

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

**MUNICIPIO DE SALINAS**  
**AUDITORIA 2004-2005**  
**30 DE JUNIO DE 2005**

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
SINGLE AUDIT REPORT  
YEAR ENDED JUNE 30, 2005

*Call 406-1465*

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SINGLE AUDIT REPORT

JUNE 30, 2005

TABLE OF CONTENTS

Basic Financial Statements:

Independent Auditor's Report 1-2

Required Supplementary Information (Part I):

Management's Discussion and Analysis 3-12

Government-wide Financial Statements:

Statement of Net Assets 13

Statement of Activities 14

Governmental Fund Financial Statements:

Balance Sheet – Governmental Funds 15

Reconciliation of the Balance Sheet – Governmental Funds to the Statement of  
Net Assets 16

Statement of Revenues, Expenditures and Changes in Fund Balances –  
Governmental Funds 17

Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund  
Balances of to the Statement of Activities 18

Notes to Basic Financial Statements 19-51

Required Supplementary Information (Part II):

Budgetary Comparison Schedule – General Fund 52-53

Schedule of expenditures of federal awards 54-55

Notes to the schedule of expenditures of federal awards 56

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SINGLE AUDIT REPORT

JUNE 30, 2005

TABLE OF CONTENTS (CONTINUED)

**INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS**

Independent auditor's report on compliance and on internal control over financial reporting based on an audit of financial statements performed in accordance with <i>Government Auditing Standards</i>	57-58
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**INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS (CONTINUED)**

Independent auditor's report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A- 133	59-61
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**FINDINGS AND QUESTIONED COSTS**

Schedule of findings and questioned cost	62-81
Summary schedule of prior year audit findings	82-86



**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 AUDITOR'S 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** (Municipality), as of and for the year ended June 30, 2005, 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.

Except as discussed in the following paragraphs, 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 the Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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.

The Municipality does not maintain a complete and accurate records of all interfund transactions in the due from and due to account balances. Accordingly, we were unable to obtain sufficient evidence to support and to satisfy ourselves about the amount recorded in each major fund and the aggregate remaining fund information as due from/due to other funds, stated at \$2,709,485 in the total governmental funds column of the Balance Sheet – governmental funds. Also, the accounting records for cash transactions are not adequate to identify all interfund transactions, and there may be several interfund transactions not properly recorded.

The financial statements do not disclose certain information in Note 6 related to the purpose for interfund balances and a general description of the principal purposes of interfund transfers. Also, we noted disclosures errors or omissions in the Statement of Activities and in the Financial Statements Notes 1(d), 2, 5, 7, 9 and 11. In our opinion, disclosures of that information is required to conform with accounting principles generally accepted in the United States of America.

The major funds detailed in the Governmental Fund Financial Statements, and in the Financial Statements Notes were incorrectly presented as required by Governmental Standards. In the Balance Sheet, the Special Revenue Fund Local and State Grants was presented as major fund instead of a nonmajor fund. In the Statement of Revenues, Expenditures and Changes in Fund Balance the Special Revenue Fund Local and State Grants and the Special Revenue Fund Federal Grants were presented as major fund instead a nonmajor fund. Also, even though the Total Governmental Funds column is correctly presented, the Special Revenue Fund Federal Grants was incorrectly presented as a major and a nonmajor fund.

In our opinion, except for the effects of such adjustment, if any, as might have been determined to be necessary has we been able to audit evidence regarding interfund transactions, as explained in the third paragraph

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

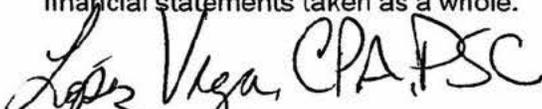
and except for the omissions of the matters discussed in the fourth and fifth paragraphs, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund and the aggregate remaining fund information of the **Municipality of Salinas, Puerto Rico**, as of June 30, 2005, 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 June 13, 2006 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of audit.

The Management's Discussion and Analysis on pages 3 through 12 and the Budgetary Comparison Schedule-General Fund on page 52 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. 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.

The major funds detailed in the Management's Discussion and Analysis were incorrectly presented. Also, we noted disclosures errors in the Budgetary Comparison Schedule, and the Management's Discussion and Analysis.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the **Municipality of Salinas, Puerto Rico** basic financial statements. 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 also not a required part of the basic financial statements of the **Municipality of Salinas, Puerto Rico**. The schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects, in relation to the basic financial statements taken as a whole.

  
LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico  
June 13, 2006

Stamp No. 2106136 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

Management of the Municipality of Salinas of the Commonwealth of Puerto Rico (the Municipality) provides this *Management's Discussion and Analysis* (MD&A) for the readers of the Municipality's basic financial statements. This narrative represents an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2005. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

During fiscal year ended June 30, 2003, the Municipality implemented the new required financial reporting standards established by Statement No. 34, *Basic Financial Statements – and Management's Discussion – and Analysis – for State and Local Governments*, issued by the Governmental Accounting Standards Board (GASB No. 34).

**FINANCIAL HIGHLIGHTS**

**a) Government-Wide Highlights**

- **Assets** – The Municipality has reported assets amounting to \$20.9 millions in the accompanying statement of net assets, of which the most significant are capital assets and cash amounting to \$14.8 millions, \$5.4 millions, respectively.
- **Liabilities** – The Municipality has reported liabilities amounting to \$20.9 millions in the accompanying statement of net assets, of which the most significant are accounts payable, Intergovernmental payable, deferred revenues, and other noncurrent liabilities such as bonds payable and notes payable, amounting to \$0.7 millions, \$0.9 millions, \$0.9 millions and \$17.8 millions respectively.
- **Net assets** – The liabilities of the Municipality exceeded its assets by \$2.0 millions at June 30, 2005, which is presented as “net deficit” in the accompanying statement of net assets. Restricted net assets and unrestricted deficit amounted to \$4.3 millions, as restated, and (\$19.2) millions, respectively. Net assets invested in capital assets amounted to \$12.8 millions.
- **Net change in net assets** – The Municipality's net assets decreased by \$2.3 millions during fiscal year ended June 30, 2005. Net assets at June 30, 2004 amounted to \$0.2 millions. The increased in net deficit was principally for negative result of operations and decrease in the Municipality's overall financial position in comparison with the prior fiscal year.
- **Revenues** – The Municipality has reported total revenues amounting to \$14.7 millions in the accompanying statement of activities, of which the most significant are tax revenues, operating grants and capital grants and contributions amounting to \$4.6 millions, \$6.3 millions, and \$3.1 million, respectively.
- **Expenses** – The Municipality has reported total expenses amounting to \$17 millions in the accompanying statement of activities.

**b) Governmental Funds Highlights**

- **Assets** – The Municipality's governmental funds have reported combined assets amounting to \$8.7 millions in the accompanying balance sheet – governmental funds, of which the most significant are cash and due from other funds, amounting to \$5.4 millions, and \$2.7 millions respectively.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS

- **Liabilities** – The Municipality's governmental funds have reported combined liabilities amounting to \$7.8 millions in the accompanying balance sheet – governmental funds, of which the most significant are accounts payable, intergovernmental payable, interfund due to other funds, and claims and judgments, amounting to \$0.8 millions, \$0.9 millions, \$2.7 millions, and \$2.5 millions respectively.
- **Governmental fund balances** – The Municipality's governmental funds reported combined fund balance amounting to \$0.8 million, of which \$4.4 millions and (\$3.6) millions represent reserved and unreserved fund balances, respectively.
- **Net change in governmental fund balances** – The Municipality's governmental fund balances decreased by (\$2.9) millions during fiscal year ended June 30, 2005. Governmental fund balances at June 30, 2004 amounted to \$3.7 millions. The decrease in fund balances represents the excess of expenditures and other financing uses over revenues and other financing sources.
- **Revenues** – The Municipality's governmental funds have reported combined revenues amounting to \$14.7 millions in the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, of which the most significant are property taxes, intergovernmental grants and contributions, municipal license, construction excise taxes, and federal grants amounting to \$3 millions, \$7.8 millions, \$0.8 millions, \$0.7 million, and \$1.6 million respectively.
- **Expenditures** – The Municipality's governmental funds have reported combined expenditures amounting to \$17.6 millions in the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, of which the most significant are categorized as general government; public works, health and welfare, and culture and recreation amounting to \$8.1 millions, \$3.8 millions, \$2.0 million and \$1.2 millions respectively.

#### USING THIS ANNUAL REPORT

This annual report consist of a series of financial statements similar to the previous financial statements. The focus is on both the Municipality as a whole (government-wide) and the major individual funds. Both perspectives (government-wide and major fund) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability.

#### OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The Municipality's financial statements include three components: (1) the government-wide financial statements, (2) the fund financial statements, and (3) the notes to the financial statements (collectively known as the basic financial statements). This report also contains additional required supplementary information (budgetary schedules) and other supplementary information (combining financial statements) in addition to the basic financial statements themselves. These components are described below:

##### Government-Wide Financial Statements

The *government-wide financial statements* are designed to provide readers with a broad overview of the Municipality's operations and finance as a whole in a manner similar to private-sector business. These statements

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at the end of the fiscal year. These financial statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means that these financial statements follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year ended June 30, 2005 even if cash involved have not been received or paid. The government-wide financial statements include: (1) the statements of net assets and (2) the statement of activities.

**Statement of Net Assets**

The statement of net assets presents all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity). Over time, increases or decreases in the net assets may serve as a useful indicator of whether the financial position of the Municipality is either improving or deteriorating.

**Statement of Activities**

The statement of activities presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2005. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

Both of the abovementioned financial statements present all the governmental activities of the Municipality, which consist mostly by taxes and intergovernmental revenues (such as federal grants). Most services provided by the Municipality fall into this category, including culture and education, general government, health and sanitation, public safety, public housing and welfare, etc.

**Fund Financial Statements**

The Municipality's fund financial statements, which consist of: (1) the balance sheet – governmental funds and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results of operations of the Municipality's governmental funds.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions.

The fund financial statements focus on: (1) individual parts of the Municipality's government and (2) reporting the Municipality's operations in more detail than the government-wide financial statements. For financial reporting purposes, the Municipality classifies its funds within the following fund categories: (1) general fund, (2) debt service fund, (3) special revenue funds and (4) capital projects funds (collectively known as the "governmental funds").

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Governmental funds are used to account for all of the services provided by the Municipality. Governmental funds are used to account for essentially the same functions reported as governmental activities in the governmental-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources. They also focus on the balances of spendable resources available at the end of the fiscal year (June 30, 2005). This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the Municipality's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, that is, evaluating the Municipality's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the fund information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Municipality's near-term financial decisions.

For financial reporting purposes the Municipality has three major funds: (1) the general fund, (2) state legislature joint resolutions and (3) the head start.

#### **Notes to the Basic Financial Statements**

The notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and the fund financial statements. The notes to the basic financial statements can be found immediately following the basic financial statements.

#### **Required Supplementary Information**

The basic financial statements are followed by a section of required supplementary information consisting of a budgetary comparison between actual operating results with the original budget and the final amended budget for the general fund.

#### **INFRASTRUCTURE ASSETS**

Historically, a government's largest group of assets (infrastructure – roads, bridges, traffic signals, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in governmental financial statements. GASB 34 requires that these assets be valued and reported within the governmental column of the Government-Wide Financial Statements. Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (modified approach) which periodically (at least every third year), by category, measures and demonstrates its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of condition of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

As of July 1, 2002, the Municipality commenced the prospective reporting of infrastructure assets. The Municipality expect to retroactively record the historical costs of infrastructure assets during the fiscal year beginning on July 1, 2006. Also the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

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

**Net Assets**

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. In the case of the Municipality, net deficit (excess of liabilities over assets) amounted to (\$2.0) millions at June 30, 2005, compared to net assts of \$0.3 millions at the end of the previous year, as restated.

The largest portion of the Municipality's net assets are invested in capital assets net of their related debt (\$12.8 millions). The Municipality's net assets is also composed of net assets amounting to \$4.4 millions that are restricted for (1) future debt service payments, (2) the future acquisition or construction of capital assets and (3) other purposes, mainly the financing of federal and state assisted programs. In addition, the Municipality's unrestricted deficit reported is (\$19.2) millions.

The unrestricted deficit is the consequence of previous budgets which did not provide funding for incurred long-term obligations such as compensated absences and others. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation. Consequently, the Municipality cannot draw from its existing assets to provide services to its citizens and depends on its taxing ability to continue its operations.

The portion of the Municipality's net assets invested in capital assets such as land, buildings, equipment, etc., less any outstanding related debt used to acquire those assets., are used by the Municipality to provide services to its citizens; consequently these assets are not available for future spending. Although the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from the debt service fund, since the capital assets themselves cannot be used to liquidate these liabilities.

The following is a condensed presentation of the Municipality's financial position, as reported in the government-wide financial statements:

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS

	2005	2004	Change	%
Current assets	\$ 6,090,757	\$ 6,504,027	(413,270)	(6%)
Noncurrent assets	14,812,606	12,510,373	2,302,233	18%
Total assets	<u>20,903,363</u>	<u>19,014,400</u>	<u>1,888,963</u>	10%
Current liabilities outstanding	6,164,837	2,748,183	3,416,654	124%
Noncurrent liabilities outstanding	16,738,465	15,985,356	753,109	5%
Total liabilities	<u>22,903,302</u>	<u>18,733,539</u>	<u>4,169,763</u>	22%
Net assets/(liabilities):				
Invested in capital assets, net of related debt	12,841,727	9,863,494	2,978,233	30%
Restricted	4,366,137	7,598,091	(3,231,954)	(43%)
Unrestricted	<u>(19,207,803)</u>	<u>(17,180,724)</u>	<u>(2,027,079)</u>	12%
Total net assets	<u>\$ (1,999,939)</u>	<u>\$ 280,861</u>	<u>\$ (2,280,800)</u>	(812%)

**Changes in Net Assets**

The Municipality's net deficit increased by \$2.3 millions. Approximately 31 percent of the Municipality's total revenues came from taxes, while 65 percent resulted from restricted and unrestricted capital and operating grants, contributions and reimbursements, including federal financial assistance. The Municipality's expenses cover a range of services. The largest expenses were for general government (56 percent), health and welfare (12 percent) and public works (11 percent).

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following is a condensed presentation of the Municipality's results of operations, as reported in the government-wide financial statements:

<b>Condensed Statement of Activities:</b>	<b>2005</b>	<b>2004</b>	<b>Change</b>	<b>%</b>
<b>Revenues:</b>				
<b>Program revenues:</b>				
Operating grants and contributions	\$ 1,646,798	\$ 3,335,865	\$ (1,689,067)	(51%)
Capital grants and contributions	3,121,419	3,467,464	(346,045)	(10%)
Charges for services	261,661	298,604	(36,943)	(12%)
<b>General revenues:</b>				
Property taxes	3,022,154	2,931,364	90,790	3%
Municipal license taxes	872,072	687,950	184,122	27%
Construction excise taxes	694,932	969,553	(274,621)	(28%)
Unrestricted intergovernmental contributions	4,718,453	4,790,333	(71,880)	(2%)
Unrestricted interest on deposits	186,753	81,747	105,006	128%
Miscellaneous	165,698	91,602	74,096	81%
<b>Total revenues</b>	<b>14,689,940</b>	<b>16,654,482</b>	<b>(1,964,542)</b>	<b>(12%)</b>
<b>Expenses:</b>				
General government	9,510,235	2,326,942	7,183,293	309%
Public safety	1,619,472	709,919	909,553	128%
Public works	1,922,321	1,266,519	655,802	52%
Health and welfare	1,997,793	2,178,722	(180,929)	(8%)
Culture and recreation	1,059,029	383,641	675,388	176%
Community development	417,837	2,540,725	(2,122,888)	(84%)
Urban development	-	31,691	(31,691)	(100%)
Economic development	-	537,811	(537,811)	(100%)
Education	37,277	-	37,277	35812%
Interest on bonds and notes	406,776	340,596	66,180	19%
<b>Total expenses</b>	<b>16,970,740</b>	<b>10,316,566</b>	<b>6,654,174</b>	<b>64%</b>
<b>Net increase in net assets</b>	<b>(2,280,800)</b>	<b>6,337,916</b>	<b>(8,618,716)</b>	<b>(136%)</b>
<b>Net assets - at beginning of year</b>	<b>280,861</b>	<b>(6,057,055)</b>	<b>6,337,916</b>	<b>(105%)</b>
<b>Net assets - at end of year</b>	<b>\$ (1,999,939)</b>	<b>\$ 280,861</b>	<b>(2,280,800)</b>	<b>(812%)</b>

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

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

**Governmental Funds** - The focus of the Municipality's *governmental funds* is to provide information on near-term inflows, outflows, and balance of *spendable resources*. Such information is useful in assessing the Municipality's

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS

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 fiscal year. The following is a condensed presentation of the Municipality's balance sheet and results of operations of governmental funds:

<u>Condensed Balance Sheet - Governmental funds</u>	2005	2004	Change
Total assets- major funds	\$ 7,948,555	\$ 7,569,960	\$ 378,595
Total assets- nonmajor funds	721,498	103,973	617,525
Total assets	<u>8,670,053</u>	<u>7,673,933</u>	<u>996,120</u>
Total liabilities- major funds	7,123,934	3,805,181	3,318,753
Total liabilities- nonmajor funds	699,467	103,973	595,494
Total liabilities	<u>7,823,401</u>	<u>3,909,154</u>	<u>3,914,247</u>
<b>Fund Balances:</b>			
Reserved- major funds	5,765,832	6,116,863	(351,031)
Reserved- nonmajor funds	22,031	-	22,031
Unreserved- nonmajor funds	-	-	-
Unreserved- major funds	(4,941,211)	(2,352,084)	(2,589,127)
Total net assets	<u>\$ 846,652</u>	<u>\$ 3,764,779</u>	<u>(2,918,127)</u>
 <u>Condensed Statement of Operations - Governmental funds</u>			
Total revenues- major funds	\$ 12,907,032	\$ 13,595,303	(688,271)
Total revenues- nonmajor funds	1,748,747	328,514	1,420,233
Total revenues	<u>14,655,779</u>	<u>13,923,817</u>	<u>731,962</u>
Total expenditures- major funds	15,799,354	15,592,794	206,560
Total expenditures- nonmajor	1,774,552	328,514	1,446,038
Total expenditures	<u>17,573,906</u>	<u>15,921,308</u>	<u>1,652,598</u>
Other financing sources (uses) - major fund (excluding interfund)	-	2,900,000	(2,900,000)
Net change in fund balances	<u>\$ (2,918,127)</u>	<u>\$ 902,509</u>	<u>(3,820,636)</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

The accompanying statement of net assets reported total gross capital assets, at cost, amounting to \$20,781,804 at June 30, 2005. The related accumulated depreciation and amortization of capital assets amounted to \$3,962,427 at June 30, 2005. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the municipal government, such as roads, bridges, streets and sidewalks, drainage systems and similar items.

Actual costs incurred to purchase or construct capital assets were \$2,920,096 for the year ended June 30, 2005. Depreciation and amortization charges for the year totaled \$617,863.

The Municipality finances a significant portion of its construction activities through bond issuances and state and federal grants. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes.

**Debt Administration**

The laws and regulations of the Commonwealth of Puerto Rico have 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 laws and regulations also require 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 the Government Development Bank for Puerto Rico, 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 laws and regulations 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.

**ECONOMIC FACTORS AND NEXT BUDGETS AND RATES**

The Municipality relies primarily on property and municipal license taxes, as well as, federal and state grants to carry out the governmental activities. Historically, property and municipal license taxes have been very predictable with increases not generally exceeding ten percent. Federal grant revenues may vary if new grants are available but the revenue is also very predictable.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Those factors were considered when preparing the Municipality's budget for the 2004-2005 fiscal year. There were no significant changes between the budget for fiscal year 2004-2005 and the one for fiscal year 2005-2006.

**FINANCIAL CONTACT**

The Municipality's financial statements are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the Municipality's finances and demonstrate the Municipality's accountability. If you have any questions about the report or need additional financial information, contact the Municipality's Director of Finance, Mr. Roberto Santiago, at PO Box 1149, Salinas, Puerto Rico, 00751, or call (787) 824-2883.

Commonwealth of Puerto Rico  
Municipality of Salinas  
Statement of Net Assets  
June 30, 2005

Assets	Governmental Activities
<b>Current assets:</b>	
Cash in commercial banks	\$ 628,632
Cash with fiscal agent	4,808,191
Accounts receivable:	
Municipal licence tax	73,515
Intergovernmental	268,543
Federal grant	216,985
Other	94,891
Total current assets	6,090,757
<b>Noncurrent assets:</b>	
Capital assets, net of accumulated depreciation and amortization of \$3,962,428	14,812,606
Total noncurrent assets	14,812,606
Total assets	\$ 20,903,363
<b>Current Liabilities (due within one year):</b>	
Accounts payable and accrued liabilities	\$ 784,628
Due to other governmental entities	875,244
Accrued interest payable on long-term debt	125,963
Deferred revenues	938,579
Claims and Judgments	2,515,463
Current portion of noncurrent liabilities	924,960
Total current liabilities	6,164,837
<b>Noncurrent liabilities (due in more than one year):</b>	
Total liabilities	16,738,465 \$ 22,903,302
<b>Net assets (liabilities):</b>	
Invested in capital assets, net of related debt	\$ 12,841,727
Restricted for:	
Capital projects	2,360,848
Debt service	1,278,614
Other specified purposes	726,675
Unrestricted net assets (deficit)	(19,207,803)
Total net assets (deficit)	\$ (1,999,939.00)

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

Commonwealth of Puerto Rico  
Municipality of Salinas  
Statement of Activities  
June 30, 2005

Functions/programs	Expenses	Charges for services	Program Revenues		Net Expenses and Charges in Net Assets
			Operating grants and contributions	Capital grants and contributions	
<b>Governmental activities:</b>					
General government	\$ 9,510,235	\$ 572	\$ 561,864		(\$8,947,799)
Public safety	1,619,472	74,967	31,884		(1,512,621)
Public works	1,922,321	141,874	335,062	\$ 1,598,010	152,625
Health and welfare	1,997,798	6,998	705,288		(1,285,507)
Culture and recreation	1,059,029	23,815	12,700	776,900	(245,614)
Community development	417,837			746,509	328,672
Education	37,277	13,435			(23,842)
Interest on long-term obligation	406,776				(406,776)
<b>Total governmental activities</b>	<b>\$ 16,970,740</b>	<b>\$ 261,661</b>	<b>\$ 1,646,798</b>	<b>\$ 3,121,419</b>	<b>(\$11,940,862)</b>
<b>General Revenues:</b>					
Property taxes					3,022,154
Municipal license taxes					872,072
Other local taxes					694,932
Grants and contributions, not restricted to specific programs					4,718,453
Interests on investment earnings					186,753
Miscellaneous					165,698
<b>Total general revenues</b>					<b>9,660,062</b>
					<b>Net changes in net assets (2,280,800)</b>
					<b>Net assets (deficit) at beginning of the year, as restated 280,861</b>
					<b>Net assets (deficit) at the end of the year (\$1,999,939)</b>

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Balance Sheet - Governmental Funds  
June 30, 2005

**MAJOR FUNDS**

	General Fund	Special Revenue Fund Local and State Grants	Capital Project Fund Local and State Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
<b>ASSETS</b>						
Cash and cash equivalents	\$ 28,273	\$ 146,542	\$ 99,699	\$ -	\$ 354,119	\$ 628,633
Cash in fiscal agent	2,507,381	-	936,784	1,231,821	132,205	4,808,191
Account receivable:						
Municipal license	-	-	-	-	-	-
Intergovernmental	-	91,406	-	177,138	-	268,544
Federal grant	-	-	-	-	216,985	216,985
Due from other funds	275,763	621,411	1,794,122	-	18,189	2,709,485
Other	35,836	-	-	2,379	-	38,215
Total assets	<u>\$ 2,847,253</u>	<u>\$ 859,359</u>	<u>\$ 2,830,605</u>	<u>\$ 1,411,338</u>	<u>\$ 721,498</u>	<u>\$ 8,670,053</u>
<b>LIABILITIES</b>						
Accounts payable and accrued liabilities	\$ 412,086	\$ 27,320	\$ 211,808	\$ -	\$ 133,416	\$ 784,630
Intergovernmental	875,244	-	-	-	-	875,244
Due to other funds	2,202,682	134,776	257,949	6,761	107,317	2,709,485
Deferred revenue	479,845	-	-	-	458,734	938,579
Claims and Judgments	2,515,463	-	-	-	-	2,515,463
Matured bonds due and payable	-	-	-	-	-	-
Matured interests due and payable	-	-	-	-	-	-
Total liabilities	<u>6,485,320</u>	<u>162,096</u>	<u>469,757</u>	<u>6,761</u>	<u>699,467</u>	<u>7,823,401</u>
<b>FUND BALANCE</b>						
Reserved for:						
Encumbrances	1,295,763	-	-	-	-	1,295,763
Debt service	-	-	-	1,404,577	-	1,404,577
Capital projects	-	-	2,360,848	-	-	2,360,848
Other specified purposes	7,381	697,263	-	-	22,031	726,675
Unreserved, reported in:						
General fund	(4,941,211)	-	-	-	-	(4,941,211)
Total fund balances (deficit)	<u>(3,638,067)</u>	<u>697,263</u>	<u>2,360,848</u>	<u>1,404,577</u>	<u>22,031</u>	<u>846,652</u>
<b>TOTAL LIABILITIES AND FUND BALANCE</b>	<u>\$ 2,847,253</u>	<u>\$ 859,359</u>	<u>\$ 2,830,605</u>	<u>\$ 1,411,338</u>	<u>\$ 721,498</u>	<u>\$ 8,670,053</u>

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Reconciliation of the Balance Sheet - Governmental Funds to the Statement of Net Assets  
June 30, 2005

Aggregate fund balance reported in the balance sheet - governmental funds	\$	846,652
Governmental activities' amounts reported in the statement of net assets and the balance sheet - governmental funds are different because:		
Assets not available to pay current period expenditures not reported in the governmental funds		130,189
Capital assets used in governmental activities are not financial resources, therefore, are not reported in the governmental funds		14,812,606
The following liabilities are not due (mature) in the current period, therefore, are not reported in the governmental funds:		
Bonds and notes payable		(8,228,379)
Accrued interests on bonds and notes payable		(125,963)
Income tax - Treasury Department		(139,488)
Property tax debt- CRIM		(162,733)
Compensated absences		(922,082)
Landfill closure and postclosure care costs		(4,731,445)
CRIM Debt-Law 42		(1,102,214)
CRIM Debt-Law 146		(872,137)
Puerto Rico Aqueduct and Sewer Company		(243,710)
Department of Labor - Unemployment insurance payable		(35,423)
Claims and judgments		(1,225,812)
		(1,225,812)
Net assets as reported in the accompanying statement of net assets	\$	(1,999,939)

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF SALINAS**  
Statement of Revenues, Expenditures and Change in Fund Balance - Governmental Funds  
Year Ended June 30, 2005

**MAJOR FUNDS**

	MAJOR FUNDS						Total Governmental Funds
	General Fund	Special Revenue Fund Local and State Grants	Special Revenue Fund Federal Grants	Capital Project Fund Local and State Grants	Debt Service Fund	Other Nonmajor Funds	
<b>REVENUES</b>							
Property taxes	\$ 2,295,777	\$ -	\$ -	\$ -	\$ 726,377	\$ -	\$ 3,022,154
Municipal license taxes	798,558	-	-	-	-	-	798,558
Licenses, permits and other local taxes	734,285	-	-	-	-	-	734,285
Charges of service	186,155	8,482	6,998	-	-	6,998	201,635
Intergovernmental	4,482,089	502,813	85,417	2,769,809	-	85,417	7,840,138
Rent of Property	34,636	-	-	-	-	-	34,636
Fines and forfeitures	16,989	-	-	-	-	-	16,989
Interest	186,635	37	22	58	-	22	186,752
Federal grants	-	-	1,307,733	-	-	1,646,532	1,646,532
Miscellaneous	159,697	4,625	9,778	-	-	9,778	174,100
<b>Total Revenues</b>	<b>\$ 8,894,831</b>	<b>\$ 515,957</b>	<b>\$ 1,409,948</b>	<b>\$ 2,769,867</b>	<b>\$ 726,377</b>	<b>\$ 1,748,747</b>	<b>\$ 14,655,779</b>
<b>EXPENDITURES</b>							
<b>Current:</b>							
General government	7,665,183	403,331	-	-	-	-	8,068,514
Public safety	790,354	22,486	36,797	-	-	36,797	849,637
Public works	3,011,576	44,563	335,062	390,118	-	335,062	3,781,319
Health and welfare	1,279,768	45,861	317,385	-	-	656,184	1,981,813
Culture and recreation	377,114	266,955	-	569,553	-	-	1,213,622
Community development	-	-	746,509	-	-	746,509	746,509
Education	38,216	-	-	-	-	-	38,216
<b>Debt service:</b>							
Principal	-	-	-	-	508,500	-	508,500
Interest	-	-	-	-	365,776	-	365,776
<b>Total Expenditures</b>	<b>13,162,211</b>	<b>783,196</b>	<b>1,435,753</b>	<b>959,671</b>	<b>894,276</b>	<b>1,774,552</b>	<b>17,573,906</b>
Excess (Deficiency) of Revenues over expenditures	(4,267,380)	(267,239)	(25,805)	1,810,196	(167,899)	(25,805)	(2,918,127)
<b>OTHER FINANCING SOURCES (USES)</b>							
Transfer in from other funds	147,500	255,000	-	-	333,609	-	736,109
Transfer out to other funds	(588,609)	-	-	(147,500)	-	-	(736,109)
<b>Total Other Financing Sources (uses)</b>	<b>(441,109)</b>	<b>255,000</b>	<b>-</b>	<b>(147,500)</b>	<b>333,609</b>	<b>-</b>	<b>-</b>
<b>NET CHANGE IN FUND BALANCE</b>	<b>(4,708,489)</b>	<b>(12,239)</b>	<b>(25,805)</b>	<b>1,662,696</b>	<b>165,710</b>	<b>(25,805)</b>	<b>(2,918,127)</b>
<b>FUND BALANCE AT BEGINNING OF YEAR</b>	<b>1,070,422</b>	<b>709,502</b>	<b>47,836</b>	<b>698,152</b>	<b>1,238,867</b>	<b>47,836.00</b>	<b>3,764,779</b>
<b>FUND BALANCE (DEFICIT) AT END OF YEAR</b>	<b>\$ (3,638,067)</b>	<b>\$ 697,263</b>	<b>\$ 22,031</b>	<b>\$ 2,360,848</b>	<b>\$ 1,404,577</b>	<b>\$ 22,031.00</b>	<b>\$ 846,652</b>

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

Commonwealth of Puerto Rico  
Municipality of Salinas  
Reconciliation of Statement of Revenues, Expenditures and Changes in Fund Balance  
Governmental Funds to the Statements of Activities  
For the Year Ended June 30, 2005

Net change in fund balances- total governmental funds \$ (2,918,127)

Governmental activities amounts reported in the statement of activities and the statement of Revenues, expenditures and changes in fund balances governmental funds are different because:

Revenues in the statement of activities that not provide current financial resources, therefore are not reported as revenues in the funds:

Net Change in Noncurrent Receivables 34,161

Under the modified accrual basis of accounting used in the governmental funds, expenditures are not recognize for transactions that are not normally paid with expendable financial resources. In the Statements of Activities , however, wich is presented in the accrual basis, expenses and liabilities are presented regardless of when financial resources are available:

Net Change in Compensated Absences Liability	(166,848)
Landfill Closure and Post closure care costs	(847,542)
CRIM Property Tax - Act Number 42 Liability	(212,697)
Puerto Rico Water and Sewer Authority	(70,710)
Department of Labor - Unemployment Debt	(35,423)
Claims and Judgments	(850,016)
2004-2005 CRIM Property Tax Final Liquidation	(162,733)

Governmental funds report capital outlays as expenditures. However in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation and amortization expenses. This the amount by which capital outlays exceed depreciation expenses. 2,302,233

Repayment of principal of long-term obligation is an expenditures in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets 667,902

Interst expense change is reported in the Government-Wide Statements 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 (21,000)

Net changes in net assets reported in the accompayning statements of activities \$ (2,280,800)

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

**1. Summary of Significant Accounting Policies**

The Municipality of Salinas of the Commonwealth of Puerto Rico (the "Municipality") is a local government with full legislative, fiscal and administrative powers to operate as a government under Law No. 81 of August 30, 1991, as amended, known as the *Autonomous Municipalities Act of the Commonwealth of Puerto Rico (Law No. 81)*.

The Municipality's governmental system consists of executive and legislative branches. The Constitution of the Commonwealth of Puerto Rico (the "Commonwealth") provides for the separation of powers of the executive, legislative and judicial branches. A Mayor, elected every four years by the citizens, exercises the executive power of the Municipality. The legislative power is exercised by the Municipal Legislature, which is also elected every four years. The General Justice Court System of the Commonwealth, which has jurisdiction over the Municipality, exercises the judiciary power.

The Municipality assumes responsibility for providing services to its citizens related to public housing, welfare, public safety, health, sanitation, education, culture, recreation, urban and economic development, and many other general and administrative duties.

**a) *New Financial Reporting Model***

The accompanying basic financial statements present the financial position and the results of operations of the Municipality as a whole, and its various governmental funds as of and for the year ended June 30, 2005, in conformity with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB).

In June 1999, GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34). This statement established new financial reporting requirements for state and local governments. On July 1, 2002, the Municipality adopted the provisions of GASB No. 34 as well as other statements referred to below.

According to the new financial reporting model established by GASB No. 34, the minimum required financial statement presentation applicable to the Municipality is composed of the following elements: (1) government-wide financial statements (GWFS), (2) governmental fund financial statements (GFFS), (3) notes to basic financial statements, and (4) required supplementary information (RSI).

The RSI, which consists of a management discussion and analysis (MD&A), is information presented along with, but separate from, the Municipality's basic financial statements. The MD&A is a narrative report that introduces the accompanying basic financial statements and provides an analytical overview of the Municipality's financial activities for the year ended June 30, 2005, based on the Municipality's knowledge of the transactions, events and conditions reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

As previously mentioned, on July 1, 2002, other statements and interpretations were also adopted in conjunction and simultaneously with GASB No. 34. Those statements and interpretations are: (1) GASB Statement No. 33 - *Accounting and Financial Reporting for Nonexchange Transactions*, (2) GASB Statement No. 37 - *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, (3) GASB Statement No. 38 - *Certain Financial Statement Note Disclosures* and (4) GASB Interpretation No. 6 - *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

GASB No. 34 also required that the accounting for all governmental activities reported in the GWFS be based on applicable pronouncements issued by the Financial Accounting Standards Board (FASB) and its predecessor bodies, such as the Accounting Principles Board (APB), issued on or before November 30, 1989, provided those pronouncements do not conflict with or contradict GASB pronouncements. Accordingly, in conjunction and simultaneously with the adoption of GASB No. 34, the Municipality also adopted the following pronouncements: (1) APB Opinion No. 20 - *Accounting Changes*, (2) APB Opinion No. 21 - *Interest on Receivables and Payables*, (3) FASB Statement No. 5 - *Accounting for Contingencies* and (4) FASB Statement No. 16 - *Prior Period Adjustments*. The Municipality has elected to not apply all statements and interpretations issued by FASB after November 30, 1989.

**b) Financial Reporting Entity**

The accompanying basic financial statements include all departments, agencies and municipal entities that: (1) are under the legal and administrative control of the Mayor and (2) whose funds are under the legal custody and control of the Municipality's Director of Finance and Budget, as prescribed by Law No. 81.

The Municipality's management has considered all potential component units for which it may be financially accountable and other legally separate organizations for which the nature and significance of their relationship with the Municipality may be such that exclusion of their basic financial statements from those of the Municipality would cause the Municipality's basic financial statements to be misleading or incomplete.

GASB Statement No. 14 - *The Financial Reporting Entity* (GASB No. 14) has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the Municipality to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the Municipality.

On July 1, 2003, the Municipality adopted the provisions of GASB Statement No. 39 - *Determining Whether Certain Organizations are Component Units* (GASB No. 39). This statement provides additional guidance in determining whether certain organizations for which the primary government is not financially accountable should be reported as component units based on the nature and significance of their relationship with the primary government. Generally, GASB No. 39 requires

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

reporting a component unit if an organization rises and holds economic resources for the direct benefit of a governmental unit.

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality as of June 30, 2005 nor for the year then ended.

**c) *Government-wide Financial Statements***

The accompanying GWFS are composed of: (1) the statement of net assets and (2) the statement of activities. These financial statements do not report fund information but rather report information of all of the Municipality's governmental activities. These statements are aimed at presenting a broad overview of the Municipality's finances through reporting its financial position and results of operations as a whole, using methods that are similar to those used by most private businesses.

The focus of the GWFS is not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability), but on operational accountability information about the Municipality as a single economic unit. Operational accountability is the Municipality's responsibility to report to the extent to which it has met its operating objectives efficiently and effectively, using all resources available for that purpose. It focuses on the Municipality's principal operating objective, which is to provide services to its citizens.

The accompanying statement of net assets provides short-term and long-term information about the Municipality's financial position and condition by presenting all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity). This statement assists management in assessing the level of services that can be provided by the Municipality in the future, and its ability to meet its obligations as they become due. In addition, this statement reports the extent to which the Municipality has invested in capital assets, including infrastructure, and discloses legal and contractual restrictions on resources.

Net assets are classified in the accompanying statement of net assets within the following three categories:

- **Invested in capital assets, net of related debt** - These consist of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvement of capital assets have been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs.
- **Restricted net assets** - These consist of net assets restricted by external parties (such as creditors, grantors, contributors, laws or regulations of other governments, etc.), or net assets for which constraints are imposed by constitutional provisions or enabling legislation. Enabling

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

legislation is defined as legislation that authorizes the Municipality to assess, levy, charge or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

The classification of restricted net assets identifies resources that have been received or earned by the Municipality with an explicit understanding between the Municipality and the resource providers that the resources would be used for specific purposes. Grants, contributions and donations are often given under those kinds of conditions. Bond indentures also often limit the use of bond proceeds to specific purposes.

Internally imposed designations of resources, including earmarking, are not reported as restricted net assets. These designations consist of management's plans for the use of resources, which are subject to change at the discretion of the Municipal Legislature.

- **Unrestricted net assets** - These consist of net assets that are neither externally or legally restricted, nor invested in capital assets. However, unrestricted net assets often are designated to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints that are imposed by management, but can be removed or modified.

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

The accompanying statement of activities presents the results of the Municipality's operations by showing how the Municipality's net assets changed during the year ended June 30, 2005, using a net (expense) revenue format. This statement presents the cost of each function/program as well as the extent to which each of the Municipality's functions, programs or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, municipal license taxes, other local taxes, etc.).

A function/program describes a group of activities that are aimed at accomplishing a major service or regulatory responsibility. The functions/programs reported in the accompanying basic financial statements are: (1) general government, (2) public safety, (3) public works, (4) health and welfare, (5) culture and recreation, (6) economic development, (7) Community Development, and (7) education. The governmental operations of the Municipality's departments and operational units are classified within the following functions/programs in the accompanying basic financial statements: (a) general government, (b) public safety, (c) public works, (d) health and welfare, (e) culture and recreation, (f) community development, (g) and education.

The statement of activities demonstrates the degree to which program revenues offset direct expenses of a given function/program or segments. Direct expenses are those that are clearly identifiable with a specific function, segment or operational unit. This statement reports revenues in two broad categories: (1) program revenues and (2) general revenues.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

Program revenues are generated directly from a program itself or may come from parties outside the Municipality's taxpayers or citizens. In the statement of activities, program revenues reduce the costs (expenses) of the function/program to arrive at the net cost of the function/program that must be financed from the Municipality's general revenues. The accompanying statement of activities separately reports the following categories of program revenues:

- **Charges for services** – These generally consist of exchange or exchange-like transactions involving charges to customers or applicants who purchase, use or directly benefit from the goods, services or privileges provided, or are otherwise directly affected by the services. These include fees charged for specific services, charges for licenses and permits, and fines and forfeitures, among others.
- **Program-specific capital and operating grants and contributions** – These consist of transactions that are either mandatory or voluntary nonexchange transactions with other governments, organizations, or individuals that restrict the resources for use in a particular program. Capital grants and contributions consist of capital assets or resources that are restricted for capital purposes – to purchase, construct or renovate capital assets associated with a specific program. Operating grants and contributions consist of resources that are required to be used to finance the costs of operating a specific program or can be used either for operating or capital purposes of a specific program. Restricted capital and operating grants and contributions are program revenues because they are specifically attributable to a program and reduce the net expense of that program to the Municipality. They are reported net of estimated uncollectible amounts.

General revenues are the default category for revenues. It includes all revenues and gains that do not meet the definition of program revenues. Property taxes, municipal license taxes and construction excise taxes are reported as general revenues. All other non tax revenues (including unrestricted investment earnings, grants and contributions not restricted for specific programs and miscellaneous revenues) that do not meet the definition of program revenues are classified as general revenues. Resources that are dedicated internally by the Municipality are reported as general revenues rather than as program revenues. All general revenues are reported net of estimated uncollectible amounts, which are recorded as reduction of revenues rather than as expenses.

The *general government* function/program reported in the accompanying statement of activities, includes expenses that are, in essence, indirect or overhead expenses of the Municipality's other functions/programs. Even though some of these costs have been charged to other funds in the governmental fund financial statements as indirect cost allocations permitted under some federal programs, the Municipality has reported these indirect expenses as direct expenses of the general government function. Accordingly, the Municipality does not allocate general government (indirect) expenses to other functions.

The effects of all interfund governmental activities (revenues, expenditures and other financing sources/uses among governmental funds) have been removed from the accompanying statements of net assets and activities.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

The Municipality classifies all of its activities as governmental activities in the accompanying GWFS. These are activities generally financed through taxes, intergovernmental revenues and other nonexchange revenues that can be used to support the Municipality's programs or services. These governmental activities are also generally reported in the governmental fund financial statements.

The Municipality has no fiduciary activities, which are those in which the Municipality would be holding or managing net assets for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements. In addition, the Municipality has no operations or activities that are primarily financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public is financed primarily through user charges.

**d) Governmental Fund Financial Statements**

The accompanying GFFS are composed of: (1) the balance sheet – governmental funds and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results operations of the Municipality's governmental funds by presenting sources, uses and balances of current financial resources. Some of these financial statements have a budgetary orientation and focus primarily on: (1) the Municipality's major funds, as defined below, (2) the fiscal accountability and (3) the individual parts of the Municipality's government. Fiscal accountability represents the Municipality's responsibility to justify that its actions in the current year have complied with public decisions concerning the raising and spending of public moneys in the short term (one fiscal year).

Each governmental fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity or deficit, revenue and expenditures. The accompanying GFFS segregate governmental funds according to their intended purpose and are used in demonstrating compliance with legal, financial and contractual provisions. The minimum number of governmental funds is maintained consistent with legal and self-imposed managerial requirements established by the Municipality. For financial reporting purposes, the Municipality classifies its governmental funds within the following categories:

- **General fund** – The general fund is the Municipality's main operating and major fund, as defined below, used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund. It is presumed that the Municipality's governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund.
- **Special revenue funds** – The special revenue funds are used by the Municipality to account for revenues derived from grants or other revenue sources (other than major capital projects) that are either self-restricted by the Municipality or legally restricted by outside parties for use in specific purposes. The uses and limitations of each special revenue fund are specified by

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

municipal ordinances or federal and state statutes. However, resources restricted to expenditure for purposes normally financed from the general fund are reported in the Municipality's general fund provided that all applicable legal requirements are appropriately satisfied. In this case, a special revenue fund to account for such kind of transactions will be used only if legally mandated.

- **Debt service fund** - The debt service fund is used by the Municipality to account for the accumulation of resources for, and the payment of, principal and interest for: (1) bonds and notes for which debt service payments are legally mandated to be accounted for in a debt service fund and/or (2) general long-term debt for which the Municipality is being accumulating financial resources in advance, to pay principal and interest payments maturing in future years.

General long-term debts for which debt service payments do not involve the advance accumulation of resources (such as obligations under capital leases, compensated absences, claims and judgments, and notes payable, among others) are accounted for in the accompanying statement of net assets. The debt service payments of such debts are generally accounted for in the general fund.

- **Capital projects funds** - Capital projects funds are used to account for the financial resources used in the acquisition or construction of major capital facilities, other assets and permanent improvements. Significant capital outlays financed from general obligation bond proceeds are accounted for also in the capital projects funds.

The use of the capital projects funds has been reserved for major capital acquisitions or construction activities that would distort financial resources trend data if not reported separately from the other Municipality's operating activities. The routine purchases of minor capital assets (such as certain vehicles and other minor capital assets) have been reported in the fund from which financial resources were used for the purchase.

Prior to GASB No. 34, the Municipality was required to report governmental fund financial statements that presented a single aggregated column for each fund type. Each column presented the combined total of all funds of a particular type. Fund types are no longer the focus of the accompanying governmental fund financial statements. Under GASB No. 34, the focus of the governmental fund financial statements is on major funds, which generally represent the Municipality's most important funds. Accordingly, the Municipality is required to segregate governmental funds among major and non major within the governmental fund financial statements. Major individual governmental funds are reported individually as separate columns in the governmental fund financial statements, while data from all non major governmental funds are aggregated into a single column, regardless of fund type.

By definition, the Municipality's general fund is always considered a major governmental fund for financial reporting purposes. In addition, any other fund is considered a major fund for financial reporting purposes if its total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds. For the purposes of applying the

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

aforementioned major fund criteria, no eliminations of interfund balances have been made. Total revenues for these purposes means all revenues, including operating and non operating revenues (net of allowances), except for other financing sources. Total expenditures for these purposes mean all expenditures, including operating and non operating expenditures, except for other financing uses.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying governmental fund financial statements are as follow:

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

**e) Measurement Focus and Basis of Accounting**

Government-wide financial statements – The accompanying GWFS are prepared using the economic resources measurement focus and the accrual basis of accounting. Subject to the additional rules and limitations detailed below, revenues (including interest income) are generally recorded when earned and expenses are generally recorded when a liability is incurred, regardless of the timing of related cash flows.

All revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are generally recorded when the exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values.

An exchange-like transaction is one in which there is an identifiable exchange and the values exchanged, though related, may not be quite equal. Nevertheless, the exchange characteristics of the exchange-like transaction are strong enough to justify treating it as an exchange for accounting purposes (examples include fees for licenses and permits, charges for services, and miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received).

All revenues, expenses, gains, losses and assets resulting from nonexchange transactions are recorded using the criteria set forth by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (GASB No. 33), which the Municipality adopted on July 1, 2003. GASB

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

No. 33 established accounting and reporting standards for nonexchange transactions involving cash and financial or capital resources (for example, most taxes, grants and private donations). In a nonexchange transaction, the Municipality gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal values. According to GASB No. 33, the Municipality groups its nonexchange transactions into the following four classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed nonexchange revenues, (c) government mandated nonexchange transactions, and (d) voluntary nonexchange transactions.

In the case of derived tax revenue transactions (such as municipal license taxes), which result from assessments the Municipality places on exchange transactions, receivables and revenues are recorded when the underlying exchange has occurred (that generally is, when the taxpayers' net sales or revenues subject to tax take place).

In the case of imposed nonexchange revenue transactions (such as property taxes), which result from assessments made by the Municipality on nongovernmental entities, including individuals, other than assessments on exchange transactions, receivables are generally recorded in the period when an enforceable legal claim has arisen. Property taxes are generally recorded as revenues (net of amounts considered not collectible) in the period when resources are required to be used or the first period that the use of the resources is permitted.

Government-mandated nonexchange transactions (such as grants and contributions) result when a government at one level (such as the federal or state government) provides resources to another government (such as the Municipality), and the provider government requires the recipient government to use those resources for a specific purpose or purposes established in the provider's enabling legislation. In these types of transactions, receivables and revenues are generally recorded as follows:

- For reimbursement-type (commonly known as "expenditure-driven awards"), receivables and revenues are recorded when all eligibility requirements imposed by the provider have been met. The Municipality must expend resources on the specific purpose or project before the provider reimburses any amounts. Revenue is, therefore, generally recognized as qualifying reimbursable expenditures are incurred.
- For other types of grants (mainly grants and contributions with purpose restrictions but with no time requirements), receivables and revenues are recorded when all applicable eligibility requirements are met. When the provider is a government (including the government of the United States of America) the applicable recognition period for both, the provider and the recipient, is the provider's fiscal year and begins on the first day of that year.

Voluntary nonexchange transactions (such as donations and certain grants and entitlements) result from legislative or contractual agreements, other than exchanges, entered into willingly by two or more parties. In these types of transactions, receivables and revenues are generally accounted for in the same manner as government-mandated nonexchange transactions discussed above.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

Receipts of any type of revenue sources collected in advance for use in the following period are recorded as deferred revenues.

Events that are neither exchange nor nonexchange transactions are recorded when it is probable that a loss has been incurred and the amount of loss is reasonably estimable.

The measurement focus and the basis of accounting used in the accompanying GWFS differ significantly from the measurement focus and basis of accounting used in the preparation of the accompanying GFFS. Therefore, the accompanying GFFS include reconciliations to better identify the relationship between the GWFS and the GFFS.

**Governmental fund financial statements** – The accompanying GFFS are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are generally recognized as soon as they are both measurable and available. Revenues are generally considered to be available when they are collectible within the current year or soon enough thereafter to pay liabilities of the current year. For this purpose, the Municipality considers most revenues to be available if collected within 60 days after June 30, 2005, including property taxes. Revenue sources not meeting this availability criterion or collected in advance are recorded as deferred revenues at June 30, 2005. The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, intergovernmental grants and contributions and interest income. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as deferred revenues.

In a manner similar to the GWFS, but subject to and limited by the availability criteria discussed above, all revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are also generally recorded when the exchange takes place. Accordingly, fees for licenses and permits, charges for services and miscellaneous revenues are recorded as revenues when collected because they are generally not measurable until actually received.

All revenues, expenses, gains, losses and assets resulting from nonexchange transactions are recorded in a similar manner to the GWFS, using the previously discussed criteria set forth by GASB No. 33 for nonexchange transactions, but subject to and limited by the availability criteria discussed above. Accordingly, municipal license tax receivables and revenues are generally recorded when the underlying exchange has occurred. Property tax receivables are also generally recorded in the period when an enforceable legal claim has arisen while property tax revenues (net of amounts considered not collectible) are also generally recorded in the period when resources are required to be used or the first period that the use of the resources is permitted. Receivables and revenues from reimbursement-type grants, contributions, donations and entitlements are also generally recorded as qualifying reimbursable expenditures are incurred, while receivables and revenues from other types of grants are recorded when all eligibility requirements imposed by the provider have been met.

Interest income is recorded when earned only if collected within 60 days after year-end since these would be considered both measurable and available.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

As previously discussed, on July 1, 2002, the Municipality adopted the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASBI No. 6), which modifies the recognition criteria for certain expenditures and liabilities reported under the modified accrual basis of accounting and clarifies a number of situations in which the Municipality should distinguish between governmental fund liabilities and general long-term liabilities.

Pursuant to the provisions of GASBI No. 6, in the absence of an applicable accrual modification, governmental fund liabilities and expenditures should be accrued. Liabilities that governments normally pay in a timely manner and in full from expendable available financial resources (for example, salaries and utilities) should be recognized when incurred, without regard to the extent to which resources are currently available to liquidate the liability.

Modifications to the accrual basis of accounting include:

- Employees' accumulated vacation and sick leave is recorded as expenditure when consumed. The amount of the unpaid compensated absences has been reported only in the accompanying statements of net assets.
- Principal and interest on bonds and notes payable are recorded when they mature (when payment is due).
- Obligations under capital leases, amounts subject to claims and judgments under litigation and other long-term obligations are recorded only when they mature (when payment is due).
- Accounts payable and accrued liabilities not expected to be liquidated with available and expendable financial resources are recorded in the accompanying statement of net assets but not in the governmental funds.
- Executory purchase orders and contracts are recorded as a reservation of fund balance in the GFFS.

Liabilities outside the bounds of these exceptions or modifications are reported as governmental fund liabilities when incurred (including salaries, professional services, supplies, utilities, etc.) since these liabilities normally are paid in a timely manner and in full from current financial resources.

The measurement focus of the GFFS is on decreases in net financial resources (expenditures) rather than expenses. Most expenditures are measurable and are recorded when the related governmental fund liability is incurred. Allocation of costs, such as depreciation and amortization, are recorded in the accompanying statement of activities, but are not recorded in the accompanying GFFS.

Under the new financial reporting model established by GASB No. 34, all general capital assets and the unmatured long-term liabilities (determined using the modified accrual basis of accounting) are

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

no longer reported in account groups within the governmental fund balance sheet but are incorporated into the accompanying statement of net assets since July 1, 2002.

f) *Stewardship, Compliance and Accountability*

Budgetary Control

According to the Autonomous Municipalities Act of the Commonwealth of Puerto Rico, the Mayor and its Administrative Cabinet prepare annual budgets each fiscal year for the Municipality's general fund. Such legally adopted budget is based on expected expenditures by program and estimated resources. The annual budget is developed using elements of performance-based program budgeting and zero-based budgeting, and include estimates of revenues and other resources for the ensuing fiscal year under laws and regulations existing at the time the budget is prepared.

The Mayor must submit an annual budgetary resolution project (the Project) to the Commissioner of Municipal Affairs of Puerto Rico (the Commissioner) and the Municipal Legislature no later than each May 10 and May 15, respectively. The Commissioner preliminarily verifies that the Project complies with all the applicable laws and regulations and may provide comments and suggestions to the Mayor on or before each June 13.

The Municipal Legislature has 10 business days, up to June 13, to discuss and approve the Project with modifications. The Municipal Legislature may amend the budgets submitted by the Mayor but may not increase any items so far to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. After the Municipal Legislature modifies and preliminarily approves the Project, the modified Project is sent back to the Mayor for his approval or rejection within 6 days. The Mayor may decrease or eliminate any line item but may not increase or insert any new line item in the budgets. The Mayor may also veto the budgets in their entirety and return it to the Municipal Legislature with his objections. If the Mayor rejects the Project, the Municipal Legislature will have up to 8 days to adopt or reject the recommendations or objections of the Mayor. The approved Project is sent again to the Mayor, which then would have 3 days to sign and approve it.

If the budget is not adopted prior to the end of the deadlines referred to above, the annual budget for the preceding fiscal year, as approved by the Legislature and the Mayor, are automatically renewed for the ensuing fiscal year until the Municipal Legislature and the Mayor approve new budgets. This permits the Municipality to continue making payments for its operations and other purposes until the new budget is approved.

The annual budget may be updated for any estimate revisions as well as year-end encumbrances and may include any additional information requested by the Municipal Legislature. The Mayor may request subsequent amendments to the approved budget, which are subject to the approval of the Municipal Legislature.

The Municipality's Department of Finance has the responsibility to ensure that budgetary spending control is maintained. For day-to-day management control, expenditures plus encumbrances may

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

not exceed budgeted amounts at the expenditure-type level of each cost center (activity within a program within a fund). The Mayor may transfer unencumbered appropriations within programs within funds. The Municipal Legislature may transfer amounts among programs within and among funds.

The legal level of budgetary control (i.e., the level at which expenditures may not legally exceed appropriation) is at the functions/program level (general government, public safety, public works, health and sanitation, culture and recreation, economic development, community development, and education) within a fund.

Under the laws and regulations of the Commonwealth, the appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided.

#### **Budgetary Accounting**

The Municipality's annual budget is prepared under the budgetary (statutory) basis of accounting, which is not in accordance with GAAP.

Under the budgetary basis of accounting, revenue is generally recognized when cash is received. Short-term and long-term borrowings may be used to finance budgetary excess of expenditures over revenues.

The Municipality uses encumbrance accounting to record the full amount of purchase orders, contracts and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control. Accordingly, expenditures are generally recorded when the related expenditure is incurred or encumbered. Available appropriations and encumbrances are established to lapse one year after the end of the fiscal year. Amounts required to settle claims and judgments against the Municipality, and certain other liabilities, are not recognized until they are encumbered or otherwise processed for payment. Unencumbered appropriations and encumbrances lapse at year-end. Other appropriations, mainly capital projects 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 accompanying budgetary comparison schedule provides information about the general fund's original budget, the amendments made to such budget, and the actual general fund's results of operations under the budgetary basis of accounting for the fiscal year ended June 30, 2005. Further details of the Municipality's budgetary control at the legal level may be obtained from the Budgetary Liquidation Report for the fiscal year ended June 30, 2005. Copies of that report may be obtained by writing to the Municipality's Director of Finance.

Accounting principles applied for purposes of developing data on a budgetary basis differ significantly from those used to present the governmental fund financial statements in conformity

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

with GAAP. Accordingly, the accompanying budgetary comparison schedule is accompanied by a reconciliation of the differences between the budgetary basis and GAAP actual amounts.

**g) *Cash, cash equivalents, and cash with fiscal agents***

The Municipality's deposits are composed of cash on hand, demand deposits and cash equivalents in: (1) commercial banks, and (2) the Government Development Bank for Puerto Rico (GDB), a governmental bank and a major component unit of the Commonwealth, who is statutorily designated as fiscal agent of the Municipality.

The Municipality follows the practice of pooling cash. The balance in the pooled cash account is available to meet current operating requirements. Under the laws and regulations of the Commonwealth, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the federal depository insurance generally provided by the Federal Deposits Insurance Corporation (FDIC). All securities pledged as collateral are held by agents designated by the Secretary of the Treasury of the Commonwealth, but not in the Municipality's name.

Cash with fiscal agent in the debt service fund represent property tax collections which are retained and restricted for the payment of the Municipality's debt service, as established by law. Cash in fiscal agent in other governmental funds consists of unspent proceeds of bonds and notes, and the balance of interest and non interest bearing accounts which are restricted for: (1) the acquisition, construction or improvement of major capital assets and the operations of federal and state funded programs.

**h) *Accounts and Notes Receivables***

In the accompanying GWFS, receivables consist of all revenues earned but not collected at June 30, 2005. Major receivable balances for the governmental activities include intergovernmental, federal grants, volume of business taxes and construction excise tax receivables.

Tax receivables in the debt service fund consist of uncollected property taxes, which are restricted for the payment of the Municipality's debt service, as established by law.

Intergovernmental and federal grant receivables are composed of: (1) amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federal and state funded programs (recorded in the special revenue funds and capital project funds).

These accounts receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience, historical trends, current economic conditions and the periodic aging of accounts receivable.

Activities among 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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

loans). All other outstanding balances between funds are reported as "due to/from other funds". Advances between funds, as reported in the GFFS, 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.

**i) Inventories**

*Inventories consist of materials, supplies, food and medicine inventories held for consumption. Generally, inventories are recorded as expenditure when acquired, and therefore, is not recorded in the statement of net assets.*

**Capital Assets**

*Capital assets in governmental activities include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are capitalized and reported in the accompanying statement of net assets. 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.*

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

Depreciation and amortization expense is recorded only in the government-wide statement of activities. However, there is no depreciation or amortization recorded for land and construction-in-progress. Depreciable capital assets are generally depreciated or amortized over their estimated useful lives under the straight - line method, except for machinery and equipment held under capital leases which is depreciated over the shorter of its estimated useful life or the lease term. The estimated useful lives of major capital asset categories are:

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

Depreciation and amortization expense on capital assets are recorded as direct expenses of the function/program specifically identified with the asset. Depreciation and amortization of infrastructure is not allocated to various functions/programs but reported as direct expenses of the public works and economic development function.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

*j) Deferred Revenues*

The Municipality reports deferred revenue on its GFFS and GWFS. In the GFFS, deferred revenue arises when:

- Potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period. As previously discussed, available is defined as due (or past due) at June 30, and collected within 60 days thereafter to pay obligations due at June 30, or;
- The Municipality receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, the liability for deferred revenue is removed and revenue is recognized.

Deferred revenues at the government-wide level arise only when the Municipality receives resources before it has a legal claim to them.

*k) Compensated Absences*

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by GASB (GASB No. 16). Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the accompanying statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2005 and (2) is not contingent on a specific event (such as illness) that is outside the control of the Municipality and the employee. The liability for compensated absences includes salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer’s share of social security taxes and medicare taxes).

The vacation policy of the Municipality is established by law and provides for the accumulation of regular vacations at a rate of 2.5 days per month (30 days per year) per employee. Employees accumulate regular sick leave at a rate of 1.5 days per month (18 days per year). Employees accumulate compensatory time at a rate of 1.5 times the overtime worked. All vacation and sick leave days accumulated by employees in excess of 30 days and 90 days, respectively, are paid to employees each year, if not consumed, as required by law. In the case of compensatory time, the excess of 240 hours is paid to employees each year, if not consumed.

Upon termination of employment, an employee receives compensation for all accumulated unpaid regular vacation leave at the current rate. In the case of regular sick leave, if the employee terminates his or her employment with the Municipality before reaching 10 years of services, such regular sick leave is not paid to the employee, if not consumed. Upon termination of employment, an employee does not receive compensation for compensatory time, if not consumed. After 10 years of services any regular sick leave balance is paid to the employee. Accumulated vacation time is fully vested to the employee at any time.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

The liability for compensated absences is reported in the statement of net assets. A liability for compensated absences is reported in the GFFS only if they have matured, for example, as a result of employee resignations and retirements.

*l) Long-term Debt*

The long-term liabilities reported in the accompanying statements of net assets include the Municipality's bonds, notes, obligation under capital leases, compensated absences and legal claims and judgments.

All long-term debt to be repaid from governmental resources is reported as liabilities in the accompanying statement of net assets. Principal and interest payments on bonds due in July 1 of the following fiscal year are recorded as liabilities in the GWFS governmental activities column. In the GFFS, the face amount of debt issued is reported as other financing sources when issued.

*m) Accounting for Pension Costs*

For the purpose of applying the requirements of GASB Statement No. 27, Accounting for Pensions by State and Local Government Employers (GASB No. 27), the Commonwealth of Puerto Rico is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities (ERS) and System 2000, the two retirement systems in which the employees of the Municipality participate. Accordingly, the Municipality is considered a participant and not a sponsor of these retirement systems since the majority of the participants in the aforementioned pension trust funds are part of the financial reporting entity of the Commonwealth. Accordingly, no portion of the net pension obligation (NPO) related to ERS has been allocated to the Municipality in the accompanying basic financial statements. The basic financial statements of the Commonwealth account for the total amount of the net pension obligation of ERS, including any amount that may be allocated to the Municipality.

According to GASB No. 27, the Municipality accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions.

*n) Risk Management*

The Municipality carries commercial insurance covering casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department (the Treasury Department) on behalf of all municipalities of Puerto Rico. The Treasury Department pays the insurance premiums on behalf of the Municipality and then is reimbursed each year through monthly equal payments deducted from the Municipality's gross property tax collections made by CRIM.

The Municipality carries insurance coverage for death and bodily injuries caused by automobile accidents. This insurance is obtained through the Automobile Accidents Compensation

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

Administration ("ACAA", by its Spanish acronym), a discretely component unit of the Commonwealth. This insurance is compulsory for all licensed vehicles used on public roads and highways in Puerto Rico. The annual premium is \$35 per licensed motor vehicle, which is paid directly to ACAA.

The Municipality obtains workers' compensation insurance coverage through the State Insurance Fund Corporation ("FSE" by its Spanish acronym), a component unit of the Commonwealth. This insurance covers workers against injuries, disability or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. Workers' compensation insurance premiums are also paid through monthly deductions made by CRIM from the Municipality's gross property tax collections.

The Municipality obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for its employees through various insurance programs administered by the Commonwealth's Department of Labor and Human Resources (DOL). These insurance programs cover workers against unemployment and provide supplementary insurance coverage for temporary disability, or death because of work or employment-related accidents or because of illness suffered as a consequence of their employment. Unemployment compensation, non-occupational disability and drivers' insurance premiums are paid directly to DOL on a quarterly basis.

The Municipality also obtains medical insurance coverage for its employees. The current insurance policies have not been cancelled or terminated at June 30, 2005. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

**o) Reservations of Fund Balances**

Reservations of fund balances represent portions of fund balances that are legally segregated for specific future uses or are not appropriated for expenditure. The Municipality has the following types of reservations of fund balances:

- **Encumbrances** – Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts represent reservations of unexpired appropriations and generally will become liabilities in future periods as the goods or services are received.
- **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.
- **Debt Service** – Represent fund balances available to finance future debt service payments.
- **Other Specified Purposes** – Represent resources set aside for use in federal and state grant programs accounted for in the special revenue funds.

**p) Interfund Activities**

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

Permanent reallocations of resources among the Municipality's funds are classified as interfund transfers. The Municipality has the following types of activities recorded among funds in the accompanying GFFS:

- **Operating Transfers** – Represent legally required transfers that are reported when incurred as “operating transfers-in” by the recipient fund and as “operating transfer-out” by the disbursing fund.
- **Intra-entity Activities** – Represent transfers among funds that are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.
- **Advances** – Represent amounts advanced among funds, which are not considered to be currently available financial resources.

**q) Use of Estimates**

The preparation of the accompanying basic financial statements in conformity with GAAP requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the basic financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**r) Future Adoption of Accounting Pronouncements**

On November 18, 2003, the GASB issued its Statement No. 42 (GASB No. 42), *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This statement requires governments to report the effects of capital asset impairment in their financial statements. This statement also requires all governments to account for insurance recoveries in the same manner. The provisions of GASB No. 40 are effective for the Municipality's fiscal year starting on July 1, 2005.

The Municipality's management has concluded that the future adoption of GASB Statement No. 42 will not have a significant impact on the Municipality's basic financial statements.

**2. DEPOSITS**

The Municipality maintains its deposits of cash in various commercial banks located in Puerto Rico, and GDB. The balances deposited in commercial banks are insured by the Federal Deposit Insurance Corporation (“FDIC”) up to a maximum of \$100,000 per depositor.

Under the laws and regulations of the Commonwealth, public funds deposited in commercial banks must be fully collateralized for the amounts deposited in excess of federal depository insurance. All securities pledged as collateral are held by the agents of the Commonwealth's Secretary of the Treasury, in the Municipality's name.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

The Municipality's bank balance of deposits with financial institutions is categorized to provide an indication of the level of collateral risk assumed by the Municipality at June 30, 2005. Risk categories are described as follows: **Category 1:** Deposit is insured or collateralized with securities held by the Secretary of the Treasury' agents in the Municipality's name; **Category 2:** Deposit is collateralized with securities held by pledging financial institution's trust department or agent in the Municipality's name; and **Category 3:** Deposit is uncollateralized; including any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the Municipality's name.

The carrying amount (book balance) of cash at June 30, 2005 consists of the following:

	General Fund	Special Revenue Fund Local and State Grants	Capital Project Fund Local and State Grants	Debt Service Fund	Nonmajor Fund
Unrestricted (category 1): Cash in commercial banks	\$ 28,273	\$ -	\$ -	\$ -	\$ -
Restricted (category 2): Cash in commercial banks	-	146,542	99,699	-	354,119
Restricted (category 3): Cash in GDB, as fiscal agent	2,507,381	-	936,784	1,231,821	132,205
<b>Total deposits</b>	<b>\$ 2,535,654</b>	<b>146,542</b>	<b>1,036,483</b>	<b>1,231,821</b>	<b>486,324</b>

The Municipality's bank balances in commercial banks amounting to \$628,632 at June 30, 2005 were fully collateralized (Categories 1 and 2). The bank balance of deposits in GDB, which is uninsured and uncollateralized (Category 3), amounted to \$4,808,191 at June 30, 2005.

### 3. MUNICIPAL LICENSE TAXES

The Municipality is authorized by Law No. 81 to impose and collect municipal license taxes on all trade or business activities operated by any natural or legal person within the territorial area of Salinas. This is a self-assessed tax generally based on the business volume measured by gross sales. The Municipality establishes the applicable tax rates. At June 30, 2005, the municipal tax rates imposed by the Municipality were 1.50% for financing institutions and 0.30% for other types of taxpayers. Any taxpayers that have been granted with partial tax exemptions under any of the incentive tax laws of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60% and 90% under standard rates.

Each taxpayer must assess his/her corresponding municipal license tax by declaring his/her volume of business through a tax return to be filed every April 15 based on the actual volume of business generated in the preceding calendar year.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

Taxpayers with a sales volume of \$1 million or more must include audited financial statements with their tax returns. The tax can be paid by the taxpayer in two equal installments due on July 15 and January 15, subsequent to the filing of the declaration.

The first installment of the tax covers the six-month period ended December 31, subsequent to the filing date of the declaration, while the second installment of the tax covers the six-month period ended June 30 of the subsequent calendar year. If a taxpayer elects to pay the tax in full on the filing date of the declaration (generally April 15), a 5% discount is granted automatically on the total tax amount due.

Any municipal license taxes collected in advance (that is, pertaining to a future period) are recorded as deferred revenues. Deferred municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$479,845 at June 30, 2005, which represents municipal licenses collected in advance for the taxable year 2005-2006.

### 3. PROPERTY TAXES

The Municipality is authorized by Law No. 81 to impose and collect personal and real property taxes. Under the laws and regulations of the Commonwealth, personal property taxes can be imposed to any natural or legal person that at January 1 of each year is engaged in trade or business and is the owner of personal property used in trade or business.

Personal property taxes are self-assessed by taxpayers every year generally using the book value of personal property assets owned by the taxpayer at January 1 (assessment date) and reporting such taxable value through a personal property tax return filed on May 15 subsequent to the assessment date. The total personal property tax rate in force at June 30, 2005 was 6.53% (of which taxpayers pay 6.33% and 0.20% is reimbursed by the Department of Treasury); after June 30, 2005, the total personal property tax rate has been 6.83%. Real property taxes are assessed by CRIM. The assessment on real property is made every January 1 and is based on estimated current values of the property deflated to 1957 market prices. The total real property tax rate in force at June 30, 2005 was 8.53% (of which 8.33% is paid by taxpayers and 0.20% is also reimbursed by the Department of Treasury); after June 30, 2005, the total real property tax rate has been 8.83%.

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value (at 1957 market prices). For such exempt amounts, the Department of Treasury assumes payment of the basic tax (4% and 6% for personal and real property, respectively) to the Municipality, except for property assessed of less than \$3,500 (at 1957 market prices), for which no payment is made.

CRIM is responsible for the billing and collections of real and personal property taxes on behalf of the Municipality. Prior to the beginning of each fiscal year, CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, CRIM advances funds to the Municipality based on the initial estimated collections. 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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF SALINAS**  
Notes to Basic Financial Statements  
June 30, 2005

has to be completed on a preliminary basis not later than each December 31. If CRIM remits to the Municipality property tax advances, which are less than the property tax actually collected, an additional property tax receivable is recorded at June 30. However, if advances exceed the amount actually collected by CRIM, an intergovernmental payable is recorded at June 30.

Law No. 81 provides for the levy of an annual special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation. Such special tax is levied and collected by CRIM. Collections of this special tax are remitted to the Commonwealth's debt service fund for payment of debt service on general obligations of the Commonwealth.

In addition, 1.50% of the total personal and real property taxes collected by CRIM is restricted for the Municipality's debt service requirements and is retained by GDB for such purposes.

The Additional Lottery System of the Commonwealth (the "Additional Lottery") is an operational unit reported as an enterprise fund of the Commonwealth, which currently operates several betting alternatives to the citizens of Puerto Rico. The Additional Lottery is required every year to distribute a portion of its excess of revenues over expenses as follows:

- i. Thirty five percent (35%) of its net earnings (defined as the excess of revenues over expenses less an amount earmarked for the Fund for Rent and Home Improvement Subsidy Program for the Low-Income Qualifying Elderly) is earmarked to the municipalities of the Commonwealth, of which a maximum of \$26 million, on an annual basis, is distributed to the Municipal Equalization Fund held by CRIM to cover operating expenses and permanent improvements of the municipalities.
- ii. An additional amount not exceeding \$16 million, on an annual basis, is distributed to the Municipal Equalization Fund, provided it is within the 35% corresponding to the municipalities of the Commonwealth. When the accumulated municipal appropriations from the municipalities' Puerto Rico Health Reform are covered up to June 30, 1997, these resources will be assigned to the Health Insurance Administration, a component unit of the Commonwealth.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

5. RECEIVABLES FROM (TO) GOVERNMENTAL ENTITIES

a) Amounts due from governmental entities as of June 30, 2005 follows:

Entity	Non-Federal Government	Federal Government
Municipal Revenue Collection Center (CRIM) Debt Service Fund - property tax	\$ 177,138	\$ -
Municipal Consortium - WIA One-Stop delivery system (ASIFAL) - Special Revenue Fund - Local and State Grants	60,468	
State Department of Labor - Special Revenue Fund - Local and State Grants - Law 52 Grant	30,938	
State Office of Commissioner of Municipal Affairs (OCAM) - Special Revenue Fund - Federal Grants - Community Development Block Grant program		201,759
State Administration for Child Care and Development (ACUDEN) - Special Revenue Fund - Federal Grants - Child Care and Development Block Grant program		15,226
<b>Total</b>	<b>\$ 268,544</b>	<b>\$ 216,985</b>

b) Amounts due to governmental entities as of June 30, 2005 follows:

Entity	Amount
State Treasury Department	\$ 394,673
Internal Revenue Services	150,089
State Retirement System Administration	138,738
State Department of Labor	108,561
State Water and Sewer Authority	28,219
State General Services Administration	54,964
<b>Total</b>	<b>\$ 875,244</b>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

6. INTERFUND BALANCES

On July 1, 2003 the Municipality adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures, issued by the Governmental Accounting Standards Board*. This statement requires the disclosure of the flow of the resources between funds and to assess the collectibility of interfund balances. Interfund balances at June 30, 2005 consisted of the following:

a) Operating transfer-in/out:

Operating transfers-in:				
	General Fund	Special Revenue Fund Local and State Grants	Debt Service Fund	Total
<b>Operating transfers-out:</b>				
<b>General Fund</b>	\$ -	\$ 255,000	\$ 333,609	\$ 588,609
<b>Capital Project Fund-State and Local Grants</b>	147,500	-	-	147,500
<b>Total</b>	\$ 147,500	\$ 255,000	\$ 333,609	\$ 736,109

b) Due/advances from/to:

Due/advances from:						
Major funds						
	General Fund	Special Revenue Fund Local and State Grants	Capital Project Fund Local and State Grants	Debt Service Fund	Nonmajor governmental Funds	Total
<b>Due/advances to:</b>						
<b>Major funds:</b>						
General Fund	\$ -	\$ 134,776	\$ 26,909	\$ 6,761	\$ 107,317	\$ 275,763
Special Revenue Fund - Local and State Grants	390,371	-	231,040	-	-	621,411
Capital Project Fund - Local and State Grants	1,794,122	-	-	-	-	1,794,122
Nonmajor governmental funds	18,189	-	-	-	-	18,189
<b>Total</b>	\$ 2,202,682	\$ 134,776	\$ 257,949	\$ 6,761	\$ 107,317	\$ 2,709,485

At June 30, 2005 all amounts due to among funds are considered collectible by the Municipality's management.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

7. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2005, including the depreciation expense charged to function/activities in the accompanying government wide statement of activities was as follows:

	Balance at June 30, 2004	Additions/ Increases	Disposals/ decreases	Balance at June 30, 2005
<b>COST BASIS:</b>				
Cost basis of capital assets, not subject to depreciation and amortization:				
Land	\$ 4,855,013	\$ -	\$ -	\$ 4,855,013
Construction in progress	3,326,399	285,091	(2,007,426)	1,604,064
Total cost basis of capital assets, not subject to depreciation	<u>8,181,412</u>	<u>285,091</u>	<u>(2,007,426)</u>	<u>6,459,077</u>
Cost basis of capital assets, subject to depreciation:				
Buildings	3,665,487	2,648,120	-	6,313,607
Buildings Improvements	586,169			586,169
Infrastructure	299,159	614,422	-	913,581
Infrastructure Improvements	409,078			409,078
Equipment	531,768	23,000	-	554,768
Furnishing	256,162			256,162
Work of Arts	7,306			7,306
Computers	83,654			83,654
Vehicles	1,834,088	29,985	-	1,864,073
Total cost basis of capital assets subject to depreciation	<u>7,672,871</u>	<u>3,315,527</u>	<u>-</u>	<u>10,988,398</u>
Total cost basis of capital assets	<u>\$ 15,854,283</u>	<u>\$ 3,600,618</u>	<u>\$ -2,007,426</u>	<u>\$ 17,447,475</u>
<b>ACCUMULATED DEPRECIATION:</b>				
Buildings	\$ 1,604,444	215,925	-	\$ 1,820,369
Buildings Improvements	\$ 18,964			18,964
Infrastructure	37,296	1,035	-	38,331
Infrastructure Improvements	9,332			9,332
Equipment	308,480	126,723		435,203
Furnishing	217,590			217,590
Work of Arts	1,943			1,943
Computers	58,927			58,927
Vehicles	1,086,934	45,323	-	1,132,257
Total accumulated depreciation and amortiza	<u>3,343,910</u>	<u>389,006</u>	<u>-</u>	<u>3,732,916</u>
CAPITAL ASSETS, NET	<u>\$ 12,510,373</u>			<u>\$ 13,714,559</u>
The depreciation expense is detailed as follow:				
General government				\$ 162,598
Public safety				46,754
Public works				283,473
Health and welfare				17,961
Culture and recreation				39,659
Community development				67,147
Education				272
Total depreciation expense				<u>\$ 617,864</u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF SALINAS**  
Notes to Basic Financial Statements  
June 30, 2005

**8. EMPLOYEES RETIREMENT SYSTEM**

The Municipality's employees participate in the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (the "System"). The System is the administrator of a multi-employer cost-sharing (as related to the Municipality's reporting entity) defined pension plan established by the Commonwealth. The System was created under Act. No. 447 approved on May 15, 1951, as amended, and became effective on January 1, 1952. The System covers all regular employees of the Commonwealth and its instrumentalities, the Municipality and other municipalities of the Commonwealth.

The System is independent, thus assets may not be transferred to another system or used for any purpose other than to benefit each system's participants. The System issues publicly available financial reports that include its basic financial statements and required supplementary information for each of them, including required six-year trend information. Those reports may be obtained by writing to the administrator of the System.

The System provides for retirement, death and disability benefits. Death and disability retirement benefits are available to members for occupational and non-occupational death and disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after 10 years of plan participation.

Retirement benefits are determined by the application of stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a plan member is eligible, is limited to a minimum of \$200 per month and a maximum of 75 percent of the average compensation.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the System, was enacted with the purpose of establishing a new pension system ("System 2000"). System 2000 became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999, had the option to either stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000, are the only required to become members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as cash balance plan. Under this new plan, there is a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. The Commonwealth nor the Municipality will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275 percent of the employees' salary up to a maximum of 10.00 percent) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity U.S. Treasury Note; (2) earn a rate equal to 75 percent of the return of the System 2000's investment portfolio (net of management fees); or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

Disability pensions are not being granted under System 2000. The employer's contributions (9.275 percent of the employees' salary which is applicable to the Municipality) will be used to fund the current plan.

System 2000 reduced the retirement age from 65 years to 60 for those employees who joined the current plan on or later January 1, 2000.

**Funding Policy:**

Contribution requirements are established by law and are as follows:

Municipality	9.275% of gross salary
Employees:	
Hired on or before March 31, 1990	5.775% of gross salary up to \$6,600
	8.275 of gross salary over \$6,600
Hired on or after April 1, 1990	8.275% of gross salary

On August 12, 2000, Act No. 174 was approved to allow certain participants of the ERS to be eligible for early retirement upon attaining at least age 55 with 25 years of service, provided they made their election on or before April 1, 2001. Those who elected early retirement under this law will receive monthly benefits of 75 percent (if 25 or more year of service and 55, or 30 or more years or services and age 50) or benefits of 65 percent (if 25 years of service by less than age 55) of their average compensation which is computed based on the highest 36 months of compensation recognized by the System. In these cases, the employer (including the Municipality) is responsible for contributing to the System the amount needed to cover the benefit payments and employer contribution with respect to the participants covered until the participants reaches the normal retirement age.

Historically, the Commonwealth has reported the System as a single-employer plan (as relates only to the financial reporting entity of the Commonwealth) in its comprehensive annual financial report. Accordingly, any actuarial deficiency that may exist or arise related to the Municipality's participating employees will be assumed by the Commonwealth since the System does not allocate any actuarial deficiencies pertaining to municipal employees participating in the System. The Municipality is only required by law to make statutory contributions in the rates mentioned above. As a result, no net pension obligation nor net pension asset that may be allocable to the

Municipality's participating employees, if any, has been recorded in the accompanying basic financial statements.

The Municipality's actual contributions for the current year, which are equal to the statutory required contributions, are as follows: \$152,273 for Act. Number 447, and \$126,530 for System 2000.

**9. LONG-TERM DEBT**

The Municipality's Legislature is legally authorized to determine the contracting of debts of the Municipality. Nevertheless, the laws and regulations of the Commonwealth also provide that:

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF SALINAS**  
Notes to Basic Financial Statements  
June 30, 2005

- Direct obligations of the Municipality (evidenced principally by bonds and notes) are backed by the full faith, credit and taxing power of the Municipality; and
- Direct obligations are not to be issued if the amount of the principal of, and interest on, such bonds and notes (and on all such bonds and notes issued thereafter) which are payable in any fiscal year, together with any amount paid by the Municipality in the preceding fiscal year on account of bonds or notes guaranteed by the Municipality, exceed 10 percent of the total assessed value of the property located within the Municipality plus the 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 or notes are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. At June 30, 2005, the Municipality is in compliance with the debt limitation requirements. The general long-term debt activity for the year ended June 30, 2005 was as follows:

	Balance at June 30, 2004	Borrowings or Additions	Payments or Deductions	Balance at June 30, 2005	Due Within One Year
Bonds and notes payables	\$ 8,736,879	\$ -	\$ (508,500)	\$ 8,228,379	\$ 551,750
Notes payable to:					
Puerto Rico Treasury Department:					
Financing agreement for the excess of property tax advances over collections	167,385	-	(27,897)	139,488	27,897
Municipal Revenue Collection Center (CRIM):					
Act No. 42 - Financing agreement for the excess of property tax advances over collections through fiscal year 2000	974,023	212,696	(84,505)	1,102,214	84,505
Act No.146 -Financing of delinquent property tax accounts sold	872,137	-		872,137	-
Fiscal Year 2004-2005 Final Settlement	-	162,733	-	162,733	-
State Water and Sewer Authority Debt Agreement	220,000	70,710	(47,000)	243,710	84,000
State Department of Labor - Debt Agreement		35,423		35,423	11,808
Compensated absences	755,273	341,376	(174,565)	922,084	75,000
Claims and judgments	2,875,795	1,249,518	(2,899,501)	1,225,812	90,000
Estimated landfill closure and postclosure care costs	3,883,863	847,582	-	4,731,445	-
<b>Total</b>	<b>\$ 18,485,355</b>	<b>\$ 2,920,038</b>	<b>\$ (3,741,968)</b>	<b>\$ 17,663,425</b>	<b>\$ 924,960</b>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

**a) Bonds and Notes Payable**

The Municipality issues general and special (public improvements) obligations bonds and notes to provide for the acquisition and construction of major capital facilities and equipment, as well as, to cover certain operating needs. Bonds and notes payable at June 30, 2005 is composed of the following debts:

<u>General and Special Obligations</u>	<u>Outstanding Amount</u>
\$600,000 special obligation bonds series of 1982 payable in semi annual installments ranging from \$30,000 to \$140,000 through July 2008, interest from 5%	\$ 117,000
\$1,092,000 special obligation bonds series of 1985 payable in semi annual installment ranging from \$10,000 to \$55,000 through July 2010, interest from 6%	403,879
\$2,300,000 notes payable series of 1992 in semi annual installments ranging from \$20,000 to \$25,000 through July 2012, interest ranging from 5% to 8.25%	1,232,500
\$2,240,000 public improvement bonds series of 1997 payable in annual installments ranging from \$1,000 to \$2,000 through January 2017, interest at 5% to 8%	1,770,000
\$1,495,000 general obligation bonds series of 2002 payable in semi annual installments ranging from \$5,000 to \$20,000 through July 2027, interest from 5% to 6.50%	1,450,000
\$1,710,000 public improvement bonds series of 2003 payable in annual installments ranging from \$5,000 to \$15,000 through January 2029, interest at 6%	1,680,000
\$385,000 general obligation bonds series of 2003 payable in semi annual installments ranging of \$10,000 to \$30,000 through July 2028, interest from 6.5%	375,000
\$805,000 public improvement bonds series of 2003 payable in annual installments ranging from \$7,000 to \$23,000 through January 2028, interest at 6%	775,000
\$395,000 general obligation note series of 2002 payable in semi annual installments ranging of \$5,000 to \$10,000 through July 2007, interest ranging from 5% to 3.54%	215,000
\$370,000 general obligation bond series of 2002 payable in annual installments ranging of \$7,000 to \$21,000 through July 2008, interest at 5% to 7%	210,000
<b>Total bonds and notes:</b>	<u><u>\$8,228,379</u></u>

These bonds are payable from the ad valorem property tax of 1.5% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

The laws and regulations of the Commonwealth provide that public debt of the Municipality will constitute a first claim on the available revenue of the Municipality. Public debt includes bonds and

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

notes payable. The good faith, credit and taxing power of the Municipality are irrevocably pledged for the prompt payment of the principal and interest of the bonds and notes payable.

The Municipality levies an annual additional special tax of 1.50% of the assessed value of personal and real property. The proceeds of this additional special tax are deposited in a sinking fund established at GDB whereby sufficient funds must be set aside to redeem the bonds in minimum annual or biannual principal and interest payments. The proceeds of this special tax are recorded in the debt service fund.

Interest rates on serial bonds subject to variable rates are reviewed periodically by GDB and are based on the fluctuation of GDB's weighted average rate for its commercial paper program, not to exceed 8%. Under this program, GDB issues commercial paper in the U.S. taxable and tax-exempt markets, in the Eurodollar market and to corporations that have tax exemption under the Commonwealth's Industrial Incentives Act and qualify for benefits provided by the U.S. Internal Revenue Code Section 936.

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

Year ended June 30,	Principal	Interest	Total
2006	\$ 551,750	422,164	\$ 973,914
2007	581,500	479,396	1,060,896
2008	622,500	444,267	1,066,767
2009	458,500	408,955	867,455
2010	485,379	380,157	865,536
2011-2015	1,833,750	1,491,278	3,325,028
2016-2020	1,450,000	918,050	2,368,050
2021-2025	1,205,000	528,462	1,733,462
2026-2030	1,040,000	122,287	1,162,287
<b>Totals</b>	<b>\$ 8,228,379</b>	<b>5,195,016</b>	<b>\$ 13,423,395</b>

**b) Notes Payable to Puerto Rico Treasury Department**

Financing of the excess of property tax advances over collections - The Municipality entered into a financing agreement with the Puerto Rico Treasury Department to pay a debt related to the excess of property tax advances over collections made by the Puerto Rico Treasury Department prior to the creation of CRIM in 1993. The outstanding principal balances of the note payable to the Puerto Rico Treasury Department amounted to \$139,488 at June 30, 2005.

**c) Notes Payable to CRIM**

Act No. 42 - Act No. 42 of January 26, 2000 was enacted to authorize CRIM to enter into a financing agreement of up to \$200 million, for a term not exceeding 30 years. The financing agreement allows for the financing of a debt that the municipalities of Puerto Rico have with CRIM, arising from the final

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF SALINAS**  
Notes to Basic Financial Statements  
June 30, 2005

settlements of property tax advances versus actual collections through fiscal year 2000. The amounts that the municipalities will collect from the additional property taxes resulting from the increases in the subsidy from the Commonwealth to the municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law No. 238 of August 15, 1999.

In addition, on February 12, 2003, the Municipality entered into a repayment agreement with GDB and CRIM to pay off the excess of property tax advances through fiscal year 2000 and 2001. CRIM retains the payment from the property tax advances of the Municipality. The amounts retained by CRIM are remitted to GDB on July 1 of each year through July 1, 2032. The outstanding balances of the note payable to the CRIM amounted to \$1,102,214 at June 30, 2005.

Financing of delinquent property tax accounts sold – The Municipality entered into a financing agreement with CRIM for the payment of delinquent property tax account sold to private investors. The financing agreement in the form of a line of credit bearing interests at 6.50% during the first 5 years, and variable interests 125 points over LIBOR rate during the next 25 years. At June 30, 2005, the outstanding principal balances amounted to \$872,137.

Fiscal year 2004-2005 final settlement – For the fiscal year ended on June 30, 2005 the CRIM notify to the Municipality that the final settlement of property tax advances versus actual collections through fiscal year 2005 result in an overpayment to the Municipality. At June 30, 2005, the outstanding balances amounted to \$162,733.

**d) Note Payable to Puerto Rico Water and Sewer Authority (AAA)**

The Municipality entered into a financing agreement with AAA for the payment of the Municipality's debt for water and sewer services. The balance at June 30, 2005 is \$243,710.

**e) Note Payable to State Department of Labor**

The Municipality entered into a financing agreement with State Department of Labor for the payment of the Municipality's debt for unemployment benefits. The balance at June 30, 2005 is \$35,423.

**10. LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS OBLIGATIONS**

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. Although closure and postclosure care costs will be paid only near or after the date that the landfill stops accepting waste, the Municipality reports a portion of these closure and postclosure care costs as an operating expense in each period based on landfill capacity used as of each statement of net assets date. The \$4,731,445 reported as landfill closure and postclosure care liability at June 30, 2005, represents the cumulative amount reported to date based on the percentage used of the estimated capacity of the landfill. The Municipality will recognize the remaining estimated cost of closure and postclosure care as the remaining estimated capacity is filled. These amounts are based on what it would

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

cost to perform all closure and postclosure care in 2004. The estimated closing date of the landfill is the year 2006, but the Municipality expect to to expand the boudaries of the existing landfill to extend the usefull life of the landfill. Actual cost may be higher due to inflation, changes in technology, or changes in regulations.

## 11. COMMITMENTS AND CONTINGENCIES

### Litigations

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 \$2,515,463 in the general fund for awarded unfavorable judgment, plus \$1,225,812 in the government wide statement of net assets in addition to the amount reported in the general fund for awarded unfavorable judgment in appeal process by the Municipality. These amounts were 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.

### Federal Programs

The municipality participates in a number of federal financial assistance programs. These programs are subject to audit on behalf the grantors to assure compliance with grant provisions. If expenditures are disallowed due to noncompliance with grant programs requirements, the Municipality may be required to reimburse, these costs, to the grantor agency. It is the Municipality's Management opinion, that any amount disallowed by federal agencies, will be immaterial to the financial statements.

### Commitments

The Municipality has reported, outstanding encumbrances amounting to \$1,540,963 in the general fund at June 30, 2005. The municipality intends to honor these encumbrances, which will continue to be liquidated under the current year's budget during a lapse of period that extends into the subsequent fiscal year.

## 12. SUBSEQUENT EVENTS

### Ordinance Number 13, 2005-2006 Series

On December 20, 2005 the Municipality executive branch, with the approval of the legislative branch, imposed a 2% tax rate for artistic shows to be presented in the Municipality to be paid by the private

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Basic Financial Statements  
June 30, 2005

enterprises or persons wich present it. The funds colected from such tax will be used for security services and maintenance costs.

Ordinance Number 21, 2005-2006 Series

On February 27, 2006 the Municipality executive branch, with the approval of the legislative branch, increased the municipal licence tax rate, applicable for the fiscal year 2006-2007 and thereafter. The Municipality will impose and collect municipal licence tax as follows:

- a) 1.5% of business volume for each person dedicated to any financial business; or
- b) .5% of business volume to each person dedicated to provide any services, sales of goods or to any industry.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF SALINAS**  
 Budgetary Comparison Schedule- General Fund  
 (See Notes to Budgetary Comparison Schedule)  
 June 30, 2005

	Budgeted Amounts		Actual amounts (budgetary basis) (see note 1)	Variance with final budget over (under)
	Original	Final		
<b>Revenues:</b>				
Property taxes	\$ 2,047,160	\$ 2,047,160	\$ 2,315,257	\$ 268,097
Municipal licence taxes	883,500	883,500	798,558	(84,942)
Licence, permits and other local taxes	2,346,353	2,346,353	795,489	(1,550,864)
Charges for services	400,000	400,000	188,663	(211,337)
Intergovernmental	4,437,569	4,437,569	4,513,017	75,448
Rent of property	108,000	108,000	34,636	(73,364)
Fines and forfeitures	2,475	2,475	16,989	14,514
Interest	75,000	75,000	186,636	111,636
Miscellaneous	155,000	155,000	169,078	14,078
Total revenues	<u>10,455,057</u>	<u>10,455,057</u>	<u>9,018,323</u>	<u>(1,436,734)</u>
<b>Expenditures:</b>				
Current:				
General government	4,152,392	4,238,764	4,361,548	(122,784)
Public safety	820,496	862,718	816,633	46,085
Public works	3,301,886	3,077,133	3,350,059	(272,926)
Health and welfare	1,361,504	1,364,571	1,281,816	82,755
Culture and recreation	405,762	498,654	388,807	109,847
Education	65,301	65,501	41,823	23,678
Operating Transfer Out	347,716	347,716	333,609	14,107
Total expenditures	<u>10,455,057</u>	<u>10,455,057</u>	<u>10,574,295</u>	<u>(119,238)</u>
<b>Excess (deficiency) of revenues over expenditures</b>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (1,555,972)</u>	<u>\$ (1,555,972)</u>

**Explanation of Differences:**

**Sources/inflows of financial resources:**

Actual amounts (budgetary basis) "available for appropriations" from the budgetary comparison schedule	\$ 9,018,323
Differences - budget basis to GAAP:	
Fiscal year 03-04 GAAP receivables recorded as revenues for budgetary purposes	(123,491)
Total revenues as reported on the statement of revenues, expenditures and changes in fund balances	<u>\$ 8,894,832</u>

**Uses/outflows of financial resources:**

Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule	\$ 10,574,295
Differences - budget basis to GAAP:	
Nonbudgeted expenditures	2,379,371
Net change in encumbrances	627,154
Nonbudgeted operating transfer out	170,000
Total expenditures and other financial uses as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds	<u>\$ 13,750,820</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS  
Notes to Budgetary Comparison Schedule- General Fund  
June 30, 2005

**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, 2005 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2005.

**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	\$4,238,764	\$4,361,548	(\$122,784)
Public works	\$3,077,133	\$3,350,059	(\$272,926)

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2005

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
<b>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:</b>			
Direct Program :			
Section 8 Housing Choice Voucher	14.871		\$ 338,799
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	
		98-FD-56	
		99-FD-IP-56	
		00-FD-56	
		01-FD-56	
		02-AB-56	
		02-FC-56	746,509
<b>Total U.S. Department of Housing and Urban Development</b>			<b><u>1,085,308</u></b>
<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	13,740
Pass-through the Commonwealth of Puerto Rico - Governor Authorized Representative (GAR):			
Public Assistance Grants	83.544	Not Available	249,645
<b>Total U.S. Homeland Security Department</b>			<b><u>263,385</u></b>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2005

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
<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 C - Nutrition Services	93.045		126,755
Pass-through the Commonwealth of Puerto Rico Administration for Children and Families (ADFAN):			
—Child Care and Development Block Grant	93.575		171,084
<b>Total U.S. Department of Health and Human Services</b>			<b>297,839</b>
<b>TOTAL EXPENDITURES OF FEDERAL AWARDS</b>			<b>\$ 1,646,532</b>

The accompanying notes are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2005

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 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	Other Governmental Funds
Per Schedule of Expenditures of Federal Awards	\$ 1,646,532
Non federal programs Expenditures	<u>128,020</u>
Total expenditures in the fund financial statements	<u>\$ 1,774,552</u>



**López-Vega, CPA, PSC**

Certified Public Accountants / Management Advisors

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

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS 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 accompanying financial statements of the governmental activities, each mayor fund, and the aggregate remaining fund information of the **Municipality of Salinas** as of and for the year ended June 30, 2005, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated June 13, 2006, which was qualified. 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.

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 financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting 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 controls over financial reporting that, in our judgment, could adversely affect **Municipality of Salinas's** ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described in the accompanying schedule of findings and questioned costs items 05-01 through 05-03.

A material weakness is a reportable 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 caused by error or fraud in amounts that would be material in relation to the 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 all reportable conditions that are also considered to be material weaknesses. However, we believe items 05-01 and 05-02 of the reportable conditions described in the accompanying Schedule of Findings and Questioned Costs are material weaknesses.

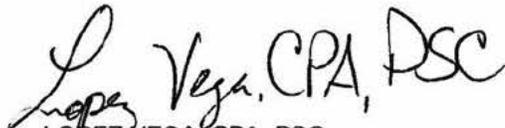
INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS (CONTINUED)

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality of Salinas's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 05-04 through 05-11.

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 June 13, 2006.

This report is intended solely for the information and use of the audit committee, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

  
LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico  
June 13, 2006

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*López-Vega, CPA, PSC*

Certified Public Accountants / Management Advisors

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- 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 INTERNAL  
CONTROL OVER COMPLIANCE REQUIRED BY 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, 2005. 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, 2005. 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, 05-04 through 05-11.

**INDEPENDENT AUDITORS' REPORT  
ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL  
CONTROL OVER COMPLIANCE REQUIRED BY 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 05-04 through 05-11.

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 items 05-05 through 05-11, 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 June 13, 2006.



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 solely for the information and use of the audit committee, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

*López Vega, CPA, PSC*  
LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico  
June 13, 2006

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COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2005

Section I - Summary of Auditors' Results

Financial Statements

Type of auditors' report issued:	Qualified	
Internal control over financial reporting:		
Material weakness identified?	Yes X	No
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	<u>\$ 300,000</u>
Auditee qualified as low-risk auditee?	Yes No X

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section II - Financial Statements Findings

Finding Reference	05-01
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. <i>OK</i>
Responsible Person:	Mr. Roberto Santiago - 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, 2005

Section II - Financial Statements Findings

Finding Reference 05-02

Requirement Financial Reporting - Interfund Transactions

Statement of Condition During our examination, we noted that for the fiscal year 2004-2005, the accounting records of the Municipality related to interfund transactions were not adequate.

Criteria Article 8.010 (C) (2) and (3) of State Act Number 81 of August 30, 1991, stated that Municipality should maintain accurate accounting records and fund controls.

Cause of Condition The Management's controls and procedures failed to assure that the Municipality maintain accurate accounting records related to interfund transactions.

Effect of Condition The Municipality did not maintain an adequate control of the accountability regarding interfund transactions.

Recommendation We recommend that the Municipality should implement internal control and procedures in order to maintain an accounting system that contains information pertaining to interfund transactions.

Questioned Costs None

Management Response and Corrective Action As part of our corrective action plan, we'll give instructions to the Municipality's accountant to correct the accounting records in order to comply with State Act Number 81.

Responsible Person: Roberto Santiago - Finance Department Director

Implementation Date: April 1, 2006



OK  
S.M.S.  
As 05-01  
==>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section II - Financial Statements Findings

Finding Reference	05-03
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 seventeen (17) <u>CDBG State Program disbursement vouchers</u>, thirty one (31) Section-8 Housing Voucher disbursement vouchers, and eight (8) operational bank account disbursement vouchers and found the following exceptions:</p> <ul style="list-style-type: none"><li>a. In twelve (12) cases the purchase order was issued after receiving the goods and services.</li><li>b. In four (4) cases the purchase order was not signed by the Finance Director.</li><li>c. In four (4) cases the original invoice from supplier was not available for examination.</li><li>d. In seventeen (17) cases the disbursement voucher were not marked as paid or cancelled.</li><li>e. In fourteen (14) cases the disbursement voucher does not state the procurement process.</li><li>f. In one (1) case the account affected in the disbursement voucher (92.38) and the one in the service contract (94.32) are not the same.</li></ul>
Criteria	<p>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.</p>
Cause of Condition	<p>The Municipality internal control failed to assure that all transactions include all the required signatures and documentation as required by law.</p>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference      05-03 (Continued)

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 and procedures in order to assure that disbursement vouchers, cancelled checks and other supporting documents are available for examination by auditors and includes all required documentation and approvals.

Questioned Costs      None

Management Response  
and Corrective Action      Management issued instructions to the new Finance Department Director to strengthen the internal controls of the disbursement process, which include Federal Programs and the pre-interventor office, for a more efficient audit process of disbursement of Federal funds. PAV

Responsible Person:      Mr. Roberto Santiago - 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, 2005

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-04
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	Cash Management
Statement of Condition	During our Cash Management test, we noted that during the fiscal year 2004-2005, the Municipality maintained an average cash balance in books of approximately \$30,549.60. In addition, the Municipality requested funds that were not disbursed on a reasonable lapse of time.
Criteria	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.
Cause of Condition	The Municipality's disbursements procedures failed to assure that funds requested and received from the Pass-through Grantor are disbursed in compliance with the Code of Federal Regulations Requirements.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Subpart I, Sec.570.489 (c).
Recommendation	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.
Questioned Costs	None

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COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference      05-04 (Continued)

Management Response  
and Corrective Action

The Municipality's management has established more effective internal controls, which include instructions to the Federal Programs accountant that funds should be reimbursed within five (5) days after being received from the Agency.

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Responsible person:    Mr. Roberto Santiago - Federal Programs Department Director

Implementation date:    June, 2006

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-05
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	Allowable Activities
Statement of Condition	<p>During our examination of five (5) Housing Rehabilitation Participant's files, we noted the following:</p> <ul style="list-style-type: none"><li>a. In five (5) participants files the deficiencies were not incorporated in the participation contract.</li><li>b. In five (5) participants files the application form is not dated.</li><li>c. In three (3) cases the participant file does not include evidence of family composition.</li><li>d. In one (1) participant file the applicant eligibility or non-eligibility determination was not properly documented, no final determination, amount approved and the date of approval were documented.</li><li>e. In four (4) cases the Program Grant stated that the activities should start six (6) days after the Release of Funds. The activities started several months later.</li></ul>
Criteria	24 CFR, Section 570.506, states that when CDBG funds are used for rehabilitation the grantee must assure that the work is properly completed and appropriate documentation is maintained.
Cause of Condition	The Municipality's monitoring procedures failed to assure that the assistance for housing rehabilitations were used for allowed activities
Effect of Condition	The Municipality is not in compliance with 24 CFR, Section 570.506.
Recommendation	We recommend management to instruct program staff to follow procedures established through the Municipal Housing Regulation for the Housing Rehabilitation Section. Also, the Municipality should consider the assignment of additional program staffs to inspect the rehabilitation work upon completion to assure that is carried out in accordance with contracts specifications.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference 05-05 (Continued)

Questioned Costs None

Management Response  
and Corrective Action Management concurs with the finding. The federal Program Director named a Housing Rehabilitation Program Coordinator to oversee the proper functioning of the program.

Responsible Person: Mrs. Nilsa Baez - Housing Rehabilitation Program Coordinator.

Implementation Date: July, 2006

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COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-06
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	Davis-Bacon Act
Statement of Condition	<p>During our Davis-Bacon Act test for the construction and public improvement project 03-FC-56-004 "Mejoras de Centro Comunal", we noted the following situation:</p> <p>a. For the project 03-FC-56-004 the Municipality did not include in the contract provisions for payment of prevailing wage rate with compliance with David Bacon Act requirements. In addition, the contractor weekly payrolls were not reviewed by the Municipal employee responsible of applying monitoring procedures.</p>
Criteria	Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7).
Cause of Condition	The Municipality did not apply all monitoring system procedures developed to test applicable contractors with respect to payment of prevailing wages.
Effect of Condition	The Municipality is not in compliance with Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7).
Recommendation	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.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-06 (Continued)
Questioned Costs	None
Management Response and Corrective Action	The Municipality's management concurs with the finding. The Federal Program Director named a functionary to oversee and coordinate all aspects concerning the compliance with Davis Bacon Act.
Responsible person	Mrs. Gloribeth Reyes - Davis Bacon Act Compliance Coordinator
Implementation date:	June, 2006

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COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-07
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 (OCAM)
Requirement	Procurement, Suspension and Debarment
Statement of Condition	<p>During our contract provision test, we examined one (1) construction contract and one (1) professional services contract and noted the following situations:</p> <ul style="list-style-type: none"><li>a. One (1) contract did not include a provision for compliance with the Clean Air Act and Water Act.</li><li>b. One (1) contract did not include a provision for compliance with Davis Bacon Act.</li><li>c. One (1) contract 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 access to GAO or other federal 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. One (1) contract did not include a provision for compliance with the Copeland "Anti-Kickback" Act.</li><li>g. Two (2) contracts did not include a provision for retention of all required records for three (3) years.</li></ul>
Criteria	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.
Cause of Condition	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, 2005

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-07 (Continued)
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Part 570.489 (g).
Recommendation	We recommend management to update contract model according with the federal requirements.
Questioned Costs	None
Management Response and Corrective Action	Municipality's management concurs with the finding. The Municipal Contract Division established a checklist including the necessary clauses for formalizing a contract. In addition, with the help of the functionary in charge of overseeing the compliance of Davis Bacon Act, each federal program contract will be reviewed before signing. Also, instructions were given to the pre-interventor office to audit all contracts payments before funds are disbursed.
Responsible person	Ms. Ivette Ortiz Zayas - Federal Program Department Director
Implementation date:	June, 2006

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COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-08
Program	Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test – Housing Assistance Payment (HAP)
Statement of Condition	Our examination of fifteenth (15) participant's files revealed that for fifteenth (15) cases, the Housing Assistance Payment Register was not updated as of our examination date.
Criteria	Code of Federal Regulations 24, section 982.158 states that the PHA's are required to maintain a HAP contract register or similar record in which to record the PHA's obligation for monthly HAP's. This record must provide information as to: the name and address of the family, the name and address of the owner, dwelling unit size, the beginning date of the lease term, the monthly rent payable to the owner, monthly rent payable by the family to the owner, and the monthly HAP. The record shall also provide data as to the date the family vacates and the number of days the unit is vacant, if any.
Cause of Condition	The PHA controls and procedures failed to assure that all HAP transactions will be recorded promptly in the HAP Register.
Effect of Condition	The PHA is not in compliance with Code of Federal Regulations 24, section 982.158.
Recommendation	We recommend to the Municipality's management to strengthen controls procedures to assure that all HAP transactions will be recorded promptly in the HAP Register. Also, the Municipality could consider the use of computer software to maintain a HAP Register, instead of a manual basis Register.
Questioned Costs	None.
Management Response and Corrective Action	Management will review instructions and performance of the accounting personnel to assure the completeness of the accounting records in order to include all HAP's payments and/or transactions as per regulations.
Responsible Person:	Ms. Ivette Ortiz Zayas - Federal Programs Department Director.
Implementation Date:	June 2006

N/A

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-09
Program	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test - Reasonable Rent
Statement of Condition	During our Reasonable Rent test we found that during the year 2004-2005 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.
Criteria	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.
Cause of Condition	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.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Section 982.158 (f) (7) and Section 982.507.
Recommendation	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.
Questioned Costs	None

N/A

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference      05-09 (Continued)

Management Response  
and Corrective Action      Management concurs with the finding. Rent Reasonableness test must be  
done to all participants before signing any new contract as prescribed in the  
Administrative Plan.

Responsible person      Ms. Ivette Ortiz Zayas - Federal Program Department Director

Implementation date:      June, 2006

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-10
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:  a. During the fiscal year 2004-2005 the Municipality did not updated the Utility Allowance Schedule. The Municipality updated the schedule in April 1, 2004 and applied it during the current fiscal year through June 30, 2005, fifteen (15) months from the last revision.
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

N/A

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference      05-10 (Continued)

Management Response  
and Corrective Action

The new Municipality management (since January 2005) gave instructions to the 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 HAP using applicable utility allowance schedule.

Responsible person      Ms. Ivette Ortiz Zayas - Federal Program Department Director

Implementation date:      June, 2006

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference 05-11  
Program Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development  
Requirement Reporting

N/A

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

- a. The amounts reported in the account 4715, Housing Assistance Payments and the Administrative Expenditures in the Quarterly HUD Voucher Management System, submitted to HUD, are not traceable to the amounts presented in the accounting records.

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 Municipality did not reconcile the general ledger account balance to HUD revised Voucher Management System reports in order to adjust the differences.

Effect of Condition The Municipality is not in compliance with OMB Common Rules, Subpart C, 24 CFR 85.20 (b) (1) and 85.20 (b) (2).

Recommendation The program must improve its reconciliation procedures in order to assure that the accounting records balances agree with the HUD revised Voucher Management System reports.

Questioned Costs None

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference      05-11 (Continued)

Management Response    The Municipality management gave instructions to the program accountant to modify the accounting records in order to comply with the Program financial management and accounting requirements.

Responsible Person:     Ms. Ivette Ortiz Zayas - Federal Programs Department Director

Implementation Date:    July, 2006

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF PRIOR YEARS AUDIT FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2005

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
04-04	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 05-04.</p>
04-05	14.228	<p><u>For the project 03-FC-56-004 the Municipality did not include in the contract provisions for payment of prevailing wage rate with compliance with David Bacon Act requirements. In addition, the contractor weekly payrolls were not 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 05-06.</p>
04-06	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 05-07.</p>
04-07	14.228	<p><u>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.</u></p> <p>Corrective Action was taken.</p>
04-08	14.228	<p><u>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: The Financial Quarterly Report for the period ended on June 30, 2004 was not submitted on a timely basis.</u></p> <p>Corrective Action was taken.</p>

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COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF PRIOR YEARS AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
04-09	14.871	<u>The Municipality should establish monitoring procedures to assure that Housing Assistance payments are duly computed as required by the Federal Regulations.</u>  Corrective Action was taken.
04-10	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 has been taken. The auditor reissued the finding for the current year. Reference Finding 05-11. <span style="float: right;">N/A</span>
04-11	14.871	<u>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. We could not determine how participants were selected from the top of the waiting list.</u>  Corrective Action was taken.
04-12	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 has been taken. The auditor reissued the finding for the current year. Reference Finding 05-09. <span style="float: right;">N/A</span>
04-13	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 has been taken. The auditor reissued the finding for the current year. Reference Finding 05-10. <span style="float: right;">N/A</span>
04-14	14.871	<u>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). The Municipality did not perform the required Housing Quality Control re-inspections during the audit period.</u>  Corrective Action was taken.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF PRIOR YEARS AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (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 05-04.</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 05-06.</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 05-07.</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>Corrective action was taken.</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 05-04.</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 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</u></p>

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COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF PRIOR YEARS AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<u>compliance and the nature and extend of violations, if any.</u>
		No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 05-06.
02-12	14.228	<u>The Municipality should update the contract model according with the federal requirements.</u>
		No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 05-07.
02-13	14.228	<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>
		Corrective action was taken..
02-14	14.871	<u>The Municipality should establish monitoring procedures to assure that Housing Assistance payments are duly computed as required by the Federal Regulations.</u>
		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 05-11.
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>
		Corrective action was taken.
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>

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COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SALINAS

SCHEDULE OF PRIOR YEARS AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30,2005

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 05-09.
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 current year. Finding Reference 05-10.
02-21	14.871	<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>
		Corrective action was taken.

N/A

N/A