,421                  |
| Federal grant revenues                     |                     |  | 178,454                                      |   |                     | 94,203                   | 272,657                  |
| Other                                      |                     |  |  |   |                     |                          | -                        |
| <b>Total liabilities</b>                   | <b>2,058,934</b>    | <b>388,500</b>                                 | <b>593,332</b>                               | <b>762,178</b>                                  | <b>2,237</b>        | <b>103,973</b>           | <b>3,909,154</b>         |
| <b>Fund balances:</b>                      |                     |  |  |   |                     |                          |                          |
| <b>Reserved for:</b>                       |                     |  |  |   |                     |                          |                          |
| Encumbrances                               | 913,809             |  |  |   |                     |                          | 913,809                  |
| Capital projects                           |                     |  |  | 898,152   |                     |                          | 898,152                  |
| Other purposes                             |                     | 709,502  | 47,836                                       |   |                     |                          | 757,338                  |
| Debt service fund                          |                     |  |  |   | 1,238,867           |                          | 1,238,867                |
| <b>Unreserved:</b>                         |                     |  |  |   |                     |                          |                          |
| Designated for specific fund purposes      | 2,508,697           |  |  |   |                     |                          | 2,508,697                |
| Undesignated                               | (2,352,084)         |  |  |   |                     |                          | (2,352,084)              |
| <b>Total fund balances (deficit)</b>       | <b>1,070,422</b>    | <b>709,502</b>                                 | <b>47,836</b>                                | <b>898,152</b>                                  | <b>1,238,867</b>    | <b>-</b>                 | <b>3,764,779</b>         |
| <b>Total liabilities and fund balances</b> | <b>\$ 3,129,356</b> | <b>\$ 1,098,002</b>                            | <b>\$ 641,168</b>                            | <b>\$ 1,460,330</b>                             | <b>\$ 1,241,104</b> | <b>\$ 103,973</b>        |                          |

Amounts reported for governmental activities in the statement of net assets are different because:

|   |                       |
|---|-----------------------|
| Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds                                  | 12,510,373            |
| Accrual basis of accounting account receivables used in governmental activities are not financial resources and, therefore, are not reported in the funds | 96,028                |
| Long-term liabilities and accrued interest are not due and payable in the current period, and therefore, are not reported in the funds                    | (18,590,319)          |
| <b>Net assets (deficit) of governmental activities</b>  | <b>\$ (2,219,139)</b> |

Commonwealth of Puerto Rico  
Municipality of Salinas  
Statement of Revenues, Expenditures and Changes in Fund Balances  
Governmental Funds  
For the Year Ended June 30, 2004

|   | General Fund        | Special Revenue Fund<br>Local and State Grants | Special Revenue Fund<br>Other Federal Grants | Capital Projects Fund<br>Local and State Grants | Debt Service Fund   | Other Governmental Funds | Total Governmental Funds |
|---|---------------------|--|--|---|---------------------|--------------------------|--------------------------|
| <b>Revenues</b>   |                     |  |  |   |                     |                          |                          |
| Property taxes  | \$ 5,723,034        | \$ -   | \$ -   | \$ -  | \$ 554,144          | \$ -                     | \$ 6,277,178             |
| Municipal license taxes                                   | 706,314             |  |  |   |                     |                          | 706,314                  |
| Licenses, permits and other local taxes                   | 1,120,776           |  |  |   |                     |                          | 1,120,776                |
| Charges for services                                      | 212,251             |  |  |   |                     |                          | 212,251                  |
| Intergovernmental   | 1,547,997           | 1,135,453                                      | 19,436                                       | 585,286   |                     | 16,112                   | 3,304,284                |
| Rent of property  | 21,446              | 50,395   |  |   |                     |                          | 71,841                   |
| Fines and forfeitures                                     | 515                 |  |  |   |                     |                          | 515                      |
| Interest  | 81,747              |  |  |   |                     |                          | 81,747                   |
| Federal grants  |                     |  | 1,748,982                                    |   |                     | 312,402                  | 2,061,384                |
| Miscellaneous   | 51,736              | 1,850  | 27,566                                       | 6,376   |                     |                          | 87,527                   |
| <b>Total revenues</b>                                     | <b>9,465,815</b>    | <b>1,187,698</b>                               | <b>1,795,984</b>                             | <b>591,662</b>                                  | <b>554,144</b>      | <b>328,514</b>           | <b>13,923,817</b>        |
| <b>Expenditures</b>                                       |                     |  |  |   |                     |                          |                          |
| Current:  |                     |  |  |   |                     |                          |                          |
| General government  | 4,115,372           |  |  |   |                     |                          | 4,115,372                |
| Public safety   | 571,323             | 72,967   | 32,554                                       |   |                     |                          | 676,844                  |
| Public works  | 2,808,099           | 250,677  | 23,024                                       | 599,909   |                     |                          | 3,681,709                |
| Health and welfare  | 1,210,252           | 239,722  | 391,297                                      |   |                     | 328,514                  | 2,169,785                |
| Culture and recreation                                    | 343,857             | 173,767  |  | 22,455  |                     |                          | 540,079                  |
| Economic development                                      |                     | 537,811  |  |   |                     |                          | 537,811                  |
| Community development                                     |                     |  | 1,344,947                                    | 2,053,623                                       |                     |                          | 3,398,570                |
| Urban development   |                     |  |  |   |                     |                          |                          |
| Education   | 32,012              |  |  |   |                     |                          | 32,012                   |
| Debt service:   |                     |  |  |   |                     |                          |                          |
| Principal   |                     |  |  |   | 442,750             |                          | 442,750                  |
| Interest  |                     |  |  |   | 326,316             |                          | 326,316                  |
| <b>Total expenditures</b>                                 | <b>9,080,915</b>    | <b>1,274,944</b>                               | <b>1,791,822</b>                             | <b>2,675,047</b>                                | <b>769,066</b>      | <b>328,514</b>           | <b>\$ 15,921,308</b>     |
| Excess (deficiency) of revenues over (under) expenditures | 384,900             | (87,246)                                       | 4,162  | (2,084,385)                                     | (214,922)           | -                        | (1,997,491)              |
| <b>Other financing sources (uses)</b>                     |                     |  |  |   |                     |                          |                          |
| Transfers in  | 38,963              | 307,080  |  | 735,055   | 302,243             |                          | 1,381,341                |
| Transfers out   | (869,388)           | (112,754)                                      | (18,979)                                     | (380,220)                                       |                     |                          | (1,381,341)              |
| Long-term debt issued                                     | 2,900,000           |  |  |   |                     |                          | 2,900,000                |
| <b>Total other financing sources (uses)</b>               | <b>2,067,575</b>    | <b>194,326</b>                                 | <b>(18,979)</b>                              | <b>354,835</b>                                  | <b>302,243</b>      | <b>-</b>                 | <b>2,900,000</b>         |
| <b>Net change in fund balance</b>                         | <b>2,452,475</b>    | <b>107,080</b>                                 | <b>(14,817)</b>                              | <b>(1,729,550)</b>                              | <b>87,321</b>       | <b>-</b>                 | <b>902,509</b>           |
| Fund balance (deficit), beginning, as restated            | (1,382,053)         | 602,422  | 62,653                                       | 2,427,702                                       | 1,151,548           |                          | 2,862,270                |
| <b>Fund balance (deficit), ending</b>                     | <b>\$ 1,070,422</b> | <b>\$ 709,502</b>                              | <b>\$ 47,836</b>                             | <b>\$ 698,152</b>                               | <b>\$ 1,238,867</b> | <b>\$ -</b>              | <b>\$ 3,764,779</b>      |

Commonwealth of Puerto Rico  
Municipality of Salinas  
Reconciliation of the Statement of Revenues,  
Expenditures, and Changes in Fund Balances of  
Governmental Funds to the Statement of Activities  
For the Year Ended June 30, 2004

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|  |    |             |
|--|----|-------------|
| Net Change in Fund Balances - Total Governmental Funds   | \$ | 902,509     |
| Amounts reported for governmental activities in the Statement of Activities are different because:   |    |             |
| Prior Year Accounts Receivable reported in the Governmental Fund Financial Statements as revenues, but reversed in the Government-Wide Statement of Activities and Changes in Net Assets.  |    | (247,540)   |
| Accounts Receivable reported in Government-Wide Statement of Net Assets collected after year end, but not available soon enough to pay current liabilities, and therefore are not reported in the Governmental Funds.  |    | 96,028      |
| Donations of Capital Assets from outside parties, do not provide current financial resources in Governmental Funds, but the transaction must be reflected in the Government-Wide Statement of Net Assets based on the fair value of the donated property.  |    | 2,882,177   |
| Governmental Funds report capital outlays as expenditures. However in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period.   |    | 3,229,408   |
| Depreciation Expense on Capital Assets is reported in the Government-Wide Statements of Activities and Change in Net Assets, but they do not require the use of current financial resources. Therefore, Depreciation expense is not reported as expenditures in Governmental Funds Financial Statements.   |    | (406,350)   |
| Interest Expense change is reported in the Government-Wide Statement of Activities and Change in Net Assets, but not require the use of current financial resources. Therefore, Interest expense change is not reported as expenditures in Governmental Funds Financial Statements.  |    | (14,279)    |
| Long Term Debt issuances are reported in the Government-Wide Statement of Net Assets, but not require the use of current financial resources. Therefore Long Term debt issuances are not reported as expenditures in Governmental Funds Financial Statements.  |    | (272,552)   |
| Long Term Debts payments are reported as expenditures in the Governmental Funds Financial Statements which require the use of current financial resources. Therefore Long Term debts payments are not reported as expenditures in the Government-Wide Statement of Activities and Change in Net Assets.  |    | 278,181     |
| Change in Landfill Accrual   |    | (152,416)   |
| Bonds proceeds provides current financial resources to Governmental Funds, but issuing debt increase long-term liabilities in the Government-Wide statement of Net Assets. Repayment of bond principal is an expenditure in Governmental Funds, but the repayment reduces long -term liabilities in the Government-Wide Statement of Net Assets. This is the amount by which the debt proceeds exceed debt service principal payments. |    | (2,457,250) |
| Change in Net Assets of Governmental Activities  | \$ | 3,837,916   |

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS**

**YEAR ENDED JUNE 30, 2004**

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**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The **Municipality of Salinas** (the Municipality) was founded on the year 1841. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a fourteen member Municipal Legislature who are elected for a four-year term.

The Municipality provides a full range of services for its citizens. These services include public safety, public works, culture and recreation, health and welfare, community development, education, and other miscellaneous services.

The accounting policies and financial reporting practices of the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units.

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements and Management's and Discussion and Analysis for State and Local Governments." This Statement, known as the Reporting Model, provides for the most significant change in financial reporting for state and local governments in over 20 years and affects the way the Municipality prepares and presents financial information. The Statement was adopted as of July 1, 2003. In addition to this Statement, GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Note Disclosures" have been adopted and are reflected in these financial statements.

As part of this Statement, there is a new reporting requirement regarding the capitalization of local government infrastructure (roads, bridges, traffic signals, etc.). This requirement permits an optional four-year delay for implementation to fiscal year ended on June 30, 2007. The Municipality has elected to delay the capitalization of infrastructure

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**A. Component Units**

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, The Financial Reporting Entity, of the GASB. The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary government appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

**B. Government-wide and fund financial statements**

Financial information of the Municipality is presented in this report as follow:

1. Management's discussion and analysis introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.
2. The government-wide financial statements (i.e. the statement of net assets and the statement of activities) report information on all the activities of the Municipality and its component units, if any. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-typed activities, if any, which rely to a significant extent on fees and charges for support. Interfund activity has been removed from these statements to minimize the duplicating effect on assets and liabilities within the governmental activities.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenue. Direct expenses are those that are charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

3. Fund financial statements focus on information about the Municipality's major governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The Municipality reports the following major governmental funds:

**General Fund**- is the accounting entity in which all governmental activity, except that which is required to be accounted for in another fund, is accounted for. Its revenues consist mainly of taxes, licenses and permits, intergovernmental revenue, charges for services and other.

**Special Revenue Fund – Local and State Grants**- is the accounting entity in which revenues derived from local funds, state or other restricted revenue source is accounted for the uses and limitations specified by Municipality ordinances or state statutes.

**Special Revenue Fund – Other Federal Grants**- is the accounting entity in which revenues derived from federal grants, is accounted for. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

**Capital Projects Fund – Local and State Grants** - is the accounting entity in which revenues derived from local funds and state grants or other restricted revenue sources related to capital projects, is accounted for. The uses and limitations of each capital project fund are specified by Municipality ordinances or federal and state statutes.

**Debt Service Fund** - is the accounting entity used to account for the resources accumulated and payments made for principal and interest on long-term general obligation bonds of governmental funds.

4. The notes to the financial statements provide information that is essential to a user's understanding of the basic financial statements.
5. Required supplementary information such as the budgetary comparison schedule-general fund and other types of data required by GASB.
6. Notes to the budgetary comparison schedule-general fund.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Financial reporting presentation

The accounts of the Municipality are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Fund types are as follows:

**General Fund-** General Fund is the general operating fund of the Municipality. It is used to account for all governmental activity, except those required to be accounted for in another fund.

**Special Revenue Fund – State and Local Grants -** Special Revenue Funds are used to account for revenues derived from local funds, state grants or other restricted revenue sources. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

**Special Revenue Fund – Section 8 Housing Choice Voucher -** Special Revenue Funds are used to account for revenues derived from section 8 choice voucher program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

**Special Revenue Fund – Other Federal Grants -** Special Revenue Funds are used to account for revenues derived from federal grants. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

**Capital Projects Funds – Local, State and Federal Grants -** Capital Project Funds are used to account for financial resources used for the acquisition or construction of major capital facilities.

**Debt Service Funds-** Debt Service Funds are used to account for the accumulation of resources for and the payment of, general long-term debt principal, interest, and related costs.

D. Measurement focus, basis of accounting and financial presentation

Except for budgetary purposes, the basis of accounting used by the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The Municipality has elected not to apply all Statements and Interpretations issued by the Financial Accounting Standard Board after November 30, 1989, in accordance with GASB Statement No.20.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within the current period or soon enough thereafter. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditure in governmental funds. Proceeds from issuance of general long-term debt reported as other financing sources.

Property taxes, franchise taxes, licenses, rent, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when the government receives cash.

Private-sector standards of accounting and financial reporting issue prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Municipality has elected not to follow subsequent private-sector guidance.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants, and contributions, and 3) capital grants and contributions, including special assessments, if any. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

When both restricted and unrestricted resources are available for use, it is the government's policy to use restricted resources first, then unrestricted resources, as they are needed.

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**E. Assets, liabilities and net assets**

- 1. Cash, cash equivalents, and cash with fiscal agent-** The Municipality's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

Cash with fiscal agent in the debt services fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

- 2. Receivables and payables-** Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds."

Advances between funds, as reported in the fund financial statements, if any, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivables in the General Fund represents mostly contributions from the Puerto Rico Electric Power Authority (PREPA), which, pays the municipalities as contributions in lieu of taxes greater of the following amounts:

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

(a) twenty percent (20%) of its net revenues as defined in the Trust Indenture signed with the Trustee as representative of the bondholders, adjusted by subsidies granted by the PREPA; (b) an amount equal to the actual cost of electric power consumed by each Municipality in its common facilities during the current year; or (c) an average of the contribution in lieu of taxes paid by PREPA to each municipality during the past five fiscal years. The contribution in lieu of tax revenue and related receivable recorded in the General Fund for the current fiscal year was determined based on the preliminary liquidation made by the PREPA. Such liquidation is subject to final results of the PREPA financial statements audit. Intergovernmental receivable in the special revenue or capital project funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded or state funded programs.

- 3. Inventories-** Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net assets.
- 4. Capital assets-** Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than \$25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

Capital assets of the Municipality are depreciated using the straight-line method over the following estimated useful lives:

| <u>Description</u>              | <u>Useful Life</u> | <u>Capitalization threshold</u> |
|---------------------------------|--------------------|---------------------------------|
| Buildings and site improvements | 40 years           | \$1                             |
| Infrastructure                  | 40 years           | \$1                             |
| Works of art                    | 10 years           | \$1                             |
| Vehicles                        | 5 years            | \$1                             |
| Furniture and fixtures          | 5 years            | \$25                            |
| Machinery and equipment         | 3 to 5 years       | \$25                            |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

- 5. Long-term obligations-** The liabilities reported in the government-wide financial statements include to general and special obligation bonds and notes, and other long-term liabilities, such as vacation, sick leave, litigation, long-term liabilities to other governmental entities.

In the fund financial statements, governmental fund types recognize bond issuances cost, during the current period. The face amount of debt issued is reported as other financing sources, while bond issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

- 6. Compensated absences-** Employees accumulate vacation leave at a rate of 2.5 days per month up to a maximum of 60 days. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. All vacation pay it is accrued when incurred in the government-wide financial statements.

Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Municipality.

- 7. Claims and judgments-** The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund.

- 8. Reservation of fund balance-** Reservations of fund balance in the fund financial statements, represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

- a. **Capital Projects-** Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
- b. **Encumbrances-** Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.
- c. **Other Purposes-** Represents net assets available for specific use and/or legally segregated for other specific future use.
- d. **Debt Service Fund-** Represents net assets available to finance future debt service payments.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**9. Interfund and intra-entity transactions-** The Municipality has the following types of transactions among funds:

- a. **Operating Transfers-** Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.
- b. **Intra-Entity Transactions-** Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.

**10. Risk financing-** The Municipality carries commercial insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the Municipalities of Puerto Rico.

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the CRIM for the year ended June 30, 2004 amounted to approximately \$142,970. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$172,381 for workers compensation insurance covering all municipal employees.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

**11. Reconciliation of Government-wide and Fund Financial Statements**

The governmental fund balance sheet includes reconciliation between fund balance-total governmental funds and net assets-governmental activities as reported in the government-wide statement of net assets. The two elements of that reconciliation explains that "long term liabilities, including compensated absences, bonds and notes payable, are not due and payable in the current period and therefore are not reported in the funds.", and that "capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. The details of this reconciliation are as follows:

|  |                    | <u>Total Net Assets -<br/>Governmental Activities</u> |
|--|--------------------|---|
| <b><u>Net assets invested in capital assets, net of related debt</u></b> |                    |   |
| Capital assets, net of depreciation                                      | \$12,510,373       |   |
| Deduct:  |                    |   |
| Bonds Payable, related to capital assets                                 | (2,096,879)        |   |
| Notes Payable, related to capital assets                                 | <u>(550,000)</u>   |   |
|  |                    | \$9,863,494   |
| <b><u>Net assets restricted for capital projects</u></b>                 |                    |   |
| Fund balance restricted for capital projects                             |                    | \$ 698,152  |
| <b><u>Net assets restricted for debt service</u></b>                     |                    |   |
| Fund balance restricted for debt service                                 | \$ 1,238,867       |   |
| Deduct:  |                    |   |
| Interest payable   | <u>(104,963)</u>   | 1,133,904   |
| <b><u>Net assets restricted for other purposes</u></b>                   |                    |   |
| Funds balance restricted for other purposes                              |                    | \$3,266,035   |
| <b><u>Net assets unrestricted (deficit)</u></b>                          |                    |   |
| General fund - total deficit:  | \$ 1,070,422       |   |
| Fund balance restricted for specific purposes                            | (2,508,697)        |   |
| Add:   |                    |   |
| Accrual Basis account receivables  | 96,028             |   |
| Deduct:  |                    |   |
| Bond Payables related to operational debts                               | (6,090,000)        |   |
| Compensated absences debt  | (755,273)          |   |
| Landfill Obligation  | (3,883,863)        |   |
| CRIM - Property Tax Payable  | (167,386)          |   |
| CRIM Law 42  | (974,023)          |   |
| Aqueduct and Sewer Authority   | (220,000)          |   |
| CRIM Law 146   | (872,137)          |   |
| Claims and judgments debt  | <u>(2,875,795)</u> | <u>(17,180,724)</u>                                   |
| <b>Total net assets - governmental activities</b>                        |                    | <b><u>(\$2,219,139)</u></b>                           |

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**2. DEPOSITS**

Under Puerto Rico statutes public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The Municipality's bank balances in commercial banks of approximately \$12,362, \$652,229, \$253,145 and \$233,746, in the general fund, special revenue fund – local and state grants, special revenue fund – other federal grants, capital project fund – local and state grants, respectively, were fully collateralized at June 30, 2004. In the other governmental funds there were deposits with commercial banks of approximately \$103,973, which were fully collateralized.

The deposits at GDB of approximately \$2,508,697, that is restricted principally for restricted purpose in the general fund, the \$2,202 that is restricted principally for specific purpose in the special revenue fund-other federal grants, the \$541,885 that is restricted principally for capital projects in the capital project fund – local and state grant, and the \$1,204,602 in the debt service fund are unsecured and collateralized, as no collateral is required to be carried by governmental banks.

**3. RECEIVABLES**

**A. *Municipal License Tax***- The Municipality imposes a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Act of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 24 of each year. Entities with sales volume of \$1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2004, the tax rates were as follows:

1. Financial business- 1.50% of gross revenues
2. Other organizations- 0.50% of gross revenues

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**3. RECEIVABLES (CONTINUED)**

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 24. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2004, net of allowance for uncollectibles.

Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year are recorded as deferred revenues.

- B. Intergovernmental Receivables-** Intergovernmental receivables in the general fund principally consist of the amounts due from the Puerto Rico Electric Power Authority ("PREPA") resulting from the revenues the Municipality is entitled to receive in lieu of payment of taxes, and the amounts due from the Municipal Revenue Collection Center ("CRIM") of the Commonwealth of Puerto Rico resulting from the excess of current year property tax collections over current year advances. The amounts receivable from governmental entities are as follows:

| <u>Governmental Entity</u>                     | <u>Amount</u>           |
|--|-------------------------|
| Puerto Rico Electric Power Authority ("PREPA") | \$ 30,919               |
| Municipal Revenue Collection Center ("CRIM")   | <u>19,480</u>           |
| <b>Total</b>                                   | <b><u>\$ 50,399</u></b> |

On September 7, 2004, Act Num. 255 was enacted and a new formula as described in Note 1 (E) (2), was established for the calculation of the contribution in lieu of taxes to be paid to the municipalities by PREPA. Since the final liquidation following such formula was not available for fiscal year 2003-2004, the PREPA issued a preliminary liquidation, which could be affected by final results of the PREPA financial statements audit.

Intergovernmental receivable in special revenue fund – local and state grants, represent expenditures incurred not yet reimbursed by the local government. Following is a detail of the intergovernmental receivable:

| <u>Program Description</u> | <u>Amount</u>            |
|----------------------------|--------------------------|
| Department of Labor        | \$ 287,812               |
| "Consortio Sur Central"    | <u>60,467</u>            |
| <b>Total</b>               | <b><u>\$ 348,279</u></b> |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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3. RECEIVABLES (CONTINUED)

Federal grant receivable in the special revenue fund – other federal grants represent expenditures incurred not yet reimbursed by the Federal government. Following is a detail of the federal grants receivables:

| <u>Program Description</u>                           | <u>Amount</u>            |
|--|--------------------------|
| Community Development Block Grant/Entitlement Grants | \$ 367,007               |
| Child Care Development Block Grant Program           | 18,580                   |
| Other  | <u>234</u>               |
| <b>Total</b>   | <b><u>\$ 385,821</u></b> |

Intergovernmental receivable in the debt service fund represent property tax receivable. Following is a detail of the intergovernmental receivable:

| <u>Program Description</u>                   | <u>Amount</u>           |
|--|-------------------------|
| Municipal Revenue Collection Center ("CRIM") | <u>\$ 35,731</u>        |
| <b>Total</b>                                 | <b><u>\$ 35,731</u></b> |

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

**4. INTERFUND TRANSACTIONS**

Interfund receivables and payables at June 30, 2004, and interfund transfers during the fiscal year ended at June 30, 2004, are summarized as follows:

**a. Due from/to other fund:**

| <u>Receivable Fund</u>                           | <u>Payable Fund</u>                              | <u>Purpose</u>  | <u>Amount</u>              |
|--|--|---|----------------------------|
| General Fund                                     | Special Revenue Fund -<br>Other Federal Grants   | Payroll and related accruals<br>paid and not reimbursed | \$ 119,183                 |
| General Fund                                     | Other Governmental funds                         | Payroll and related accruals<br>paid and not reimbursed | 9,770                      |
| General Fund                                     | Debt Service Fund                                | Interest Revenue  | 2,237                      |
| General Fund                                     | Special Revenue Fund -<br>Local and State grants | Payroll and related accruals<br>paid and not reimbursed | 325,642                    |
| General Fund                                     | Capital Project Fund-Local<br>and State grants   | Loan to finance capital<br>project activities           | 26,909                     |
| Capital Project Fund -<br>Local and State grants | General Fund                                     | Cash pool in the same<br>bank account                   | 606,713                    |
| Capital Project Fund -<br>Local and State grants | General Fund                                     | Loan for operating<br>purposes                          | <u>175,480</u>             |
| <b>Total</b>                                     |  |   | <b><u>\$ 1,265,934</u></b> |

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

**4. INTERFUND TRANSACTIONS (CONTINUED)**

**b. Transfer in/out to other fund**

| <u>Transfer out</u>                              | <u>Transfer in</u>                               | <u>Purpose</u>                                      | <u>Amount</u>              |
|--|--|---|----------------------------|
| General Fund                                     | Debt Service Fund                                | Debt Retirement                                     | \$ 302,243                 |
| General Fund                                     | Special Revenue Fund –<br>Local and State grants | Transfer for culture and<br>recreational activities | 147,080                    |
| General Fund                                     | Capital Project Fund-Local<br>and State grants   | Contribution for capital<br>asset acquisition       | 420,065                    |
| Special Revenue Fund-<br>Local and State grants  | Capital Project Fund-Local<br>and State grants   | Contribution for capital<br>asset acquisition       | 75,791                     |
| Special Revenue Fund-<br>Local and State grants  | General Fund                                     | Reimbursement of<br>Expenditures                    | 36,963                     |
| Special Revenue Fund –<br>Other Federal grants   | Capital Project Fund-Local<br>and State grants   | Contribution for capital<br>asset acquisition       | 18,979                     |
| Capital Project Fund –<br>Local and State grants | Capital Project Fund-Local<br>and State grants   | Contribution for capital<br>asset acquisition       | <u>380,220</u>             |
| <b>Total</b>                                     |  |   | <b><u>\$ 1,381,341</u></b> |

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

**5. CAPITAL ASSETS**

Capital assets; those with an estimated useful life of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2004, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

| <b>Governmental Activities:</b>                    | <b>Balance<br/>July 1, 2003<br/>as Restated</b> | <b>Additions</b>    | <b>Retirements</b> | <b>Balance<br/>June 30, 2004</b> |
|--|---|---------------------|--------------------|----------------------------------|
| <b>Capital asset, not being depreciated:</b>       |   |                     |                    |                                  |
| Land   | \$ 1,542,707                                    | \$ 1,899,662        | (\$115,970)        | \$ 3,326,399                     |
| Construction in progress                           | <u>1,972,835</u>                                | <u>2,882,178</u>    |                    | <u>4,855,013</u>                 |
| <b>Total capital assets not being depreciated</b>  | <u>3,515,542</u>                                | <u>4,781,840</u>    | <u>(115,970)</u>   | <u>8,181,412</u>                 |
| <b>Capital assets, being depreciated:</b>          |   |                     |                    |                                  |
| Buildings  | 3,333,987                                       | 331,500             |                    | 3,665,487                        |
| Buildings improvements                             | 305,197   | 280,972             |                    | 586,169                          |
| Infrastructure                                     | 259,332   | 39,827              |                    | 299,159                          |
| Infrastructure improvements                        |   | 409,078             |                    | 409,078                          |
| Equipment  | 435,200   | 96,568              |                    | 531,768                          |
| Furnishing   | 248,548   | 7,614               |                    | 256,162                          |
| Work of Arts                                       | 7,306   |                     |                    | 7,306                            |
| Computers  | 63,991  | 19,663              |                    | 83,654                           |
| Vehicles   | <u>1,573,594</u>                                | <u>260,494</u>      |                    | <u>1,834,088</u>                 |
| <b>Total capital assets being depreciated</b>      | <u>6,227,155</u>                                | <u>1,445,716</u>    |                    | <u>7,672,871</u>                 |
| <b>Less accumulated depreciation for:</b>          |   |                     |                    |                                  |
| Buildings  | (1,521,094)                                     | (83,350)            |                    | (1,604,444)                      |
| Buildings improvements                             | (6,251)   | (12,713)            |                    | (18,964)                         |
| Infrastructure                                     | (30,340)  | (6,956)             |                    | (37,296)                         |
| Infrastructure improvements                        |   | (9,332)             |                    | (9,332)                          |
| Equipment  | (236,133)                                       | (72,347)            |                    | (308,480)                        |
| Furnishing   | (201,543)                                       | (16,047)            |                    | (217,590)                        |
| Computers  | (44,831)  | (14,096)            |                    | (58,927)                         |
| Work of Arts                                       | (1,212)   | (731)               |                    | (1,943)                          |
| Vehicles   | <u>(896,156)</u>                                | <u>(190,778)</u>    |                    | <u>(1,086,934)</u>               |
| <b>Total accumulated depreciation</b>              | <u>(2,937,560)</u>                              | <u>(406,350)</u>    |                    | <u>(3,343,910)</u>               |
| <b>Total capital assets being depreciated, net</b> | <u>3,289,595</u>                                | <u>1,039,366</u>    |                    | <u>4,328,961</u>                 |
| <b>Governmental activities capital assets, net</b> | <u>\$ 6,805,137</u>                             | <u>\$ 5,821,206</u> | <u>(\$115,970)</u> | <u>\$12,510,373</u>              |

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**5. CAPITAL ASSETS (CONTINUED)**

Depreciation expense was charged to functions/programs of the Municipality as follows:

**Governmental activities:**

|                        |            |
|------------------------|------------|
| General government     | \$ 144,773 |
| Public safety          | 44,044     |
| Public works           | 165,188    |
| Culture and recreation | 9,688      |
| Health and welfare     | 17,440     |
| Community development  | 25,175     |
| Education              | <u>42</u>  |

**Total depreciation expense-governmental activities** **\$ 406,350**

**6. PROPERTY TAXES**

The personal property tax is self assessed by the taxpayer on a return which is to be filed by May 15 of each year with the CRIM, a governmental entity created by the government of Puerto Rico as part of the Municipal Governmental Autonomous Law of August 1991. Real property tax is assessed by the CRIM on each piece of real estate and on each building.

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July 1 and January 1. The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collect for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**6. PROPERTY TAXES (CONTINUED)**

On December 31, 1992 the Municipality entered into an agreement with the Commonwealth of Puerto Rico for the repayment of excess property tax advances. As of June 30, 2004, the related unpaid property tax advances presented in the statement of net assets amounted to approximately \$167,385 and is payable as follows:

| <u>Year Ending<br/>June 30,</u> | <u>Amount</u>            |
|---------------------------------|--------------------------|
| 2005                            | \$ 27,898                |
| 2006                            | 27,898                   |
| 2007                            | 27,898                   |
| 2008                            | 27,898                   |
| 2009                            | 27,898                   |
| 2010                            | <u>27,895</u>            |
| <b>Total</b>                    | <b><u>\$ 167,385</u></b> |

On January 26, 2000, Public Law 42 was enacted which authorized the CRIM to obtain a loan up to \$200,000,000, and for a term not to exceeding 10 years, to allow for the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections through fiscal year ended June 30, 2000. The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law 238, enacted on August 15, 1999. On October 11, 2001, Public Law 146 was enacted to amend Public Law 42, to extend the loan amortization period up to 30 years. Also, on October 11, 2002, Public Law 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law 42 enacted on January 26, 2000.

On June 26 1997, Public Law Num. 21 was enacted authorizing the CRIM, among other things, to sell the property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. Such property tax receivables were purchased by the Public Financing Corporation, a subsidiary of the Government Development Bank of Puerto Rico (GDB) using the proceeds of a bond issuance executed for such purposes. Said Law imposed the CRIM the obligation to replace uncollectible property tax receivables with any valid property tax receivable or equivalent in money.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**6. PROPERTY TAXES (CONTINUED)**

Subsequent to the approval of the Law and to the sale transaction, it was detected that a substantial percentage of the receivables sold were uncollectible. In order to protect the economic damage to the financial structure of municipalities caused by the substitution of uncollectible tax receivables with sound collectible receivables, on October 11, 2001, Public Law 146 was approved and enacted.

Through this Law, the CRIM was authorized to obtain a loan from any qualified financial institution and pay in advance the outstanding balance of the bonds issued and any related cost incurred for the purchase by the Public Financing Corporation (a GDB subsidiary) of the tax receivables. The loan is being paid by the municipalities thru a 30 year long term financing negotiated by the CRIM with GDB on behalf of such municipalities as authorized by the indicated Law.

The Government-Wide Statement of Net Assets includes an outstanding debt balance of \$974,022 and \$872,137 related to Law 42 and Law 146 respectively.

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$ 15,000 of the assessed value. For such exempted amounts, the Puerto Rico Treasury Department assumes payment of the basic tax to the Municipalities, except for property assessed at less than \$ 3,500 for which no payment is made. As part of the Municipal Autonomous Law of 1991, the exempt amount to be paid by the Puerto Rico Treasury Department to the Municipalities was frozen as of January 1, 1992. In addition, the law grants a tax exemption from the payment of personal property taxes of up to \$ 50,000 of the assessed value to retailers having annual net sales of less than \$ 150,000.

The annual tax rate is 8.33% for real property and 6.33% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 5.8% and 3.8%, respectively, represents the Municipality's basic property tax rate which is appropriated for basics and accounted for in the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 1.50% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

**7. DUE TO OTHER GOVERNMENTAL ENTITIES:**

The amounts due to other governmental entities in the General Fund include the following:

| <u>Governmental Entity</u>                  | <u>Amount</u>     |
|---|-------------------|
| Department of Labor - Chauffeur's Insurance | \$1,030           |
| General Services Administration             | 54,113            |
| Department of Labor - Unemployment          | 14,312            |
| Department of Treasury                      | 87,905            |
| State Insurance Fund Corporation            | 41,272            |
| Retirement System Administration            | 58,985            |
| Internal Revenue Service                    | 4,007             |
| Puerto Rico Aqueduct and Sewer Authority    | <u>15,081</u>     |
| Total                                       | <u>\$ 276,705</u> |

**8. DEFERRED REVENUES**

**A. Municipal License Tax-** The deferred revenues of approximately \$451,421 in the general fund relates to municipal license tax collected in fiscal year 2003-04 that will be earned in fiscal year 2004-05.

**B. Federal Government-** The deferred revenues presented in other governmental funds represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

| <u>Program Description</u>                    | <u>Amount</u>     |
|---|-------------------|
| Section 8 Housing Choice Voucher Program      | \$ 94,203         |
| Community Services Block Grant- State program | 44,537            |
| Juvenile Justice and Delinquency Prevention   | 64                |
| Emergency Management Assistance               | 18,568            |
| Special Program for the aging - Title III     | 19,960            |
| Nutrition Service- Justice Department         | 78,579            |
| Urban Development Action plan                 | 10,618            |
| Others  | <u>6,128</u>      |
| Total   | <u>\$ 272,657</u> |

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

**9. LONG-TERM LIABILITIES**

Long-term liability activity for the year ended June 30, 2004, was as follows:

| <u>Description</u>                              | <u>Beginning<br/>Balance</u> | <u>Borrowings<br/>or Additions</u> | <u>Payments or<br/>Deductions</u> | <u>Ending<br/>Balance</u>  | <u>Due Within<br/>One Year</u> |
|---|------------------------------|------------------------------------|-----------------------------------|----------------------------|--------------------------------|
| Bonds Payable                                   | \$5,614,629                  | \$2,900,000                        | (\$327,750)                       | \$8,186,879                | \$383,500                      |
| Notes Payable                                   | 665,000                      |                                    | (115,000)                         | 550,000                    | 125,000                        |
| Income Tax - Treasury<br>Department             | 93,153                       |                                    | (93,153)                          | -                          | -                              |
| Property Tax Debt - CRIM<br>Department of labor | 195,283                      |                                    | (27,898)                          | 167,385                    | 27,898                         |
| Compensated Absences                            | 749,529                      | 5,744                              |                                   | 755,273                    | 58,000                         |
| Landfill obligation                             | 4,466,972                    | 152,416                            | (735,525)                         | 3,883,863                  |                                |
| CRIM Debt-Law42                                 | 1,059,555                    |                                    | (85,532)                          | 974,023                    | 85,532                         |
| CRIM Debt-Law 146                               | 872,137                      |                                    |                                   | 872,137                    |                                |
| Puerto Rico Aqueduct and<br>Sewer Company       | 270,000                      |                                    | (50,000)                          | 220,000                    | 70,000                         |
| Claims and judgments                            | <u>2,630,587</u>             | <u>266,408</u>                     | <u>(21,599)</u>                   | <u>2,875,396</u>           | <u>          </u>              |
| <b>Total</b>                                    | <b><u>\$16,616,845</u></b>   | <b><u>\$3,324,568</u></b>          | <b><u>\$(1,456,457)</u></b>       | <b><u>\$18,484,956</u></b> | <b><u>\$749,930</u></b>        |

1. **Legal debt margin-** The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment of property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds and notes payable (excluding notes payable to the Land Authority), is paid with unrestricted funds.
  
2. **Bonds payable-** The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities. During the current year, the Municipality issued bonds for approximately \$1,495,000. Bonds payable outstanding at June 30, 2004 are as follows:

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

**9. LONG-TERM LIABILITIES (CONTINUED)**

| <u>Type of bonds</u>               | <u>Maturity<br/>Date</u> | <u>Original<br/>Amount</u> | <u>Range of<br/>Interest Rates</u> | <u>Balance at<br/>June 30, 2004</u> |
|------------------------------------|--------------------------|----------------------------|------------------------------------|-------------------------------------|
| 1982-Series                        | 1-1-2008                 | 600,000                    | 5.00%                              | \$ 153,000                          |
| 1985-Series                        | 1-1-2010                 | 1,092,000                  | 6.00%                              | 468,879                             |
| 1992-Series                        | 10-1-2012                | 2,300,000                  | 5.00% to 8.25%                     | 1,360,000                           |
| 1997-Series                        | 7-1-2017                 | 2,240,000                  | 5.00% to 8.00%                     | 1,850,000                           |
| 2002-Series                        | 7-1-2027                 | 1,495,000                  | 5.00% to 6.50%                     | 1,475,000                           |
| 2003-Serie                         | 7-1-2029                 | 1,710,000                  | 6.00%                              | 1,710,000                           |
| 2003-Serie                         | 7-1-2028                 | 385,000                    | 6.50%                              | 380,000                             |
| 2003-Serie                         | 7-1-2028                 | 805,000                    | 6.00%                              | <u>790,000</u>                      |
| <br>Total general obligation bonds |                          |                            |                                    | <br><u>\$8,186,879</u>              |

These bonds, except the 1992 Series bond and 2003 Series bond for \$385,000 and 805,000, are payable from the ad valorem property tax of 1.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

Annual debt service requirements to maturity for bonds payable are as follows:

| <u>Year Ending<br/>June 30,</u> | <u>Principal</u>          | <u>Interest</u>           |
|---------------------------------|---------------------------|---------------------------|
| 2005                            | \$ 383,500                | \$ 382,848                |
| 2006                            | 416,750                   | 532,859                   |
| 2007                            | 441,500                   | 502,536                   |
| 2008                            | 472,500                   | 470,093                   |
| 2009                            | 458,500                   | 435,586                   |
| 2010-2014                       | 2,009,129                 | 1,664,747                 |
| 2015-2019                       | 1,560,000                 | 1,027,225                 |
| 2020-2024                       | 1,135,000                 | 606,510                   |
| 2025-2029                       | <u>1,310,000</u>          | <u>205,525</u>            |
| <b>Total</b>                    | <b><u>\$8,186,879</u></b> | <b><u>\$5,827,929</u></b> |

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

**9. LONG-TERM LIABILITIES (CONTINUED)**

**3. Notes Payable-** The proceeds of the issuance of notes payables were used principally to pay debt incurred in prior years and to cover the expenditures of a special event. The notes are payable as follows:

| <u>Type of notes</u>       | <u>Maturity<br/>Date</u> | <u>Original<br/>Amount</u> | <u>Range of<br/>Interest rates</u> | <u>Balance at<br/>June 30, 2004</u> |
|----------------------------|--------------------------|----------------------------|------------------------------------|-------------------------------------|
| 2002-Series                | 7-1-2007                 | \$395,000                  | 5.00% to 3.54%                     | \$ 280,000                          |
| 2002-Series                | 7-1-2008                 | 370,000                    | 5.00% to 7.00%                     | <u>270,000</u>                      |
| <b>Total notes payable</b> |                          |                            |                                    | <b><u>\$ 550,000</u></b>            |

These notes except 2002 Series for \$370,000, are payable from the ad valorem property tax of 1.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

Annual debt service requirements to maturity for notes payable are as follows:

| <u>Year Ending<br/>June 30,</u> | <u>Principal</u>        | <u>Interest</u>        |
|---------------------------------|-------------------------|------------------------|
| 2005                            | \$125,000               | 24,035                 |
| 2006                            | 135,000                 | 20,614                 |
| 2007                            | 140,000                 | 13,929                 |
| 2008                            | <u>150,000</u>          | <u>6,577</u>           |
| <b>Total</b>                    | <b><u>\$550,000</u></b> | <b><u>\$65,155</u></b> |

**4. Property Tax Debt-** These amounts represent the balance owed to the Treasury Department and to the Municipal Revenue Collection Center (CRIM) at June 30, 2004, as described in Note 6, from property tax advances in excess of actual collections and other property tax debts.

**5. Compensated absences-** The government-wide statement of net assets includes approximately \$279,051 of accrued sick leave benefits, and approximately \$476,222 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**9. LONG-TERM LIABILITIES (CONTINUED)**

6. **Landfill obligation-** State and federal laws and regulations require the Municipality to place a final cover on its landfill site when closed and perform certain maintenance and monitoring functions at the landfill site for 30 years after closure. In accordance with Statement No. 18 of the GASB, "Accounting for Municipal Solid Waste Landfill Closure and Post Closure Care Costs", the Municipality has performed a study of the activities that need to be implemented at the Municipality's landfill to guarantee the maximum yield of available space. In addition to operating expenses related to the current activities of the landfill, an expense provision and related liability are being recognized based on the future closure and post-closure care cost that will be incurred near or after the date the landfill no longer accepts waste. The recognition of these landfill closure and post-closure care costs is based on the amount of landfill used during the year. The estimated liability for landfill closure and post-closure care costs has a balance of \$3,883,863 as of June 30, 2004 reported in the Government -Wide Financial Statements, which is based on 78% usage (filled) of the landfill. It is estimated that an additional \$1,085,197 will be recognized as closure and post-closure care expenses between the date of the balance sheet and the date the landfill is expected to be filled to capacity (2006). The estimated total current cost of the landfill closure and post-closure care (\$4,969,060) is based on the amount that would be paid if all equipment, facilities and services required to close, monitor, and maintain the landfill were acquired as of June 30, 2004. However, the actual cost of closure and post-closure care may be higher due to inflation, changes in technology, or changes in landfill laws and regulations. The private administrator of the landfill of the Municipality of Salinas will finance closing and post-closing costs up to the amount of \$1,250,000.
  
7. **Due to Agencies -** The municipality signed a debt agreement with Puerto Rico Aqueducts and Sewer Authority for five year period ending in December, 2007 to liquidate a debt amounting to \$290,000 with a monthly payment of \$5,000. At June 30 2004 the debt balance amounted to \$220,000.

**10. PENSION PLAN**

The Employee's Retirement System of the Commonwealth and its Instrumentalities (the Retirement System) is a cost-sharing multiple defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of the Municipality under 55 years of age at the date of employment become members of the Retirement System as a condition to their employment.

The Retirement System provides retirement, death and disability benefits pursuant to legislation enacted by the Commonwealth's legislature. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after ten years of plan participation.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**10. PENSION PLAN (CONTINUED)**

Members who have attained 55 years of age and have completed at least 25 years of creditable service or members who have attained 58 years of age and have completed ten years of creditable service are entitled to an annual benefit payable monthly for life.

The amount of the annuity shall be one and one-half percent of the average compensation, as defined, multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than \$200 per month.

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive 65 percent of the average compensation, as defined; otherwise they will receive 75 percent of the average compensation, as defined. No benefits are payable if the participant receives a refund of his/her accumulated contributions.

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$ 550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total employee and employer contributions during the year ended June 30, 2003 amounted to approximately \$241,098 and \$270,234, respectively.

On September 24, 1999, an amendment to Act. No. 447 of May 15, 1951, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employee's participation in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining the Municipality on or after January 1, 2000, will only be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS together with those of the current defined benefit plan. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% to the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

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**10. PENSION PLAN (CONTINUED)**

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2004, a copy of which can be obtained from the Retirement System, Minillas Station, P.O. Box 42003, San Juan, PR 00940-2003.

**11. RISK MANAGEMENT**

The Finance Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Finance Department Division compiles the information of all property owned and its respective market value. After evaluating this information, the Finance Department Division submits the data regarding the Municipality's properties to the Public Insurance Department at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities.

**12. CONTINGENCIES**

The Municipality is a defendant in a number of lawsuits arising principally from claims against the Municipality for alleged improper actions, and other legal matters that arise in the ordinary course of the Municipality's activities.

With respect to pending and threatened litigation, the Municipality has reported liabilities of approximately \$2,875,396 for awarded and anticipated unfavorable judgments. This amount was included in the financial statements and represents the amount estimated as probable liability or a liability with a fixed or expected due date, which will require future available financial resources for its payment.

It is management's opinion, based on the advice of the legal counsel, that the potential claims against the Municipality not covered by insurance will not materially affect the financial resources for its payment.

The Municipality participates in a number of federal financial assistance programs funded by the Federal Government. Expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. The amount, if any, of expenditures which may be disallowed by such audits cannot be determined at this time, although the Municipality management expects such amounts, if any, will not be material.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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**13. BEGINNING FUND BALANCES RESTATEMENT:**

The beginning Fund Balance (Deficit) for General Fund has been restated by \$60,833 to properly presents the previously reported fund balance at June 30, 2003. The restatement is mainly due to the correction of interfund balance and adjustments to due to agencies balances.

The beginning Fund Balance for Special Revenue Fund Local and State Grants has been restated by \$37490 to properly present the previously reported fund balances at June 30, 2003. The restatement is mainly due to the reclassification of funds to the general fund..

The beginning Fund Balance for Special Revenue Fund- Other Federal Grants has been restated by \$62,653 to properly presents the previously reported fund balances at June 30, 2003. The restatement is mainly due to the reclassification of funds to the Special Revenue Fund Local and State Grants.

The beginning Fund Balance for Capital Projects Fund- Local and States Grants has been restated by \$100,000 to properly present the previously reported fund balances at June 30, 2003. The restatement is mainly due to the elimination of a due to general fund.

The beginning Fund Balance for Debt Service Fund has been restated by \$71,098 to properly presents the previously reported fund balances at June 30, 2003. The restatement is mainly due to the recognition of the amount due from CRIM related to the Final Liquidation of the fiscal year 2002-2003.

The beginning Governmental Activities Net Assets has been restated by approximately \$6,031,699 to properly present the previously reported net assets at June 30, 2003. . The restatement is mainly due to fund balances restatement described above, the recognition of bond and notes accrued interest as of the beginning of the current fiscal year, and adjustment to beginning capital assets and long-term debt balances.

**14. SUBSEQUENT EVENTS**

On September 7, 2004, Public Law 255 was enacted amending Public Law 83 of May 2, 1941, as amended. In addition to the new formula established for the calculation of the contribution in lieu of taxes as described in Note 1 (E) (2), applicable on fiscal year 2002-2003 and each subsequent fiscal year, the Law provides for quarterly revisions to be prepared by PREPA of its estimates corresponding to the contribution in lieu of taxes for the current fiscal year.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**BUDGETARY COMPARISON SCHEDULE- GENERAL FUND  
(SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)  
YEAR ENDED JUNE 30, 2004**

|   | <u>Budgeted Amounts</u> |                   | Actual Amounts<br>(Budgetary Basis)<br>(See Note 1) | Variance with<br>Final Budget<br>Positive<br>(Negative) |
|---|-------------------------|-------------------|---|---|
|   | Original                | Final             |   |   |
| <b>REVENUES:</b>  |                         |                   |   |   |
| Property taxes  | \$5,346,943             | \$5,675,312       | \$5,750,318   | \$75,006  |
| Municipal license tax   | 925,000                 | 925,000           | 737,656   | (187,344)   |
| Licenses, permits and other local taxes   | 1,353,500               | 1,353,500         | 1,137,866   | (215,634)   |
| Charges for service   | 400,000                 | 400,000           | 222,295   | (177,705)   |
| Intergovernmental   | 1,076,412               | 1,603,340         | 1,584,278   | (19,062)  |
| Rent of property  | 100,000                 | 100,000           | 21,445  | (78,555)  |
| Fines and forfeitures   | 2,475                   | 2,475             | 515   | (1,960)   |
| Interest  | 75,000                  | 75,000            | 81,747  | 6,747   |
| Miscellaneous   | <u>130,000</u>          | <u>146,888</u>    | <u>51,735</u>                                       | <u>(95,153)</u>   |
| <b>Total revenues</b>   | <u>9,409,330</u>        | <u>10,281,515</u> | <u>9,587,855</u>                                    | <u>(693,660)</u>  |
| <b>EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:</b>   |                         |                   |   |   |
| Current:  |                         |                   |   |   |
| General government  | \$3,592,109             | \$4,345,626       | \$4,461,781   | (116,155)   |
| Public safety   | 773,664                 | 613,303           | 582,277   | 31,026  |
| Public works  | 3,026,501               | 2,830,234         | 2,840,195   | (9,961)   |
| Health and welfare  | 1,260,649               | 1,226,716         | 1,214,255   | 12,461  |
| Culture and recreation  | 378,660                 | 365,562           | 355,665   | 9,897   |
| Education   | 59,300                  | 34,697            | 33,977  | 720   |
| Operating transfer to other fund  | <u>318,447</u>          | <u>865,377</u>    | <u>804,388</u>                                      | <u>60,989</u>   |
| <b>Total expenditures, encumbrances and other financing uses</b>  | <u>9,409,330</u>        | <u>10,281,515</u> | <u>10,292,538</u>                                   | <u>(11,023)</u>   |
| <b>EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)</b> | <u>\$ -</u>             | <u>\$ -</u>       | <u>(\$704,683)</u>                                  | <u>(\$704,683)</u>                                      |

**Explanation of Differences:**

**Sources/inflows of resources:**

|  |                     |
|--|---------------------|
| Actual amounts (budgetary basis)"available for appropriation" from the budgetary comparison schedule       | \$ 9,587,855        |
| Differences-budget to GAAP:  |                     |
| GAAP adjustments to revenues   | <u>(122,040)</u>    |
| <b>Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances</b> | <u>\$ 9,465,815</u> |

**Uses/outflows of resources:**

|  |                |
|--|----------------|
| Actual amounts (budgetary basis)"total charges to appropriations" from the budgetary comparison schedule | \$10,292,538   |
| Differences-budget to GAAP:  |                |
| Net change in encumbrances   | (658,870)      |
| Nonbudgeted expenditures   | <u>316,635</u> |

|   |                    |
|---|--------------------|
| <b>Total expenditures and other financing uses as reported on the statement of revenues, expenditures, and changes in fund balances</b> | <u>\$9,950,303</u> |
|---|--------------------|

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

NOTES TO BUDGETARY COMPARISON SCHEDULE – GENERAL FUND

YEAR ENDED JUNE 30, 2004

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1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

A. Budgetary Control

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP, and represents departmental appropriations recommended by the Mayor and approved by the Municipal Legislature prior to the beginning of the fiscal year. Amendments to the budget require the approval of the Municipal Legislature. Transfers of appropriations within the budget, known as Mayor's Resolutions, do not require the approval of the Municipal Legislature.

The Municipality prepares its annual budget including the operations of the general fund.

For budgetary purposes, encumbrance accounting is used. The encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year.

The unencumbered balance of any appropriation at the end of the fiscal year will lapse at the end of such fiscal year. Other appropriations, mainly capital project appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2004 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2004.

B. Excess Expenditures, Encumbrances and Other Financial Sources Over Budget

The Municipality's General Fund had excess of expenditures, encumbrances and other financial uses over appropriations at the legal level of budgetary control in the following functions\programs:

| <u>Expenditures, Encumbrances and Other Financing Uses:</u> | <u>Appropriations</u> | <u>Actual Amounts</u> | <u>Excess</u> |
|---|-----------------------|-----------------------|---------------|
| General government  | \$4,345,626           | \$4,461,781           | (116,155)     |
| Public works  | 2,830,234             | 2,840,195             | (9,961)       |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2004

| <u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>                             | <u>Federal CFDA Number</u> | <u>Pass-through Entity Identifying Number</u> | <u>Expenditures</u>     |
|--|----------------------------|---|-------------------------|
| <b>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:</b>   |                            |   |                         |
| Direct Program :   |                            |   |                         |
| Section 8 Housing Choice Voucher   | 14.871                     |   | \$ 312,402              |
| Pass-through the Commonwealth of Puerto Rico - Office of the Commissioners of Municipal Affairs: |                            |   |                         |
| Community Development Block Grant - State Program  | 14.228                     |   |                         |
|  |                            | 97-FD-56                                      | 48,030                  |
|  |                            | 98-FD-56                                      | 66,916                  |
|  |                            | 99-FD-IP-56                                   | 30,000                  |
|  |                            | 00-FD-56                                      | 37,364                  |
|  |                            | 01-FD-56                                      | 377,093                 |
|  |                            | 02-AB-56                                      |                         |
|  |                            | 02-FC-56                                      | <u>785,544</u>          |
| <b>Total U.S. Department of Housing and Urban Development</b>                                    |                            |   | <u><b>1,657,349</b></u> |
| <b>U.S. HOMELAND SECURITY DEPARTMENT:</b>  |                            |   |                         |
| Pass-through the Commonwealth of Puerto Rico - Emergency Management Agency:                      |                            |   |                         |
| Emergency Management State and Local Assistance  | 83.534                     | Not Available                                 | 32,554                  |
| Pass-through the Commonwealth of Puerto Rico - Governor Authorized Representative (GAR):         |                            |   |                         |
| Public Assistance Grants   | 83.544                     | 1247-DR-PR                                    | 20,722                  |
| <b>Total U.S. Homeland Security Department</b>   |                            |   | <u><b>53,276</b></u>    |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2004

| <u>Federal Grantor/Pass-through<br/>Grantor/Program or Cluster Title</u>   | <u>Federal<br/>CFDA<br/>Number</u> | <u>Pass-through<br/>Entity Identifying<br/>Number</u> | <u>Expenditures</u> |
|--|------------------------------------|---|---------------------|
| <b>U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES:</b>   |                                    |   |                     |
| Pass-through the Commonwealth of Puerto Rico governor's Office (Elderly Office):   |                                    |   |                     |
| Special Programs for Aging – Title III, Part B<br>– Grant For Supportive Services and Senior Centers                             | 93.044                             |   | 1,135               |
| Special Programs for Aging – Title III, Part C<br>– Nutrition Services   | 93.045                             |   | 57,189              |
| Pass-through the Commonwealth of Puerto Rico Administration for Children and Families (ADFAN):<br>Community Services Block Grant | 93.569                             | Not Available   | 29,365              |
| —Child Care and Development Block Grant  | 93.575                             |   | 263,070             |
| <b>Total U.S. Department of Health and Human Services</b>  |                                    |   | <u>350,759</u>      |
| <b>TOTAL EXPENDITURES OF FEDERAL AWARDS</b>  |                                    |   | <u>\$ 2,061,384</u> |

The accompanying notes are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2004

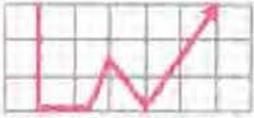
**1. BASIS OF PRESENTATION:**

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the **Municipality of Salinas** and is presented on the modified accrual basis of accounting. The basis of accounting is the same used to prepare the fund financial statements. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

**2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:**

Amounts reported in the accompanying Schedule are included in the Special Revenue Fund and Other Governmental Funds in the Municipality's fund financial statements. The reconciliation between the expenditures in the fund financial statements and the expenditures in the Schedule of Expenditures of Federal Awards is as follows:

| Description   | Special<br>Revenue Fund<br>Other Federal<br>Grants | Other<br>Governmental<br>Funds | Total              |
|---|--|--------------------------------|--------------------|
| Per Schedule of Expenditures of Federal Awards      | \$1,748,982  | \$312,402                      | \$2,061,384        |
| Non federal programs Expenditures                   | <u>42,840</u>                                      | <u>16,112</u>                  | <u>58,952</u>      |
| Total expenditures in the fund financial statements | <u>\$1,791,822</u>                                 | <u>\$328,514</u>               | <u>\$2,120,336</u> |



*López-Vega, CPA, PSC*

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• American Institute of  
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• Puerto Rico Society of  
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**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

**To the Honorable Mayor  
and the Municipal Legislature  
Municipality of Salinas  
Salinas, Puerto Rico**

We have audited the basic financial statements of the **Municipality of Salinas** as of and for the year ended June 30, 2004, and have issued our report thereon dated December 12, 2004, which was unqualified. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Compliance**

As part of obtaining reasonable assurance about whether the **Municipality of Salinas's** basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of basic financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

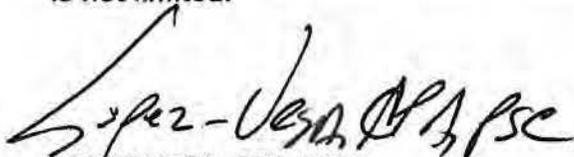
**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the **Municipality of Salinas's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting that, in our judgment, could adversely affect **Municipality of Salinas's** ability to record, process, summarize, and report financial data consistent with the assertions of management in the basic financial statements. The reportable conditions are described in the accompanying schedule of findings and questioned costs items 04-01 through 04-03.

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS (CONTINUED)

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose reportable conditions that are also considered to be material weaknesses. However, we believe the reportable conditions described in the accompanying Schedule of Findings and Questioned Costs are not material weaknesses. We also noted other matters involving the internal control over financial reporting, which we have reported to management of the Municipality of Salinas in a separate letter dated December 12, 2004.

This report is intended for the information of the management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

  
LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico  
December 12, 2004

Stamp No. 2019422 of the Puerto Rico  
Society of Certified Public Accountants  
was affixed to the record copy of this report.





**López-Vega, CPA, PSC**

Certified Public Accountants · Management Advisors

Member of:

- American Institute of Certified Public Accountants
- Puerto Rico Society of Certified Public Accountants

**INDEPENDENT AUDITORS' REPORT  
ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON  
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

To the Honorable Mayor  
and the Municipal Legislature  
Municipality of Salinas  
Salinas, Puerto Rico

Compliance

We have audited the compliance of the **Municipality of Salinas** with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2004. The **Municipality of Salinas's** major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the **Municipality of Salinas's** management. Our responsibility is to express an opinion on the **Municipality of Salinas's** compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the **Municipality of Salinas's** compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the **Municipality of Salinas's** compliance with those requirements.

In our opinion, the **Municipality of Salinas** complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2004. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items, 04-04 through 04-14.

INDEPENDENT AUDITORS' REPORT  
ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON  
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB-CIRCULAR A-133  
(CONTINUED)

Internal Control Over Compliance

The management of the Municipality of Salinas is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Municipality of Salinas's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

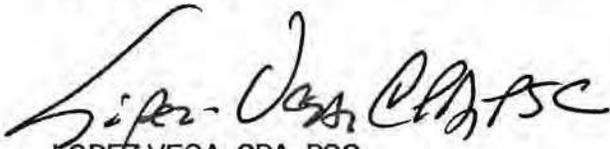
We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Municipality of Salinas's ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 04-04 through 04-14.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees on the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weakness. However, of the reportable conditions described above, we consider item 04-05 through 04-08, 04-10 through 04-13, to be material weaknesses. We also noted other matters involving the internal control over compliance and certain immaterial instance of noncompliance, which we have reported to management of the Municipality of Salinas in a separate letter dated March 5, 2005.



INDEPENDENT AUDITORS' REPORT  
ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON  
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB-CIRCULAR A-133  
(CONTINUED)

This report is intended for the information of the management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.



LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico  
March 5, 2005

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was affixed to the record copy of this report.



COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2004

**Section I – Summary of Auditors’ Results**

**Financial Statements**

|  |             |               |
|--|-------------|---------------|
| Type of auditors’ report issued:   | Unqualified |               |
| Internal control over financial reporting:                                 |             |               |
| Material weakness identified?  | Yes         | No X          |
| Reportable conditions identified not considered to be material weaknesses? | Yes X       | None reported |
| Noncompliance material to financial statements noted?                      | Yes         | No X          |

**Federal awards**

|   |             |               |
|---|-------------|---------------|
| Internal Control over major programs:   |             |               |
| Material weakness identified?   | Yes X       | No            |
| Reportable conditions identified not considered to be material weaknesses?  | Yes X       | None reported |
| Type of auditors’ report issued on compliance for major programs:   | Unqualified |               |
| Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)? | Yes X       | No            |

Identification of major programs:

| <u>CFDA Number</u>  | <u>Name of Federal Program or Cluster</u>           |
|---|---|
| 14.228  | Community Development Block Grant – State’s Program |
| 14.871  | Section 8 Housing Choice Voucher                    |
| Dollar threshold used to distinguish between Type A and Type B programs | \$ 300,000  |
| Auditee qualified as low-risk auditee?                                  | Yes <u>          </u> No X                          |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II – Financial Statements Findings

Finding Reference 04-01

|   |   |
|---|---|
| Requirement                               | Financial Reporting – Accounting Records  |
| Statement of Condition                    | During our examination of the Municipality's accounting system we noted that it does not summarize the transactions in a formal General Ledger in order to properly record and account for the transactions of all of its Governmental Funds (Local, State and Federal funds).  |
| Criteria                                  | Article 8.010 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain an effective and updated accounting system.  |
| Cause of Condition                        | The Municipality did not establish effective internal control over the transactions recorded on its accounting records. Also, the accounting data is not summarized in the form of a double-entry general ledger record.  |
| Effect of Condition                       | The Municipality's accounting system did not provide updated and complete financial information that present the financial position and the result of operations and the change in fund balances. Such information is necessary to take management decisions.   |
| Recommendation                            | We recommend that the Municipality should implement internal control and procedures in order to maintain an accounting system that contains information pertaining to authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, interfund transactions, etc.   |
| Questioned Costs                          | None  |
| Management Response and Corrective Action | The new Municipality's Management (since January 2005) gave instructions to the Finance Department personnel to strengthen the control and procedures to assure that the accounting system will provide information regarding authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, interfund transactions, etc. |
| Responsible Person:                       | Mrs. Luz. N. Arroyo<br>Finance Department Director  |
| Implementation date:                      | July, 2006  |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II - Financial Statements Findings

|                        |  |
|------------------------|--|
| Finding Reference      | 04-02  |
| Requirement            | Expenditures for Goods and Services and Accounts Payable - Purchasing and Receiving  |
| Statement of Condition | <p>During our examination of the Municipality's procedures related to the purchasing and receiving process we examined sixteen (16) CDBG State Program disbursement vouchers and fifty one (51) operational bank account disbursement vouchers. We found the following exceptions:</p> <ul style="list-style-type: none"><li>a. Twenty three (23) disbursement vouchers did not include the Mayor's or his Authorized Representative signature.</li><li>b. Five (5) disbursement vouchers from the operational bank account did not include the original invoice from the supplier. The disbursement vouchers totaled the amount of \$4,388.90.</li><li>c. Seven (7) disbursement vouchers from the operational bank account were not available for our examination. The disbursement vouchers totaled the amount of \$30,523.</li></ul> |
| Criteria               | The Revised Regulations on Basic Standards for the Municipalities of Puerto Rico establish in Chapter four (4) that the Finance Director will be responsible to account and prepare disbursements through documents duly prepared and certified, including sufficient evidential matter to support the transactions.   |
| Cause of Condition     | The Municipality internal control failed to assure that all transactions include all the required signatures and documentation as required by law.   |
| Effect of Condition    | The Municipality is not in compliance with Chapter Four (4) of the Revised Regulations on Basic Standards for the Municipalities of Puerto Rico.   |
| Recommendation         | We recommend that the Municipality should improve its internal control procedures in order to assure that a disbursement voucher contains all supporting documents and required signatures before the payment is made.   |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

**Section II - Financial Statements Findings**

**Finding Reference**      04-02 (Continued)

**Questioned Costs**      None

**Management Response  
and Corrective Action**

The new Municipality's Management (since January 2005) gave instructions to the Finance Department personnel to follow step by step the disbursements controls and procedures required by the Chapter 8 of the State Act Number 81 of August 30, 1991, and the Chapter 4 of the Revised Regulations on Basic Standards for the Municipalities of Puerto Rico to assure that conditions observed by the auditors does not occur again.

**Responsible Person:**    Mrs. Luz. N. Arroyo  
Finance Department Director

**Implementation date:**    May, 2005

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II – Financial Statements Findings

|                               |   |
|-------------------------------|---|
| <b>Finding Reference</b>      | <b>04-03</b>  |
| <b>Requirement</b>            | <b>Expenditures for Goods and Services and Account Payables – Purchasing</b>  |
| <b>Statement of Condition</b> | The following two (2) formal bid files were not available for examination; (a) the formal bid files for the construction of three (3) bridges in “Bo. San Felipe” for the amount of \$149,000; and (b) the formal bid files of the Improvement to “Sector Coco, Bo. Lapa Basketball Court” for the amount of \$96,852. Both projects were financed with Community Development Block Grant –State Program. |
| <b>Criteria</b>               | The Chapter eight (8) of the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico establishes the procedures related to the formal bids for new construction and public improvements works.  |
| <b>Cause of Condition</b>     | The Municipality’s did not maintain adequate internal controls to assure that all required documents has been retained in a file (bid and contract files) as evidence of compliance with the procurement requirements.  |
| <b>Effect of Condition</b>    | The Municipality noncompliance with the Chapter Eight (8) of the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico.   |
| <b>Recommendation</b>         | We recommend the Municipality to establish adequate internal control and procedures in order to assure that formal bid files are properly safeguarded, and that includes all required documents. Also, we recommend retaining in contract files all documents required by Law or Regulation prior to any contract execution in order to demonstrate compliance with procurement requirements.             |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

**Section II – Financial Statements Findings**

**Finding Reference**      **04-03 (Continued)**

**Management Response  
and Corrective Action**

The new Municipality's Management (since January 2005) gave instructions to the Municipal Administrative Department personnel and to the Bid Board members to follow step by step the procurement controls and procedures required by the Chapter 10 of the State Act Number 81 of August 30, 1991 and the Chapter 8 of the Revised Regulations on Basic Standards for the Municipalities of Puerto Rico to assure that conditions observed by the auditors does not occur again. Also, instructions were given to locate the formal bid files not available to the auditors.

**Responsible Person:**      Mrs. Andrea Torres  
Municipal Secretary Office Director

**Implementation date:**      May, 2005

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

|                               |   |
|-------------------------------|---|
| <b>Finding Reference</b>      | <b>04-04</b>  |
| <b>Program</b>                | <b>Community Development Block Grant – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State – Office of the Commissioner of Municipal Affairs</b>   |
| <b>Requirement</b>            | <b>Cash Management</b>  |
| <b>Statement of Condition</b> | During our Cash Management test, we noted that the Municipality maintained during the current fiscal year an average cash balance in books of approximately \$36,392.51. In addition, the Municipality requested funds that were not disbursed on a reasonable lapse of time. |
| <b>Criteria</b>               | Code of Federal Regulations 24, Subpart I, Sec.570.489 (c) requires a cash management system in order to minimize the time elapsed between the transfer of funds from the pass-through grantor and disbursements made by the grantee.   |
| <b>Cause of Condition</b>     | The Municipality’s disbursements procedures failed to assure that funds requested and received from the Pass-through Grantor be disbursed in compliance with the Code of Federal Regulations Requirements.  |
| <b>Effect of Condition</b>    | The Municipality is not in compliance with Code of Federal Regulations 24, Subpart I, Sec.570.489 (c).  |
| <b>Recommendation</b>         | We recommend management to strengthen its disbursement procedures to minimize the time elapsed between the transfer of funds from the Pass-through Grantor and the disbursements made by the Municipality.  |
| <b>Questioned Costs</b>       | None  |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference      04-04 (Continued)

Management Response  
and Corrective Action

The new Municipality's Management (since January 2005) instructed Program accounting staff in order to strength control and procedures to assure that conditions as observed by the auditors does not occurred again. Cash will be requested to the Pass-through Grantor only when needed, and disbursed promptly. Also, we contracted a Consulting Firm to provide professional services for this Program. As part of their contract, the consultants will provide guidance to the Program accountant and will monitor cash management procedures to clear this finding.

Responsible person:    Mrs. Ivette Ortiz  
Federal Programs Department Director

Implementation date:    May, 2005

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

|                               |  |
|-------------------------------|--|
| <b>Finding Reference</b>      | <b>04-05</b>   |
| <b>Program</b>                | Community Development Block Grant – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State – Office of the Commissioner of Municipal Affairs   |
| <b>Requirement</b>            | Davis-Bacon Act  |
| <b>Statement of Condition</b> | <p>During our Davis-Bacon Act test for the construction and public improvement projects 02-FC-56-002 (“Repavimentación de calles severamente deterioradas en las Comunidades Especiales del Municipio, primera y única fase”), 01-FD-56-005 (“Mejoras a los Parques de Pelota del Sector Los 80, Bo. Río Jueyes; Sector Vertedero, Bo. Lapa; y Bo. Aguirre, primera y única fase”) and 01-FD-56-007 (“Construcción de Paseo Peatonal Sector San Felipe, Bo. Aguirre”), we noted the following situations:</p> <ul style="list-style-type: none"><li>a. For the project 02-FC-56-002 and 01-FD-56-005 the Municipality did not inform the contractor during the procurement process about the requirements for compliance with David Bacon Act and the prevailing wage rates notice.</li><li>b. For the project 02-FC-56-002 and 01-FD-56-005 the Municipality did not require the contractor, the submittal of a certification and copies of weekly payrolls meeting the requirements to pay prevailing wage rates.</li><li>c. For the projects 02-FC-56-002, 01-FD-56-005 and 01-FD-56-007, the contractor and subcontractor’s laborers interviews were not consistently made.</li><li>d. For the project 02-FC-56-002 and 01-FD-56-005, the contractor weekly payrolls were not reviewed by the Municipal employee responsible of applying monitoring procedures.</li><li>e. For Project 01-FD-56-007, the contractor did not provide to the Municipality weekly payrolls from July 2003 (beginning of the project) through January 2004. Also, the weekly payrolls submitted from January 2004 were not certified by the contractor’s Equal Employment Officer (EEO).</li></ul> |
| <b>Criteria</b>               | Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7).   |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

|  |  |
|--|--|
| <b>Finding Reference</b>                         | 04-05 (Continued)  |
| <b>Cause of Condition</b>                        | The Municipality did not apply all monitoring system procedures developed to test applicable contractors with respect to payment of prevailing wages.  |
| <b>Effect of Condition</b>                       | The Municipality is not in compliance with Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7).  |
| <b>Recommendation</b>                            | We recommend management to follow monitoring system procedures developed, including obtaining contractor's and subcontractor's weekly payrolls to be reviewed on a weekly basis by the responsible Municipal employee to establish the degree of compliance and the nature and extend of violations, if any, and then, communicate contractors promptly about any failure in the payroll process.  |
| <b>Questioned Costs</b>                          | None   |
| <b>Management Response and Corrective Action</b> | At the present the Municipality did not maintain construction projects in progress. The controls and procedures described below will be conducted in future construction projects, in order to assure the compliance with Davis Bacon for projects exceeding \$2,000. We will give instructions to the Program employee in charge of labor standard duties to strengthen the administration and enforcement of Davis-Bacon requirements. The labor standard officer will be responsible for the following: (a) to determine Davis-Bacon Act applicability; (b) participate in the preparation of bid documents and contracts to assure that bid specifications and contract clauses contained Davis-Bacon wage decisions and labor standards clauses; (c) to provide contractor training to ascertain that the contractors understands its responsibilities for Davis-Bacon compliance; (d) conduct on-site interviews with laborers and mechanics; (e) review contractor and subcontractors certified payroll reports; (f) investigate probable violations and complaints of underpayment; and, (f) prepare and submit enforcement reports to the Pass-through Grantor. |
| <b>Responsible person</b>                        | Mrs. Ivette Ortiz<br>Federal Program Department Director   |
| <b>Implementation date:</b>                      | May, 2005  |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

|                               |  |
|-------------------------------|--|
| <b>Finding Reference</b>      | 04-06  |
| <b>Program</b>                | Community Development Block Grant – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State – Office of the Commissioner of Municipal Affairs (OCAM)  |
| <b>Requirement</b>            | Procurement and Suspension and Debarment   |
| <b>Statement of Condition</b> | <p>During our contract provision test, we examined two (2) construction contracts and noted the following situations:</p> <ul style="list-style-type: none"><li>a. Two (2) contracts did not include a provision for compliance with Equal Employment Opportunity.</li><li>b. Two (2) contracts did not include a provision for compliance with Davis Bacon.</li><li>c. Two (2) contracts did not include a provision for compliance with Sections 103 and 107 of the Contract Work Hours &amp; Safety Standards Act.</li><li>d. Two (2) contracts did not include a provision for granting accesses to GAO or other federally agency, to books and other documents.</li><li>e. Two (2) contracts did not include a provision for compliance with Energy Policy and Conservation Act.</li><li>f. Two (2) contracts did not include a provision for compliance with the Copeland “Anti-Kickback”.</li><li>g. Two (2) contracts did not include a provision for retention of all required records for three years.</li></ul> |
| <b>Criteria</b>               | Code of Federal Regulations 24, Part 570.489 (g) requires that all purchase orders and contracts include all clauses required by Federal Statutes, executive orders and implementing regulations.  |
| <b>Cause of Condition</b>     | The Municipality did not maintain appropriate monitoring procedures to detect the exclusion of certain contract clauses.   |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

|  |   |
|--|---|
| <b>Finding Reference</b>                         | 04-06 (Continued)   |
| <b>Effect of Condition</b>                       | The Municipality is not in compliance with Code of Federal Regulations 24, Part 570.489 (g).  |
| <b>Recommendation</b>                            | We recommend management to update contract model according with the federal requirements.   |
| <b>Questioned Costs</b>                          | None  |
| <b>Management Response and Corrective Action</b> | The new Municipality's Management (since January 2005) gave instructions to the Municipal Administrative Department personnel to include all required clauses in the federally funded contracts. New contracts for the following fiscal year will contain all clauses required by Federal Law, because we will develop a contract model with all of contract clauses required by Federal Statutes, executive orders and implementing regulations. |
| <b>Responsible person</b>                        | Mrs. Ivette Ortiz<br>Federal Program Department Director  |
| <b>Implementation date:</b>                      | July, 2005  |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Mayor Federal Award Program Findings and Questioned Costs

|                        |  |
|------------------------|--|
| Finding Reference      | 04-07  |
| Program                | Community Development Block Grant - State's Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State - Office of the Commissioner of Municipal Affairs |
| Requirement            | Procurement and Suspension and Debarment   |
| Statement of Condition | Section II - Financial Statements Findings - Finding Reference 04-03.  |

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)**

**YEAR ENDED JUNE 30, 2004**

**Section III – Major Federal Award Program Findings and Questioned Costs**

**Finding Reference**      **04-08**

**Program**                      **Community Development Block Grant – State's Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State – Office of the Commissioner of Municipal Affairs**

**Requirement**                **Reporting**

**Statement of Condition**    **Our reporting test revealed the following conditions on the Financial Quarterly Reports of the fiscal year 2003-2004:**

- a. For the Financial Quarterly Report ended on June 30, 2004, cash outlays per General Ledgers disagree with cash outlays reported in the Quarterly Reports. The following summarize the differences between the amounts presented in the Financial Quarterly Report and the amounts presented in the program's General Ledger:

| Cash Disbursements Accounting Number | Amount per Quarterly Report | Amount per General Ledger | Difference    |
|--------------------------------------|-----------------------------|---------------------------|---------------|
| 98-FD-007 (501)                      | \$ 20,451.06                | \$ 62,000.00              | \$ 41,548.94) |
| 98-FD-007(505)                       | 6,000.00                    | 10,000.00                 | (4,000.00)    |
| 02-AB-ADM (706)                      | 419.60                      | 320.30                    | 99.30         |
| 02-AB-ADM (709)                      | 1,109.41                    | 1,020.50                  | 88.91         |
| 02-AB-ADM (713)                      | 663.68                      | 279.00                    | 384.68        |
| 00-FD-ADM (707)                      | 4,500.00                    | 3,300.00                  | 1,200.00      |
| 00-FD-ADM (709)                      | 2,895.95                    | 2,250.25                  | 645.70        |
| 00-FD-ADM (718)                      | 4,000.00                    | 0                         | 4,000.00      |
| 00-FD-001(501)                       | 195,700.00                  | 176,220.00                | 19,480.00     |
| 00-FD-002 (603)                      | 149,703.02                  | 148,616.22                | 1,086.80      |
| 00-FD-004(501)                       | 25,000.00                   | 0                         | 25,000.00     |
| 01-FD-ADM(709)                       | 795.30                      | 580.30                    | 215.00        |
| 01-FD-002(501)                       | 106,852.05                  | 79,966.85                 | 26,885.20     |
| 01-FD-004(501)                       | 24,850.00                   | 22,365.00                 | 2,485.00      |
| 01-FD-004(505)                       | 4,267.00                    | 2,500.00                  | 1,767.00      |
| 01-FD-005(501)                       | 85,644.40                   | 61,831.00                 | 23,813.40     |
| 01-FD-005(505)                       | 4,257.75                    | 2,700.00                  | 1,557.75      |
| 01-FD-006(501)                       | 87,064.90                   | 60,721.00                 | 26,343.90     |
| 01-FD-007(501)                       | 97,673.85                   | 0                         | 97,673.85     |
| 01-FD-007(505)                       | 6,477.00                    | 0                         | 6,477.00      |
| 02-FC-ADM(706)                       | 128.40                      | 91.40                     | 37.00         |
| 02-FC-ADM(707)                       | 600.00                      | 0                         | 600.00        |
| 02-FC-ADM(709)                       | 182.90                      | 0                         | 182.90        |
| 02-FC-ADM (720)                      | 2,545.20                    | 0                         | 2,545.20      |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Mayor Federal Award Program Findings and Questioned Costs

|                            |  |
|----------------------------|--|
| <b>Finding Reference</b>   | <b>04-08 (Continued)</b>   |
|                            | b. The Financial Quarterly Report for the period ended on June 30, 2004 was not submitted on a timely basis.   |
| <b>Criteria</b>            | Code of Federal Regulation 24, Subpart I, Sec. 570.489 (d) (1) states that the States shall have fiscal and administrative requirements for expending and accounting for all funds received under this subpart. These requirement must be available for Federal inspection and must: (i) be sufficiently specific to ensure that funds received under this subpart are used in compliance with all applicable statutory and regulatory provisions; (ii) ensure that the funds received under this subpart are only spent for reasonable and necessary costs of operating programs under this subpart; and (iii) ensure that funds received under this subpart are not used for general expenses required to carry out other responsibilities of state and local governments. |
| <b>Cause of Condition</b>  | The Municipality used the Cash Receipt Registers and Cash Disbursement Registers to prepare the financial quarterly report but failed to update the General Ledgers.   |
| <b>Effect of Condition</b> | The Municipality did not report on time accurate financial results to the Pass-through Grantor for the quarter ended June 30, 2004.  |
| <b>Recommendation</b>      | We recommend to the Municipality's Management to reconcile differences between the Financial Quarterly Reports and the General Ledgers before report submission to the Pass-through Grantor. Also, the General Ledgers will be updated monthly.  |
| <b>Questioned Costs</b>    | None   |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

**Section III - Major Federal Award Program Findings and Questioned Costs**

**Finding Reference**        **04-08 (Continued)**

**Management Response  
and Corrective Action**

The new Municipality's Management (since January 2005) instructed Program accounting staff to update the General Ledgers in order to prepare quarterly reports from such Ledgers instead of the Cash Receipts and Disbursements Registers. Also, we contracted a Consulting Firm to provide professional services for this Program. As part of their contract, the consultants will provide guidance to the Program accountant and will monitor accounting records to clear this finding.

**Responsible person**        Mrs. Ivette Ortiz  
Federal Program Department Director

**Implementation date:**        May, 2005

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

**Section III - Major Federal Award Program Findings and Questioned Costs**

|  |   |
|--|---|
| <b>Finding Reference</b>                         | <b>04-09</b>  |
| <b>Program</b>                                   | <b>Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development</b>   |
| <b>Requirement</b>                               | <b>Eligibility of Individuals</b>   |
| <b>Statement of Condition</b>                    | <p>During our examination of fifteen (15) participant files, we noted the following exceptions related to the Housing Assistance Payment calculation:</p> <p>a. In five (5) participants' file the program used an incorrect utility allowance amount to calculate the Housing Assistance Payment. This situation produced utility reimbursement underpayment of \$121.</p> |
| <b>Criteria</b>                                  | <p>Code of Federal Regulations 24, Section 982.517 (d) (2) states that at reexamination, the PHA must use the PHA current utility allowance schedule.</p>   |
| <b>Cause of Condition</b>                        | <p>The Federal Programs Department did not use the correct utility allowance schedule, updated in April 1, 2004 for Hap's calculations performed during May and June, 2004.</p>   |
| <b>Effect of Condition</b>                       | <p>The Municipality did not paid Hap's as established in the Code of Federal Regulations 24, Section 982.17 (d) (2).</p>  |
| <b>Recommendation</b>                            | <p>We recommend improves monitoring procedures to assure that Housing Assistance payments are duly computed as required by the Federal Regulations.</p>   |
| <b>Questioned Costs</b>                          | <p>None</p>   |
| <b>Management Response and Corrective Action</b> | <p>The new Municipality's Management (since January 2005) instructed Program Coordinator to calculate the Housing Assistant Payment using the applicable utility allowance schedule. Also, we will review the utility rate data for each utility category and, if necessary, we will adjust our utility allowance schedule.</p>   |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference      04-09 (Continued)

Responsible person    Mrs. Ivette Ortiz  
Federal Program Department Director

Implementation date:   July, 2005

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

**Section III – Major Federal Award Program Findings and Questioned Costs**

**Finding Reference** 04-10

**Program** Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development

**Requirement** Reporting

**Statement of Condition** During our reporting test, we noted the following exceptions:

- a. The amounts reported in the account 4715, Housing Assistance Payments, in the Closing Report Submitted to HUD totalized \$291,321 as expenditures and the Program General Ledger totalized \$281,160 as expenditures, resulting in a difference between books and closing reports of (\$10,161).
- b. The amounts reported as Administrative Expenditures in the Closing Report Submitted to HUD totalized \$41,305 and the Program General Ledger totalized \$37,453.20 for Administrative Expenditures, resulting in a difference between books and closing reports of \$3,851.50.
- c. The amounts reported as Operating Reserve- Balance at Beginning of the fiscal year was \$88,968 instead \$104,058, resulting on a difference between books and closing reports of \$15,090.

**Criteria** OMB Common Rules, Subpart C, 24 CFR 85.20 (b)(1), requires that accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or sub-grant. Also, Subpart C, 24 CFR 85.20 (b) (2), states that the grantee must maintain records, which adequately identify the source and application of funds, provided for financially assisted activities.

**Cause of Condition** The program accountant position was vacant from March, 2003 through November, 2003. At that date, the new accountant noted that the accounting records were updated until June 30, 2002. As a consequence, the new accountant begins a process of updating the program accounting records, but at June 30, 2004 that process was not completely performed. As result the program accountant proceed to prepare the closing reports using the Finance Department disbursements reports maintained in cash basis of accounting which were not reconciliated with the program accounting records.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

**Section III - Major Federal Award Program Findings and Questioned Costs**

|  |  |
|--|--|
| <b>Finding Reference</b>                         | <b>04-10 (Continued)</b>   |
| <b>Questioned Costs</b>                          | None   |
| <b>Effect of Condition</b>                       | The Municipality is not in compliance with OMB Common Rules, Subpart C, 24 CFR 85.20 (b) (1) and 85.20 (b) (2).  |
| <b>Recommendation</b>                            | The program must assure that accounting records balances agree with the Closing Reports submitted to HUD.  |
| <b>Management Response and Corrective Action</b> | The new Municipality's Management (since January 2005) instructed Program accounting staff to update the Accounting Records, revising past transactions and, posting in the books any accounting adjustment necessary to properly present the financial position and the results of operations of the Program. When our administration started in January, 2005 we faced the dilemma that the Accounting Records were not actualized, and therefore, we contracted a Consulting Firm to provide professional services for this Program. As part of their contract, the consultants are providing support to the Program accountant and, from January 2005 we have been gathering data to actualize such books and to post monthly in the general ledger. Up to this date we have completed the accounting records up to December 2004. |
| <b>Responsible person</b>                        | Mrs. Ivette Ortiz<br>Federal Program Department Director   |
| <b>Implementation date:</b>                      | June, 2005   |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

**Section III – Major Federal Award Program Findings and Questioned Costs**

|                               |  |
|-------------------------------|--|
| <b>Finding Reference</b>      | <b>04-11</b>   |
| <b>Program</b>                | <b>Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development</b>  |
| <b>Requirement</b>            | <b>Special Test – Selection from the Section 8 Waiting List</b>  |
| <b>Statement of Condition</b> | <p>During our waiting list test, we found the following exceptions:</p> <ul style="list-style-type: none"><li>a. The waiting list did not detailed the Racial or Ethnic designation of the head of household and did not detail if the participants qualify or not for any federal or local preference.</li><li>b. We could not determine how participants were selected from the top of the waiting list.</li></ul> |
| <b>Criteria</b>               | Code of Federal Regulations 24, Sections 982.54 (d) and 982.201 through 982.207 states the waiting list procedures and that the selection from the waiting list generally occurs when the PHA notifies a family whose names reaches the top of the waiting list to come in to verify eligibility for admission.  |
| <b>Cause of Condition</b>     | The Municipality did not maintain adequate internal control procedures to assure that the waiting list include all information required by Federal Regulation and to assure that exist proper tracing which permit auditors determine how participants were selected from the top of the waiting list.   |
| <b>Effect of Condition</b>    | The Municipality is not in compliance with 24 CFR, Sections 982.54 (d) and 982.201 through 982.207.  |
| <b>Recommendation</b>         | We recommend the Municipality to follow admission procedures established in the administrative plan. Also, we recommend management to establish adequate internal controls which allow us to perform a proper tracing of participants selected from the waiting list in order to assure the participant selection from the top of the waiting list.  |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

**Section III – Major Federal Award Program Findings and Questioned Costs**

**Finding Reference**      04-11 (Continued)

**Questioned Costs**      None

**Management Response  
and Corrective Action**

The new Municipality's Management (since January 2005) will close the existing waiting list and open a new waiting list following the procedures established in the Voucher Program Guidebook-Housing Choice (7420.10G), Chapter 4, Waiting List and Tenant Selection. The new waiting list will be prepared to include applicants qualification for any local preference (if applicable) and ethnic designation of the head of household. Also, new participants will be selected following the procedures described in our administrative plan.

**Responsible person**      Mrs. Ivette Ortiz  
Federal Program Department Director

**Implementation date:**      June, 2005

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

|  |  |
|--|--|
| <b>Finding Reference</b>                         | <b>04-12</b>   |
| <b>Program</b>                                   | <b>Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development</b>  |
| <b>Requirement</b>                               | <b>Special Test – Reasonable Rent</b>  |
| <b>Statement of Condition</b>                    | During our Reasonable Rent test we found that during the year 2003-2004 the program did not document in the participant files that the rent to owners was reasonable in comparison to rent for other comparable unassisted units. The Municipality used only one comparable housing unit as reference.   |
| <b>Criteria</b>                                  | Code of Federal Regulations 24, Sections 982.158 (f) (7) and 982.507 states that the PHA must determine reasonable rent at the time of the initial leasing and before any increase in the rent to the owner and all the times during the assisted tenancy, the rent to owner may not exceed the reasonable rent as most recently determined or re-determined by the PHA. In addition, the PHA must maintain records to document the basis for the determination that the rent paid to the owner is reasonable. |
| <b>Cause of Condition</b>                        | The Federal Program Department did not maintain adequate documentation in the participant files to support the basis for the determination that the rent paid to the owner is reasonable.  |
| <b>Effect of Condition</b>                       | The Municipality is not in compliance with Code of Federal Regulations 24, Section 982.158 (f) (7) and Section 982.507.  |
| <b>Recommendation</b>                            | We recommend to the Federal Program Department to establish adequate controls to assure that the reasonable rent determination is performed for at least three (3) unassisted units and that appropriate documentation of the reasonable rent determination is maintained in participant's files.  |
| <b>Questioned Costs</b>                          | None   |
| <b>Management Response and Corrective Action</b> | The new Municipality's Management (since January 2005) gave instructions to the Program Coordinator in order to realize a reasonable rent study to be used in the reasonable rent determination, when applicable, as required by Program regulations.  |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

|                      |  |
|----------------------|--|
| Finding Reference    | 04-12 (Continued)  |
| Responsible person   | Mrs. Ivette Ortiz<br>Federal Program Department Director |
| Implementation date: | June, 2005   |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

|   |  |
|---|--|
| Finding Reference                         | 04-13  |
| Program                                   | Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development   |
| Requirement                               | Special Test – Utility Allowance Schedule  |
| Statement of Condition                    | During our Utility Allowance Schedule Test we noted the following:<br><br>a. The Municipality updated the Utility Allowance Schedule for periods after April 1, 2004, in change, that schedule was not applied in the Housing Assistance Payment calculation for the months of April through June 2004.  |
| Criteria                                  | Code of Federal Regulations 24, Section 982.517 states that the Municipality must maintain an up-to-date utility allowance schedule. The Municipality must review the utility rate data for each utility category each year and must adjust its allowance schedule if there has been a rate change of 10 percent or more for a utility category or fuel type since the last time utility allowance was revised. Also, in Section 982.517 (d) (2) states that at re-examination, the PHA must use the PHA current utility allowance schedule. |
| Cause of Condition                        | The Municipality's control and procedures established for Utility Allowance were not applied at the effective date.  |
| Effect of Condition                       | The Municipality calculated Hap's using the incorrect utility allowance schedule.  |
| Recommendation                            | The Municipality must assure that the new utility allowance schedule is used for HAP's calculation from its effective date.  |
| Questioned Costs                          | None   |
| Management Response and Corrective Action | The new Municipality's Management (since January 2005) instructed Program Coordinator to review the utility rate data for each utility category and, if necessary, to adjust the utility allowance schedule. Also, the Program Coordinator was instructed to calculate the Housing Assistant Payment using the applicable utility allowance schedule.  |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

|                      |  |
|----------------------|--|
| Finding Reference    | 04-13 (Continued)  |
| Responsible person   | Mrs. Ivette Ortiz<br>Federal Program Department Director |
| Implementation date: | July, 2005   |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

|                        |   |
|------------------------|---|
| Finding Reference      | 04-14   |
| Program                | Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development  |
| Requirement            | Special Test – Housing Quality Standards Inspections and HQS Enforcement  |
| Statement of Condition | <p>During our verification of fifteen (15) participant files, we noted the following exceptions:</p> <ul style="list-style-type: none"><li>a. In three (3) participant files with inspection items which required repairs or changes by the property owner, we did not find evidence supporting that the corrections were performed in thirty (30) calendar days. We did not find any documentation on file where the Municipality notified the property owner that the Housing Assistance Payment has been stopped (abate).</li><li>b. The Municipality did not perform the required Housing Quality Control re-inspections during the audit period.</li></ul>   |
| Criteria               | <p>Code of Federal Regulations 24, Subpart I, Section 982.158 (d) and 982.405 (b) states that the PHA must inspect the unit leased to a family at least annually to determine if the unit meets Housing Quality Standards (HQS) and the PHA must conduct quality control re-inspections. Also the PHA must prepare a unit inspection report.</p> <p>Code of Federal Regulations 24, Section 982.404 establishes that for units under contract that failed to meet HQS, the PHA must require the owner to correct any cited life threatening HQS deficiencies within 24 hours of the inspections and all other HQS deficiencies within 30 calendar days or within a specified PHA-approved extension. If the owner does not correct the cited HQS deficiencies within the specified correction period the PHA must stop the Housing Assistance Payment or must terminate the HAP contract.</p> |
| Cause of Condition     | The Municipality control procedures fail to assure that annual re-inspections and Housing Quality Control re-inspections are properly performed. Also, the Municipality fails to follow the procedures to assure the compliance with Housing Quality Standards Enforcements.  |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

|   |   |
|---|---|
| Finding Reference                         | 04-14 (Continued)   |
| Effect of Condition                       | In these cases, the Municipality fail to comply with Code of Federal Regulations 24, Subpart I, Section 982.404 and 982.158 (b) and 982.405 (b).  |
| Recommendation                            | <p>We recommend management to improves its internal control procedures to assure that annual inspections and quality control re-inspections are properly performed. The PHA supervisor or other qualified person must re-inspect a sample of units under contract during the last PHA fiscal year. Completed HQS inspections included in the sample must be no older than three months at the time of re-inspection. In addition, the quality control re-inspection should provide feedback on inspectors' work, which can be used to determine if individual performance or general HQS training issues need to be addressed.</p> <p>For HQS deficiencies that are the owner's responsibility and are not corrected within the prescribed time frames, the PHA must abate Housing Assistance Payments beginning no later than the first of the month following expiration of the PHA violation notice.</p> |
| Questioned Costs                          | None  |
| Management Response and Corrective Action | The new Municipality's Management (since January 2005) instructed the Program Coordinator to performing a through inspections as well as re-inspecting units that do not pass within 24 hours of the inspections, within 30 calendar days or within a specified approved extension. Also, detected deficiencies will be notified through letter to the owners or to the tenants, as applicable, and if the cited corrections were not made in the established timeframe, the Municipality will stop the Housing Assistance Payment or terminate the HAP contract. In addition, an inspection control log will be established. Also, a representative sample (as required in the CFR) of quality control re-inspections will be conducted by the Federal Program Department Director.  |
| Responsible person                        | Mrs. Ivette Ortiz<br>Federal Program Department Director  |
| Implementation date:                      | July, 2005  |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2004

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings<br>(As required by OMB Circular A-133)  |
|-------------------------|----------|---|
| 03-06                   | 14.228   | <p><u>The Municipality requested funds that were not disbursed on a reasonable lapse of time.</u></p> <p>No corrective action has been taken. The auditor reissued the finding for the current year. Reference Finding 04-04.</p>   |
| 03-07                   | 14.228   | <p><u>For the project 01-FD-56-004, the Municipality did not apply adequately the monitoring system developed to ensure contractors compliance with payment of prevailing wages rates to employees. For the project 01-FD-56-004, the contractor's and subcontractor's laborers interviews were not made. For the project 01-FD-56-004, the contractor weekly payrolls were not requested to be reviewed by the municipal employee responsible of applying monitoring procedures.</u></p> <p>No corrective action has been taken. The auditor reissued the finding for the current year. Reference Finding 04-05.</p> |
| 03-08                   | 14.228   | <p><u>The Municipality did not maintain appropriate monitoring procedures to detect the exclusion of certain contract clauses.</u></p> <p>No corrective action has been taken. The auditor reissued the finding for the current year. Reference Finding 04-06.</p>  |
| 03-09                   | 14.228   | <p><u>The Municipality did not maintain evidence that indicate if the Financial Quarterly Report ended on June 30, 2004 was submitted on a timely basis. For the Financial Quarterly Report ended on June 30, 2004, cash outlays per general ledgers disagree with cash outlays reported in the quarterly reports.</u></p> <p>No corrective action has been taken. The auditor reissued the finding for the current year. Reference Finding 04-08.</p>  |
| 02-09                   | 14.228   | <p><u>The Municipality should request funds only for immediate needs.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 04-04.</p>   |
| 02-10                   | 14.228   | <p><u>The Municipality should follow monitoring system procedures developed including obtaining contractor's and if applicable subcontractor's weekly</u></p>   |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings<br>(As required by OMB Circular A-133)  |
|-------------------------|----------|---|
|                         |          | <p><u>payrolls to be reviewed weekly by responsible Municipal Employee and interviewing contractor's and subcontractor's (if applicable) laborers periodically (up to ten percent (10%) of the workers on long term projects) to establish the degree of compliance and the nature and extend of violations, if any.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 04-05.</p>  |
| 02-12                   | 14.228   | <p><u>The Municipality should update the contract model according with the federal requirements.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 04-06.</p>  |
| 02-13                   | 14.228   | <p><u>The Municipality should maintain a full set of accounting records, which adequately identify the source and application of funds provided for financially-assisted activities. Also, the accounting records must contain all information pertaining to grant or sub-grant awards and authorizations, obligations, un-obligated balances, assets, liabilities, outlays or expenditures, and income. In addition, we recommend Management to prepare and submit all reports required per grant agreements in compliance with established deadlines. If the deadlines are not achievable, a request for an extension should be obtained from the Pass-through Grantor.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 04-08.</p> |
| 02-14                   | 14.871   | <p><u>The Municipality should establish monitoring procedures to assure that Housing Assistance payments are duly computed as required by the Federal Regulations.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 04-10.</p>  |
| 02-15                   | 14.871   | <p><u>The Municipality should establish adequate monitoring procedures in order to assure that release form to allow information from third parties, employment information and the Privacy Act Notice and all required</u></p>   |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings<br>(As required by OMB Circular A-133)  |
|-------------------------|----------|---|
|                         |          | <u>participants information are included in the participant files as required by Federal Regulations.</u>   |
|                         |          | Full corrective action was taken.   |
| 02-16                   | 14.871   | <u>The Municipality should establish adequate monitoring procedures in order to assure the accuracy of closing reports and accounting records.</u>  |
|                         |          | No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 04-11.  |
| 02-17                   | 14.871   | <u>The Municipality should establish adequate monitoring procedures in order to assure the program compliance with federal regulations.</u>   |
|                         |          | Full corrective action was taken.   |
| 02-18                   | 14.871   | <u>The Municipality should follow admission procedures established in the administrative plan. Also, we recommend management to establish adequate internal controls which allow us to perform a proper tracing of participants selected from the waiting list in order to assure the participant selection from the top of the waiting list.</u> |
|                         |          | No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 04-12.  |
| 02-19                   | 14.871   | <u>The Municipality should establish adequate controls to assure that the reasonable rent determination is performed for at least three (3) unassisted units and that appropriate documentation of the reasonable rent determination is maintained in participant's files.</u>  |
|                         |          | No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 04-13.  |
| 02-20                   | 14.871   | <u>The Municipality should properly document the evidence of its utility allowance study to determine if there has been a change of 10% or more in the utility rate each year as established in the federal regulations.</u>  |
|                         |          | No corrective action was taken. The auditors reissued the finding for the   |

COMMONWEALTH OF PUERTO RICO  
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SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings<br>(As required by OMB Circular A-133)  |
|-------------------------|----------|---|
|                         |          | current year. Finding Reference 04-14.  |
| 02-21                   | 14.871   | <p><u>The Municipality should implement internal control procedures to assure that annual inspections and quality control re-inspections are properly performed. The PHA supervisor or other qualified person must re-inspect a sample of units under contract during the last PHA fiscal year. Completed HQS inspections included in the sample must be no older than three months at the time of re-inspection. In addition, the quality control re-inspection should provide feedback on inspectors' work, which can be used to determine if individual performance or general HQS training issues need to be addressed. For HQS deficiencies that are the owner's responsibility and are not corrected within the prescribed time frames, the PHA must abate Housing Assistance Payments beginning no later than the first of the month following expiration of the PHA violation notice.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 04-15.</p> |
| 01-07                   | 14.228   | <p><u>The Municipality did not maintain adequate cash management procedures.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>  |
| 01-08                   | 14.228   | <p><u>Davis-Bacon Act</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>   |
| 01-10                   | 14.228   | <p><u>Procurement and Suspension and Debarment</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>  |
| 01-11                   | 14.228   | <p><u>Reporting</u></p>   |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings<br>(As required by OMB Circular A-133)  |
|-------------------------|----------|---|
|                         |          | The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.  |
| 99-2                    | 83.544   | <u>Disbursement vouchers were not available for examination</u><br>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse. |