

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

MUNICIPIO DE SALINAS
AUDITORIA 2006-2007
30 DE JUNIO DE 2007

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DE GOBIERNO MUNICIPAL
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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
SINGLE AUDIT REPORT
FISCAL YEAR ENDED JUNE 30, 2007**

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS, PUERTO RICO
SINGLE AUDIT REPORT
FISCAL YEAR ENDED JUNE 30, 2007**

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Pedro C. Ortiz Ledée

Certified Public Accountant

INDEPENDENT AUDITORS' REPORT

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

I 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 fiscal year ended June 30, 2007, 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. My responsibility is to express opinions on these financial statements based on my audit.

I conducted my 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. Those standards require that I 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 statement presentation. I believe that my audit provides a reasonable basis for my opinions.

As discussed in Note 8 to the financial statements, the Municipality did not have a complete, updated and accurate accounting records of capital assets in order to obtain sufficient and competent evidential matter related to the Capital Assets reported in the accompanying statement of net assets for \$14,238,518, net of accumulated depreciation of \$5,116,240, and accordingly, the amount by which this departure would affect the assets, net assets and expenses of the governmental activities is not reasonably determinable.

The Municipality does not maintain proper accounting records of the interfund cash transactions and the corresponding due from and due to account balances. I was unable to obtain sufficient evidence to support the amount of \$3,611,117 recorded in each major fund and the aggregate remaining fund in due from and due to in the Balance Sheet of the governmental funds.

In my opinion, because of the effects of the matter discussed in the third paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the governmental activities of the Municipality as of June 30, 2007, or the changes in financial position, thereof for the year then ended.

In addition, in my opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary has I been able to audit evidence regarding interfund transactions, as described in the fourth paragraph, the financial statements referred to above present fairly, in all material respects, the respective financial position of each major fund, and the aggregate remaining fund information of the Municipality, as of June 30, 2007, and the respective changes in financial position, for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITORS' REPORT

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The accompanying financial statements have been prepared assuming that the Municipality will continue as a going concern. As discussed in Note 12 to the financial statements, the Municipality, during several years has increased its deficit by exceeding its expenditures over its revenues. As of June 30, 2007 the unreserved accumulated deficit for its general fund (for governmental funds) amounted to \$7,566,436, with total liabilities of \$6,812,369 and total assets amounting to \$915,908. These conditions raised substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters also are described in Note 12. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

In accordance with *Government Auditing Standards*, I have also issued my report dated December 21, 2007, on my consideration of the Municipality's internal control over financial reporting and on my 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 my 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 my audit.

The Management's Discussion and Analysis and budgetary comparison information on pages 3 through 11 and 49 through 50, are not a required part of the basic financial statements but are supplementary information required by the accounting principles generally accepted in the United States of America. I 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, I did not audit the information and express no opinion on it.

My audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purpose 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. 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 my opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Pedro C. Ortiz Ledee

CPA Pedro C. Ortiz Ledee
License Number 5200,
Expires on December 1, 2008

Guayama, Puerto Rico
December 21, 2007



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007**

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, 2007. 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 \$20.6 millions in the accompanying statement of net assets, of which the most significant are capital assets and cash amounting to \$14.2 millions, \$4.0 millions, respectively.
- **Liabilities** – The Municipality has reported liabilities amounting to \$18.9 millions in the accompanying statement of net assets, of which the most significant are accounts payable and Intergovernmental payable, deferred revenues, and other liabilities such as bonds payable and notes payable and other debts.
- **Net assets** – The assets of the Municipality exceeded its liabilities by \$1.8 at June 30, 2007, which is presented as "Net Assets" in the accompanying statement of Net Assets. Restricted net assets and unrestricted deficit amounted to \$7.6 millions, as restated, and \$(17.6) millions, respectively. Net assets invested in capital assets amounted to \$11.8 millions.
- **Net change in net assets** – The Municipality's net assets decrease by \$100.0 thousand during fiscal year ended June 30, 2007. Net assets at June 30, 2006 amounted to (\$1.6) millions. The increase in net deficit was principally for positive results of operations and increase in the Municipality's overall financial position in comparison with the prior fiscal year.
- **Revenues** – The Municipality has reported total revenues amounting to \$14.4 millions in the accompanying statement of activities, of which the most significant are tax revenues, and operating grants.
- **Expenses** – The Municipality has reported total expenses amounting to \$14.7 millions in the accompanying statement of activities.

b) Governmental Funds Highlights

- **Assets** – The Municipality's governmental funds have reported combined assets amounting to \$10.0 millions in the accompanying balance sheet – governmental funds, of which the most significant are cash and due from other funds, amounting to \$4.0 millions, and \$3.6 millions respectively.

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- Liabilities – The Municipality's governmental funds have reported combined liabilities amounting to \$9.8 millions in the accompanying balance sheet – governmental funds, of which the most significant are intergovernmental payable, interfund due to other funds, and deferred revenues, amounting to \$2.5 millions, \$3.6 millions and \$2.2 millions respectively.
- Governmental fund balances – The Municipality's governmental funds reported combined fund balance amounting to \$182 thousand, of which \$6.1 millions and (\$5.9) millions represent reserved and unreserved fund balances, respectively.
- Net change in governmental fund balances – The Municipality's governmental deficit decrease by \$349 millions during fiscal year ended June 30, 2007. Governmental fund balances at June 30, 2007 amounted to \$182 thousand.
- Revenues – The Municipality's governmental funds have reported combined revenues amounting to \$15.6 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.
- Expenditures – The Municipality's governmental funds have reported combined expenditures amounting to \$17.0 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.

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 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, 2006 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.

**COMMONWEALTH OF PUERTO RICO
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MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007**

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, 2007. 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 above mentioned 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").

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, 2007). 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.

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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 statement purposes the Municipality has four major funds: (1) the General Fund, (2) State Assignment Fund, (3) the CDBG Fund and (4) the Debt Service Fund.

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.

As of July 1, 2002, the Municipality commenced the prospective reporting of infrastructure assets. The infrastructure assets recorded in the accompanying statement of net assets do not include a substantial portion of the Municipality's infrastructure assets constructed or acquired by the Municipality from 1980 through June 30, 2007. 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 assets (excess of assets over liabilities) amounted to \$1.8 millions at June 30, 2007, compared to net assets of \$1.7 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 (\$11.8 millions). The Municipality's net assets is also composed of net assets amounting to \$7.6 millions that are restricted for (1) future debt service payments, (2) the future acquisition or construction of capital assets and (3)

**COMMONWEALTH OF PUERTO RICO
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MANAGEMENT'S DISCUSSION AND ANALYSIS
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other purposes, mainly the financing of federal and state assisted programs. In addition, the Municipality's unrestricted deficit reported is (\$17.6) 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:

Condensed Statement of Net Assets:

	<u>2007</u>	<u>2006</u>	<u>Change</u>	<u>%</u>
Current assets	\$ 6,341,376	\$ 6,130,588	210,788	3%
Noncurrent assets	14,238,518	14,541,045	(302,527)	(2%)
Total assets	<u>20,579,894</u>	<u>20,671,633</u>	<u>(91,739)</u>	-
Current liabilities outstanding	4,647,133	4,522,173	124,960	3%
Noncurrent liabilities outstanding	14,171,842	14,488,491	(316,649)	(2%)
Total liabilities	<u>18,818,975</u>	<u>19,010,664</u>	<u>(191,689)</u>	(1%)
Net assets				
Invested in capital assets, net of debt	11,794,639	12,708,166	(913,527)	(7%)
Restricted	7,590,703	7,755,717	(165,014)	(2%)
Unrestricted	(17,624,423)	(18,802,914)	1,178,491	(6%)
Total net assets	<u>\$ 1,760,919</u>	<u>\$ 1,660,969</u>	<u>\$ 99,950</u>	6%

Changes in Net Assets

The Municipality's net assets increased by \$100 thousands. Approximately 50% of the Municipality's total revenues came from taxes and intergovernmental revenues, while the other revenues 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, health and welfare and public works.

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

Program revenues:			
Operating grants and contributions	\$ 1,121,516	\$ 1,829,623	\$ (708,107)
Capital grants and contributions	2,017,034	450,509	1,566,525
Charges for services	225,037	36,176	188,861
General revenues:			
Property taxes	3,034,165	2,613,198	420,967
Municipal license taxes	934,434	943,040	(8,606)
Construction excise taxes	933,378	811,152	122,226
Sales tax	904,364		
Intergovernmental Revenues	5,048,588	5,023,887	24,701
Miscellaneous	145,069	519,641	(374,572)
Total revenues	<u>14,363,585</u>	<u>12,227,226</u>	<u>1,231,995</u>
Expenses:			
General government	4,635,786	5,355,985	(720,199)
Public safety	985,192	1,111,708	(126,516)
Public works	2,478,644	2,159,992	318,652
Health and welfare	2,242,625	2,342,499	(99,874)
Culture and recreation	744,148	789,795	(45,647)
Community development	3,030,683	697,029	2,333,654
Education	113,169	145,564	(32,395)
Interest on bonds and notes	470,548	291,605	178,943
Total expenses	<u>14,700,795</u>	<u>12,894,177</u>	<u>1,806,618</u>
Net decrease in net assets	(337,210)	(666,951)	329,741
Net assets - at beginning of year	<u>2,098,129</u>	<u>2,327,920</u>	<u>(229,791)</u>
Net assets - at end of year	<u>\$ 1,760,919</u>	<u>\$ 1,660,969</u>	<u>99,950</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007**

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 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:

Condensed Balance Sheet - Governmental funds:

	2007	2006
Total assets - major funds	\$ 6,520,372	\$ 6,416,161
Total assets - nonmajor funds	3,432,121	2,712,117
Total assets	<u>9,952,493</u>	<u>9,128,278</u>
Total liabilities - major funds	8,784,406	8,623,806
Total liabilities - nonmajor funds	986,038	755,418
Total liabilities	<u>9,770,444</u>	<u>9,379,224</u>
Fund Balances:		
Reserved - major funds	3,632,427	4,296,086
Reserved - nonmajor funds	2,446,083	1,956,699
Unreserved - major funds	(5,896,461)	(6,503,731)
Total net assets	<u>\$ 182,049</u>	<u>\$ (250,946)</u>

Condensed Operations - Governmental funds:

Total revenues - major funds	\$ 13,977,584	\$ 10,810,970
Total revenues - nonmajor funds	1,660,560	1,554,772
Total revenues	<u>15,638,144</u>	<u>12,365,742</u>
Proceed of bonds	1,760,000	-
Total expenditures - major funds	15,038,973	12,292,157
Total expenditures - nonmajor	2,009,942	1,482,611
Total expenditures	<u>17,048,915</u>	<u>13,774,768</u>
Net change in fund balances	<u>\$ 349,229</u>	<u>\$ (1,409,026)</u>

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CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The accompanying statement of net assets reported capital assets net of accumulated depreciation, amounting to \$14.2 million at June 30, 2007. The related accumulated depreciation and amortization of capital assets amounted to \$5.1 at June 30, 2007. 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 \$393 thousand for the year ended June 30, 2007. Depreciation and amortization charges for the year totaled \$695 thousand.

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. Federal grant revenues may vary if new grants are available but the revenue is also very predictable.

Those factors were considered when preparing the Municipality's budget for the 2006-2007 fiscal year. There were no significant changes between the budget for fiscal year 2005-2006 and the one for fiscal year 2006-2007.

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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' Director of Finance, Mr. Luis Roberto Santiago, at PO Box 1149, Salinas, Puerto Rico, 00751, or call (787) 824-3030.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
STATEMENT OF NET ASSETS
June 30, 2007**

	Governmental Activities
ASSETS:	
Cash and Investments.....	\$ 1,012,744
Cash with Fiscal Agent.....	2,945,425
Receivables (net):	
Property Taxes.....	17,595
Federal Grants.....	1,916,878
Others.....	448,734
	<u>6,341,376</u>
Capital Assets (Note 8):	
Land, Improvements, and Construction in Progress.....	6,550,546
Other Capital Assets, (Net of Depreciation).....	7,687,972
Total Capital Assets.....	<u>14,238,518</u>
Total Assets.....	<u>20,579,894</u>
LIABILITIES:	
Bank Overdraft.....	377,391
Accounts Payable and Accrued Expense.....	642,085
Due to Governmental Activities.....	2,485,749
Claims & Judgments.....	498,028
Deferred Revenue.....	643,880
Long-Term Liabilities (Note 10):	
Due within One Year.....	1,790,324
Due in More than One Year.....	12,381,518
Total Liabilities.....	<u>18,818,975</u>
NET ASSETS	
Invested in Capital Assets, Net of Related Debt.....	11,794,639
Restricted for:	
Debt Service Fund.....	1,488,554
Other Purposes.....	6,102,149
Unrestricted (Deficit).....	(17,624,423)
Total Net Assets (Deficit).....	<u>\$ 1,760,919</u>

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue
		Charges For Services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental Activities:					
General Government.....	\$ 4,635,786	\$ -	\$ -	\$ -	\$ (4,635,786)
Public Safety.....	985,192	-	385	-	(984,807)
Public Works.....	2,478,644	-	-	-	(2,478,644)
Culture and Recreation.....	744,148	-	-	-	(744,148)
Human Services and Welfare.....	2,242,625	-	712,893	-	(1,529,732)
Urban Development.....	3,030,683	-	295,687	2,017,034	(717,962)
Education.....	113,169	-	112,551	-	(618)
Interest on Long-Term Debt.....	470,548	-	-	-	(470,548)
Total Governmental Activities....	\$ 14,700,795	\$ -	\$ 1,121,516	\$ 2,017,034	(11,562,245)

General Revenues:

Taxes:

Property Taxes, levied for General Purposes.....	2,187,051
Property Taxes, levied for Debt Services.....	847,114
Municipal License Taxes.....	934,434
Licenses, Permits and Other Local Taxes.....	933,378
Intergovernmental.....	5,048,588
Charges for Services.....	225,037
Sales Tax.....	904,364
Rent.....	59,907
Miscellaneous.....	85,162

Total General Revenues and Special Items..... 11,225,035

CHANGE IN NET ASSETS..... (337,210)

Net Assets - Beginning of Year..... 2,098,129

NET ASSETS - END OF YEAR..... \$ 1,760,919

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
BALANCE SHEET - GOVERNMENTAL FUNDS
June 30, 2007

	General Fund	State Assignment Fund	CDBG Fund	Debt Service Fund	Other Governmental Funds	Total Funds
ASSETS:						
Cash and Investments (Note 2).....	\$ -	\$ 152,703	\$ -	\$ -	\$ 860,041	\$ 1,012,744
Cash with Fiscal Agent.....	12,164	-	-	1,486,518	1,446,743	2,945,425
Receivables:						
Property Taxes.....	-	-	-	17,595	-	17,595
Sales Tax.....	50,004	-	-	-	-	50,004
Federal Grants.....	-	-	1,916,878	-	-	1,916,878
State Government.....	-	-	-	-	-	-
Due from Other Funds.....	853,740	2,030,770	-	-	726,607	3,611,117
Others.....	-	-	-	-	398,730	398,730
Total Assets.....	\$ 915,908	\$ 2,183,473	\$ 1,916,878	\$ 1,504,113	\$ 3,432,121	\$ 9,952,493
LIABILITIES AND FUND BALANCES:						
Liabilities:						
Bank Overdraft.....	377,057	-	334	-	-	377,391
Accounts Payable and Accrued Expense Liabilities...	161,653	39,600	317,531	-	123,301	642,085
Due to Governmental Units.....	2,485,749	-	-	-	-	2,485,749
Due to Other Funds.....	2,757,377	-	86,820	15,559	751,361	3,611,117
Claims & Judgments.....	498,028	-	-	-	-	498,028
Deferred Revenue:						
Volume of Business Tax.....	532,505	-	-	-	-	532,505
Federal Grants.....	-	-	1,512,193	-	111,376	1,623,569
Total Liabilities.....	6,812,369	39,600	1,916,878	15,559	986,038	9,770,444
Fund Balances:						
Reserve For:						
Encumbrances.....	1,657,811	-	-	-	-	1,657,811
Debt Service.....	-	-	-	1,488,554	-	1,488,554
Other Purposes.....	12,164	2,143,873	-	-	2,446,083	4,602,120
Unreserved (Deficit).....	(7,566,436)	-	-	-	-	(7,566,436)
Total Fund Balances.....	(5,896,461)	2,143,873	-	1,488,554	2,446,083	182,049
TOTAL LIABILITIES AND FUND BALANCES.....	\$ 915,908	\$ 2,183,473	\$ 1,916,878	\$ 1,504,113	\$ 3,432,121	\$ 9,952,493

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE - GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	General Fund	State Assignment Fund	CDBG Fund	Debt Service Fund	Other Governmental Funds	Total Funds
REVENUES						
Property Taxes.....	\$ 2,187,051	\$ -	\$ -	\$ 847,114	\$ -	\$ 3,034,165
Volume of Business Taxes.....	934,434	-	-	-	-	934,434
Sales Taxes.....	904,364	-	-	-	-	904,364
Charges for Services.....	225,037	-	-	-	-	225,037
Federal Assistances.....	-	-	1,274,559	-	673,885	1,948,444
Intergovernmental.....	5,048,588	1,477,990	-	-	986,675	7,513,253
Licenses and Permits.....	933,378	-	-	-	-	933,378
Rent.....	54,607	-	-	-	-	54,607
Miscellaneous.....	90,462	-	-	-	-	90,462
Total Revenues.....	10,377,921	1,477,990	1,274,559	847,114	1,660,560	15,638,144
EXPENDITURES						
Current:						
General Government.....	6,254,611	-	-	-	315,602	6,570,213
Public Safety.....	922,509	-	-	-	1,755	924,264
Public Works.....	2,202,354	-	-	-	-	2,202,354
Culture and Recreation.....	957,300	-	-	-	72,850	1,030,150
Human Services and Welfare.....	1,323,295	-	-	-	515,826	1,839,121
Urban Development.....	-	1,042,515	1,284,341	-	631,652	2,958,508
Education.....	-	-	-	-	112,854	112,854
Capital Outlay.....	-	-	-	-	359,403	359,403
Debt Service:						
Principal.....	-	-	-	581,500	-	581,500
Interest and Other Charges.....	-	-	-	470,548	-	470,548
Total Expenditures.....	11,660,069	1,042,515	1,284,341	1,052,048	2,009,942	17,048,915
OTHER FINANCING SOURCES (USES)						
Proceed From Issuance of Bonds.....	1,005,000	-	-	-	755,000	1,760,000
Transfers - In.....	-	-	-	399,403	-	399,403
Transfers - Out.....	(399,403)	-	-	-	-	(399,403)
Total Other Financing Sources and Uses.....	605,597	-	-	399,403	755,000	1,760,000
Net Change in Fund Balances.....	(676,551)	435,475	(9,782)	194,469	405,618	349,229
Fund Balance - Beginning as Restated (Note 12).....	(5,219,910)	1,708,398	9,782	1,294,085	2,040,465	(167,180)
Fund Balances - Ending.....	\$(5,896,461)	\$ 2,143,873	\$ -	\$ 1,488,554	\$ 2,446,083	\$ 182,049

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See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS
June 30, 2007**

Total Fund Balances – Governmental Funds (Page 14) \$ 182,049

Amounts reported for Governmental Activities in the Statement of Net Assets (Page 12) are different because:

Capital Assets used in governmental activities are not financial resources and therefore are not reported in the funds. In the current period, these amounts are:

Non Depreciable Capital Assets.....	\$ 6,550,546	
Depreciable Capital Assets	10,289,114	
Infrastructure Assets.....	2,515,098	
Accumulated Depreciation.....	<u>(5,116,240)</u>	
Total Capital Assets		14,238,518

Some of the Municipality's revenues will be collected after year-end but are not available soon enough to pay for the current period's expenditures and therefore are deferred in the funds..... 1,512,194

Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:

General Bonds and Notes Payable	8,855,129	
Treasury Department Debt.....	83,693	
Municipal Revenues Collection Center Law 42.....	1,076,992	
Land Information System Management	176,923	
Municipal Revenues Collection Center Final Settlements	166,895	
Water & Sewer Authority	75,710	
State Department of Labor	155,208	
Compensated Absences	1,228,088	
Claims & Judgments.....	291,501	
Solid Waste Landfill	2,037,703	
U.S. Department of Housing and Urban Development	<u>24,000</u>	
Total Long-Term Liabilities.....		<u>(14,171,842)</u>

Total Net Assets of Governmental Activities (Page 12)..... \$ 1,760,919

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES
June 30, 2007**

Net Change in Fund Balances – Total Governmental Funds (Page 15)..... \$ 349,229

Amounts reported for Governmental Activities in the Statement of Activities (Page 13) are different because:

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 and reported as depreciation expense. In the current period, these amounts are:

Urban Development and Capital Outlay	\$ 392,604	
Depreciation Expense	<u>(694,678)</u>	
Excess of Depreciation Expense over Capital Outlay		(302,074)

Revenues in the Statement of Revenues that correspond to Prior Year resources are recorded as Revenue in the Statement of Activities..... (1,275,012)

Bonds proceeds provide current financial resources to governmental funds, but issuing debt increases Long-Term Liabilities in the Statement of Net Assets. In the current period, proceeds received was..... (1,760,000)

Repayment of long-term principal is expenditure in the governmental funds, but the repayment reduces Long-Term Liabilities in the Statement of Net Assets. In the current year the repayments were:..... 581,500

Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. These activities consist of:

Increase in Municipal Revenues Collection Center Settlement	\$ (4,162)	
Decrease in Treasury Department Debt.....	27,898	
Decrease in Municipal Revenues Collection Center Law 42	17,070	
Decrease in Water & Sewer Authority Debt.....	84,000	
Decrease in State Department of Labor Debt	51,060	
Decrease in Compensated Absences	52,559	
Decrease in Claims & Judgments	90,641	
Increase in U.S. Department of Housing and Urban Development Debt.....	(24,000)	
Decrease in Land Information System Management Debt	33,369	
Decrease in Solid Waste Landfill.....	<u>1,740,712</u>	

Total Additional Expenditures..... 2,069,147

Change in Net Assets of Governmental Activities (Page 13)..... \$ (337,210)

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
Notes to Basic Financial Statements
June 30, 2007

NOTE 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.

The accounting policies of the Municipality conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of the more significant of such policies.

The accompanying basic financial statements of the Municipality have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). The GASB is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations) constitutes GAAP for governmental units.

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.

The accompanying basic financial statements present the financial position and the results of operations of the Municipality and its various funds and fund types. The basic financial statements are presented as of June 30, 2007, and for the fiscal year then ended. The more significant of these accounting policies are described below and, where appropriate, subsequent pronouncements will be referenced.

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 required supplementary information, 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, 2007, 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, 2007

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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.

A. 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 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, 2007.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
Notes to Basic Financial Statements
June 30, 2007

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

Government-wide Financial Statements

The accompanying government-wide financial statements 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 government-wide financial statements 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 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
Notes to Basic Financial Statements
June 30, 2007

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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, 2007, 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) human services and welfare, (5) culture and recreation, (6) urban 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) human services and welfare, (e) culture and recreation, (f) urban development and (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.

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 no exchange 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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
Notes to Basic Financial Statements
June 30, 2007**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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.

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 no exchange 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.

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).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
Notes to Basic Financial Statements
June 30, 2007

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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 Fund – 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 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
Notes to Basic Financial Statements
June 30, 2007

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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 between 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 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 – This 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.
- State Assignment Fund - This is the fund used to account for the capital project transactions of the State Assignment by Legislature Resolutions. The primarily objectives of this assignments is the acquisition or construction of major capital facilities, other assets and permanent improvements.
- CDBG Fund - This is the fund used to account for all the transactions of the Community Development Block Grant Program. The primarily objectives of this program is the development of viable communities by providing decent housing, a suitable living environment and expanded economic opportunities, principally for persons of low and moderate income.
- Debt Service Fund - 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.

B. 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.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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 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 no exchange 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 no exchange 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.

**COMMONWEALTH OF PUERTO RICO
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June 30, 2007**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

- 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 no exchange 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 no exchange transactions discussed above.

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 no exchange 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, 2007, including property taxes. Revenue sources not meeting this availability criterion or collected in advance are recorded as deferred revenues at June 30, 2007. 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 no exchange 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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
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June 30, 2007

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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.

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* (GASB 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 GASB 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.
- Executors 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.

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NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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 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.

C. Financial Statement Presentation

The basic financial statements include both government-wide (based on the Municipality as a whole) and fund financial statements. While the previous financial reporting model emphasized fund types (the total of all funds of a particular type), in the new financial model the focus is on either the Municipality as a whole, or major individual funds (within the basic financial statements). Both the government-wide and fund financial statements (within the basic financial statements) categorize primary activities as either governmental or business type.

D. Budgetary Data

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.

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June 30, 2007

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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 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, 2007. 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, 2007. 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 with GAAP. Accordingly, the accompanying budgetary comparison schedule is accompanied by a reconciliation of the differences between the budgetary basis and GAAP actual amounts.

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June 30, 2007

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

E. 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.

F. Receivables

In the accompanying GWFS, receivables consist of all revenues earned but not collected at June 30, 2007. 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 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.

G. 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.

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June 30, 2007**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

H. 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>
Buildings and site improvements	40 years	\$1
Infrastructure	40 years	\$1
Works of art	10 years	\$1
Vehicles	5 years	\$1
Furniture and fixtures	5 years	\$25
Machinery and equipment	3 to 5 years	\$25

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.

I. 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.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

J. 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, 2007 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.

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.

K. 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.

L. 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.

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NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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.

M. Insurances

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 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, 2007. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

N. Reservations of Fund Balance

The governmental fund financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditures or (2) legally segregated for a specific future use. The reserves for related assets such as inventories and prepayments are examples of the former. Reserves for debt service and other specific purposes are examples of the latter.

O. Interfund Transactions

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.

P. 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.

Q. Future Adoptions of Accounting Pronouncement

In June 2005, GASB issued its Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions* (GASB No. 45). This statement establishes standards for the measurement, recognition and display of OPEB expense/ expenditures and related liabilities/ assets, note disclosures, and if applicable, required supplementary information in the financial reports of state and local government employers. The requirements of this statement are effective for the Municipality's fiscal year commencing on July 1, 2008.

In September 2006, GASB issued its Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues* (GASB 48). This Statement established standards for the measurement, recognition and display of transactions where governments sometimes exchange an interest in their expected cash flows from collecting specific receivables or specific future revenues for immediate cash payments, generally, a single lump sum. This Statement establishes criteria that the Municipality will use to ascertain whether the proceeds received should be reported as revenue or as liability. The requirements of this statement are effective for the Municipality's fiscal year commencing on July 1, 2007.

The Municipality's management has concluded that the future adoption of GASB Statement No. 45 and 48 will not have a significant impact on the Municipality's basic financial statements.

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NOTE 2 CASH, CASH EQUIVALENTS AND INVESTMENTS

The Municipality adopted the provisions of GASB Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3*. This statement requires that state and local governments disclose essential risk information about deposits and investments. The disclosure requirements cover four main areas: (1) credit risk, (2) interest rate risk, (3) custodial credit risk, (4) foreign exchange exposure.

NOTE 2 CASH, CASH EQUIVALENTS AND INVESTMENTS (continuation)

- **Credit risk** – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth, the Municipality has adopted, as its custodial and credit risk policy, the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*. Accordingly the Municipality invests only in obligations of the Commonwealth, obligations of the United States of America, certificates of deposits, commercial paper, bankers' acceptances, or in pools of obligations of the municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality does not invest in marketable securities or any types of investments for which credit risk exposure may be significant. Therefore, the Municipality's management has concluded that the risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2007.
- **Interest rate risk** – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt investments in its investment portfolio at June 30, 2007, (2) limiting the weighted average maturity of its investments to three months or less, and (3) keeping most of its bank deposits in interests bearing accounts generating interests at prevailing market rates. At June 30, 2007, the Municipality's does not maintains any investments. Therefore, the Municipality's management has concluded that at June 30, 2007, the interest rate risk associated with the Municipality's cash and cash equivalents is considered low.
- **Custodial credit risk** – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico* the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC) generally up to a maximum of \$100,000 per depositor. In addition, public funds deposited in commercial banks by the Municipality are fully securities pledged as collateral are held, in the Municipality's name, by the agents of the Commonwealth's Secretary of Treasury. Deposits with GDB are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2007. Therefore, the Municipality's management has concluded that at June 30, 2007 the custodial credit risk associated with the Municipality's cash and cash equivalents is considered low.
- **Foreign exchange risk** – The risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, the Municipality is prevented from investing in foreign securities or any other types of investments in which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2007.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
Notes to Basic Financial Statements
June 30, 2007

NOTE 2 CASH, CASH EQUIVALENTS AND INVESTMENTS (continuation)

At June 30, 2007 the total deposits are as follows:

	<u>GENERAL FUND</u>	<u>STATE ASSIGNMENT FUND</u>	<u>CDBG FUND</u>	<u>DEBT SERVICE FUND</u>	<u>OTHER GOVERNMENTAL FUND</u>	<u>TOTAL GOVERNMENTAL FUND</u>
Unrestricted:						
Cash in commercial banks						
Total unrestricted deposits	\$ -	152,703	-	-	860,041	1,012,744
Restricted (Note 1):						
Cash in GDB, as fiscal agent	<u>12,164</u>	-	-	<u>1,486,518</u>	<u>1,446,743</u>	<u>2,945,425</u>
Total carrying amount of deposits	<u>\$12,164</u>	<u>152,703</u>	<u>-</u>	<u>1,486,518</u>	<u>2,306,784</u>	<u>3,958,169</u>
Bank overdraft:						
Cash in commercial banks, unrestricted	<u>\$377,057</u>	-	<u>334</u>	-	-	<u>377,391</u>

NOTE 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, 2007, the municipal tax rates imposed by the Municipality were 1.50% for financing institutions and 0.50% 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.

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 \$532,505 at June 30, 2007, which represents municipal licenses collected in advance for the taxable year 2007-2008.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
Notes to Basic Financial Statements
June 30, 2007

NOTE 4 SALES AND USE TAXES

On July 4, 2006, the Legislature of the Commonwealth of Puerto Rico approved Act No. 117 ("Act 117") which amends the Puerto Rico Internal Revenue Code of 1994 to provide for a sales and use tax of 5.5% to be imposed by the Commonwealth Government. Act 117 also authorizes each municipality government to impose a municipal sales and use tax of 1.5%. This municipal sales and use tax has in general the same tax base and limitations (except for unprocessed foods) as those provided by the Commonwealth's sales and use tax.

Section 6189 of the Puerto Rico Internal Revenue Code of 1994, as amended, authorizes the Municipalities in Puerto Rico to impose a sales and use tax to consumers. This tax must be imposed in conformity with the base, exemptions and limitations contained Subtitle BB of the Code. The Municipal Sales Tax is specifically imposed over all sales transactions of taxable items and combined transactions (as defined by the municipal internal regulation) taken place within municipal limits. The Municipal Tax is also specifically imposed over the purchase price for the use, storage or consumption of taxable transactions (as defined by the municipal internal regulation) taken place within municipal limits.

The Municipal Legislature approved the imposition of the municipal sales and use tax, effective on July 1, 2006. Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the Municipality. Tax is due each 20th day of each month based on tax collected in the preceding month. The Municipal Ordinance does not impose specific restrictions or limitations on the use of the municipal sales and use tax resources. Resources are recorded in the general fund of the Municipality.

NOTE 5 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, 2007 was 6.53% (of which taxpayers pay 6.33% and 0.20% is reimbursed by the Department of Treasury); after June 30, 2007, 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, 2007 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, 2007, 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

COMMONWEALTH OF PUERTO RICO
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Notes to Basic Financial Statements
June 30, 2007

NOTE 5 PROPERTY TAXES (continuation)

statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers.

This settlement has to be completed on a preliminary basis not later than 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.

NOTE 6 DUE TO OTHER GOVERNMENTAL UNITS

As of June 30, 2007, balance due to other governmental units, consists of the following:

	<u>AMOUNT</u>
State Treasury Department	\$ 863,495
State Department of Labor	2,122
General Service Administration	55,344
Internal Revenues Services	963,239
State Retirement System Administration	307,878
Water & Sewer Authority	<u>293,671</u>
 Total Due to Governmental Units	 <u>\$ 2,485,749</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
Notes to Basic Financial Statements
June 30, 2007**

NOTE 7 INTERFUND TRANSFER AND BALANCES

A. Interfund Transfers

Transfers are indicative of funding for capital projects or debt service, and subsidies of various operations. During fiscal year 2006-2007 the General Fund transfers to the Debt Service Fund \$399,403 for debt payment.

B. Interfund Receivable and Payable Balances

Interfund receivables and payables at June 30, 2007 are summarized as follows:

<u>INTERFUND RECEIVABLE</u>	<u>INTERFUND PAYABLE</u>	<u>AMOUNT</u>
General Fund	Other Funds	\$ 751,361
General Fund	Debt Service Fund	15,559
General Fund	CDBG Fund	86,820
State Assignment	General Fund	2,030,770
Other Funds	General Fund	<u>726,607</u>
TOTAL		<u>\$ 3,611,117</u>

NOTE 8 CAPITAL ASSETS

Capital Assets activities for the fiscal year ended June 30, 2007 was as follows:

<u>DESCRIPTION</u>	<u>BALANCE JULY 1, 2006</u>	<u>ADDITIONS</u>	<u>RETIREMENTS</u>	<u>BALANCE JUNE 30, 2007</u>
Non-Depreciable Capital Assets:				
Land.....	\$ 4,855,013	\$ -	\$ -	\$ 4,855,013
Construction in Progress.....	<u>1,695,533</u>	-	-	<u>1,695,533</u>
Total Non-Depreciable Capital Assets ..	<u>6,550,546</u>	-	-	<u>6,550,546</u>
Depreciable Capital Assets:				
Buildings.....	6,970,923	-	-	6,970,923
Infrastructure.....	2,515,098	-	-	2,515,098
Machinery and Equipment.....	989,533	95,166	(3,049)	1,081,650
Motor Vehicles.....	<u>2,023,081</u>	<u>297,438</u>	<u>(83,978)</u>	<u>2,236,541</u>
Total Depreciable Capital Assets	<u>12,498,635</u>	<u>392,604</u>	<u>(87,027)</u>	<u>12,804,212</u>
Less Accumulated Depreciation:				
Buildings.....	(1,966,712)	(174,273)	-	(2,140,985)
Infrastructure.....	(289,491)	(129,608)	-	(419,099)
Machinery and Equipment.....	(773,857)	(92,519)	2,595	(863,781)
Motor Vehicles.....	<u>(1,478,075)</u>	<u>(298,278)</u>	<u>83,978</u>	<u>(1,692,375)</u>
Total Accumulated Depreciation.....	<u>(4,508,135)</u>	<u>(694,678)</u>	<u>86,573</u>	<u>(5,116,240)</u>
Total Depreciable Capital Assets (Net) .	<u>7,990,500</u>	<u>(302,074)</u>	<u>(454)</u>	<u>7,687,972</u>
CAPITAL ASSETS, NET	<u>\$14,541,046</u>	<u>\$ (302,074)</u>	<u>\$ (454)</u>	<u>\$14,238,518</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
Notes to Basic Financial Statements
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NOTE 8 CAPITAL ASSETS (continuation)

Depreciation expenses were charged to governmental functions/programs as follows:

	<u>AMOUNT</u>
General Government	\$ 150,982
Public Work.....	310,645
Public Safety.....	60,928
Culture and Recreation.....	84,581
Education.....	315
Human Services and Welfare.....	15,052
Urban Development.....	<u>72,175</u>
Total Depreciation Expenses.....	<u>\$ 694,678</u>

The Municipality did not have complete and accurate accounting records of capital assets at June 30, 2007 and a physical inventory and a valuation of its capital assets of governmental activities was not performed during the fiscal year ended June 30, 2007.

The infrastructure assets recorded in the accompanying statement of net assets do not include a substantial portion of the Municipality's infrastructure assets constructed or acquired by the Municipality from 1980 through June 30, 2007.

NOTE 9 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

**COMMONWEALTH OF PUERTO RICO
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Notes to Basic Financial Statements
June 30, 2007**

NOTE 9 EMPLOYEES RETIREMENT SYSTEM (continuation)

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 becoming 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.

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 of 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
Notes to Basic Financial Statements
June 30, 2007

NOTE 9 EMPLOYEES RETIREMENT SYSTEM (continuation)

The Municipality's actual contributions for the current year, which are equal to the statutory required contributions, are as follows: \$157,274 for Act. Number 447 and \$167,230 for System 2000.

NOTE 10 GENERAL LONG-TERM DEBT

The principal long-term obligations of the Municipality are general obligations bonds and special notes issued to finance the construction and improvements of public facilities and purchase of equipment. The Municipality's obligations long-term debt retirements are appropriated and paid from resources accumulated in the Debt Service Fund (see Note 7). The special obligations long-term notes retirements are paid through retention made by the Municipal Revenue Collection Center from monthly advance of annual property tax and subsidy send to the Municipality.

A. General Obligation Bonds

General obligations bonds and notes payable as of June 30, 2007, are comprised of the following individual issues:

General and Special Obligations:

<u>DESCRIPTION</u>	<u>AMOUNT</u>
\$600,000 Series 1983, for public improvement, payable in annual installments ranging from \$12,000 to \$40,000, excluding interests at 5.00%, through July 1, 2008	\$ 40,000
\$1,092,000, Series 1986, for public improvement, payable in annual installments ranging from \$22,000 to \$92,879, excluding interests at 6.00%, through January 1, 2010..	258,879
\$2,240,000, Series 1997, payable in semi- annual installments ranging from \$55,000 to \$200,000, excluding interests from 6.00% to 8.00%, through July 1, 2017	1,585,000
\$1,495,000, Series 2002, for public improvement, payable in annual installments ranging from \$20,000 to \$115,000, excluding interests from 4.50% to 5.31% through January 1, 2027	1,390,000
\$1,710,000, Series 2004, for operational purposes, payable in semi-annual installments ranging from \$30,000 to \$125,000, excluding interests at 6.00%, through July 1, 2028	1,610,000
\$2,300,000, Series 1993, for operational purposes, payable in semi-annual installments ranging from \$15,000 to \$60,000, excluding interests from 4.375% to 8.75%, through October 1, 2012	956,250
\$385,000, Series 2004, for operation purposes, payable in semi-annual installments ranging from \$5,000 to \$30,000, excluding interests from 5.00% to 7.50%, through July 1, 2028	360,000
\$805,000, Series 2004, for operational, payable in semi-annual installments ranging from \$15,000 to \$65,000, excluding interests from 5.00% to 6.00%, through July 1, 2028	745,000

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
Notes to Basic Financial Statements
June 30, 2007

NOTE 10 GENERAL LONG-TERM DEBT

\$395,000, Series 2002, for operation purposes, payable in annual installments ranging from \$55,000 to \$75,000 excluding interests from 2.70% to 5.00%, through July 1, 2007	75,000
\$370,000, Series 2002, for operation purposes, payable in annual installments ranging from \$45,000 to \$75,000, excluding interests up to 7.00%, through July 1, 2008 ...	75,000
\$755,000, Series 2006, for purchase of equipment, payable in annual installments ranging from \$90,000 to \$130,000 excluding interests from 6.60% to 7.25%, through July 1, 2013	755,000
\$1,005,000, Series 2007, for operation purposes, payable in annual installments ranging from \$50,000 to \$120,000, excluding interests from 6.60% to 7.00%, through July 1, 2018	<u>1,005,000</u>
Total General and Special Obligations	<u>\$ 8,855,129</u>

The annual requirements to amortize the general and special obligations outstanding as of June 30, 2007 are as follows:

<u>Year ended June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 762,500	543,391	\$ 1,305,891
2009	613,500	481,674	1,095,174
2010	650,379	452,976	1,103,355
2011	597,500	412,588	1,010,088
2012	666,250	375,712	1,041,962
2013-2017	2,330,000	1,348,839	3,678,839
2018-2022	1,430,000	703,435	2,133,435
2023-2027	1,350,000	345,574	1,695,574
2028-2032	455,000	23,586	478,586
Totals	<u>\$ 8,855,129</u>	<u>4,687,775</u>	<u>\$ 13,542,904</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
Notes to Basic Financial Statements
June 30, 2007**

NOTE 10 GENERAL LONG-TERM DEBT (continuation)

B. Other Long-Term Debts

	Balance at June 30, 2006 as Restated	Borrowings or Additions	Payments or Deductions	Balance at June 30, 2007	Due Within One Year
Notes payable to:					
Puerto Rico Treasury Department:					
Excess of property tax advances over collections	\$ 111,591	\$ -	\$ 27,898	\$ 83,693	\$ 27,898
Municipal Revenue Collection Center (CRIM):					
LAW 42	1,094,062	-	17,070	1,076,992	18,143
Fiscal Years Final Settlement	162,733	4,162	-	166,895	-
Land Information Management System (LIMS)	210,292	-	33,369	176,923	35,385
State Water and Sewer Authority Debt Agreement	159,710	-	84,000	75,710	75,710
State Department of Labor - Debt Agreement	206,268	-	51,060	155,208	-
Compensated absences	1,280,647	-	52,559	1,228,088	798,257
Claims and judgments	382,142	109,925	200,566	291,501	48,431
Estimated landfill closure and postclosure care costs	3,778,415	-	1,740,712	2,037,703	-
U.S. Department of Housing and Urban Development	-	24,000	-	24,000	24,000
Total	\$ 7,385,860	\$ 138,087	\$ 2,207,234	\$ 5,316,713	\$ 1,027,824

C. Changes in Long-Term Debts

The following is a summary of changes in long-term debts for the year ended June 30, 2007:

DESCRIPTION	BALANCE JULY 1, 2006	NEW ISSUES	RETIREMENTS AND ADJUSTMENT	BALANCE JUNE 30, 2007	AMOUNTS DUE WITHIN ONE YEAR	AMOUNTS DUE AFTER NEXT YEAR
General Obligations..	\$ 7,676,629	\$ 1,760,000	\$ 581,500	\$ 8,855,129	\$ 762,500	\$ 8,092,629
Others Debts.....	7,385,860	138,087	2,207,234	5,316,713	1,027,824	4,288,889
TOTAL.....	\$15,062,489	\$ 1,898,087	\$ 2,788,734	\$14,171,842	\$ 1,790,324	\$12,381,518

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 \$83,693 at June 30, 2007.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
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June 30, 2007**

NOTE 10 GENERAL LONG-TERM DEBT (continuation)

Notes Payable to CRIM

Law 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 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 \$1,076,992 at June 30, 2007.

Land Information Management System (LIMS)- the Municipality entered into a financing agreement with CRIM for the payment of the Municipality's share of the cost of an information management system, acquired by CRIM on behalf of all municipalities, for the management of a digital database of taxpayers properties located in Puerto Rico. The outstanding balance of the note payable to the CRIM at June 30, 2007 amounted to \$176,923.

Fiscal year final settlements – For the fiscal year ended on June 30, 2007 the CRIM notify to the Municipality that the final settlement of property tax advances versus actual collections through fiscal year 2007 result in an overpayment to the Municipality of \$4,161. At June 30, 2007, the outstanding balances amounted to \$166,895.

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, 2007 is \$75,710.

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 \$2,037,703 reported as landfill closure and postclosure care liability at June 30, 2007, 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 cost to perform all closure and postclosure care in 2007. The estimated closing date of the landfill is the year 2008, but the Municipality expect to to expand the boundaries 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
Notes to Basic Financial Statements
June 30, 2007

NOTE 10 GENERAL LONG-TERM DEBT (continuation)

Note Payable to State Department of Labor

The Municipality entered into a financing agreement with the State Department of Labor for the payment of the Municipality's debt for unemployment benefits. The balance at June 30, 2007 is \$155,208.

NOTE 11 DEBT RETIREMENT

Revenues of the debt service fund consists of the ad-valorem property taxes which are recognized as revenue when collected from taxpayers and reported by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico to the Municipality.

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the Municipality. Payments are made to the Government Development Bank of the Commonwealth of Puerto Rico from such accumulated funds by the Municipal Revenue Collection Center of Puerto Rico.

NOTE 12 GOING CONCERN

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. During the current and prior years the General Fund of the Municipality has suffered recurring excess of expenditures over revenues, which have lead to an accumulated deficit in the General Fund of \$7,566,436 at June 30, 2007. The long term solution for this is situation is to bring the expenditures in line with revenues, which at this date, the Municipality has been unable to do.

Among the actions currently taken by managent in relation to this matter are; an implementation of a cost reduction plan, implementation of increased collection effort over accounts receivable, possible long term financing agreement with the Government Development Bank and monitoring the execution of the property tax, volume of business tax and sales and use tax.

The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the possible inability of the Municipality to continue as a going concern.

NOTE 13 CONTINGENCIES

Litigations

The Municipality is, at present, a defendant in a number of legal matters that arise from alleged improper application of policies and negligence in the ordinary course of the Municipality's activities. With respect to pending litigation, the Municipality has reported liabilities of \$498,028 in the General Fund for awarded unfavorable judgments, plus \$291,501 in the government wide statement of net assets in addition to the amount reported in the General Fund.

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.

In addition, the Municipality is a defendant or co-defendant in several legal proceedings, which are in discovery stage. Certain of these claims are covered by insurance. Legal counsels with the information currently available can not determine the final outcome of these proceeding. However, it has been the Municipality's experience that such actions are settled for amounts substantially less than the claim amounts.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
Notes to Basic Financial Statements
June 30, 2007**

NOTE 13 CONTINGENCIES (continuation)

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. The U.S. Department of Housing and Urban Development (HUD) issued a final resolution in relation to a disallowed cost arising from an audit of the federal program Section 8 Housing Choice Voucher in fiscal year 2005-2006. The accompanying financial statements include a liability of \$24,000 for disallowed cost in accordance with the final resolution issued by HUD.

NOTE 12 ACCOUNTING CHANGES, CHANGES IN REPORTING ENTITY AND RESTATEMENTS

Changes and restatements for the the adoption of pronouncements and others are explained below.

The beginning net assets for the Governmental Activities in the Statement of Net Assets was increased by \$559,662 to correct the balance of the long term debts with the Municipal Revenue Collection Center in accordance with the debts confirmation and reduced by \$206,268 to record a financing agreement with the State Department of Labor formalized in fiscal year 2005-2006. In addition the beginning net assets and beginning fund balance of Other Governmental Funds in the Balance Sheet was increased by \$83,766 for the elimination of outstanding checks and deferred revenues.

Net Assets Restatements

The following schedule reconciles the June 30, 2006 Net Assets, as previously reported to Beginning Net Assets, as restated, July 1, 2006.

Net Assets (Deficit), as Previously Reported, At June 30, 2006.....	\$ 1,660,969
Adjustment to Long Term Debts.....	353,394
Elimination of outstanding checks of Section 8 Program.....	5,492
Elimination of Deferred Revenue in Section 8 Program.....	<u>78,274</u>
Beginning Net Assets (Deficit), as Restated, At July 1, 2006.....	<u>\$ 2,098,129</u>

Fund Balances Restatements

The following schedule reconciles the June 30, 2006 Fund Balances, as previously reported to Beginning Fund Balances, as restated, July 1, 2006.

	OTHERS GOVERNMENTAL FUNDS
Fund Balance, as Previously Reported, June 30, 2006.....	\$ 1,956,699
Elimination of outstanding checks of Section 8 Program.....	5,492
Elimination of Deferred Revenue in Section 8 Program.....	<u>78,274</u>
Beginning Fund Balance, as Restated, July 1, 2006.....	<u>\$ 2,040,465</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
Notes to Basic Financial Statements
June 30, 2007**

NOTE 13 SUBSEQUENT EVENTS

On July 20, 2007, the Legislature of the Commonwealth of Puerto Rico enacted Act No. 80 ("the Act"), in order to make mandatory in all municipalities of Puerto Rico the imposition of a uniform municipal tax 1.5% from which the municipalities shall collect 1% of the sales and use tax pursuant to what is established in Sections 2410 and 6189 of Act No. 117 of July 4, 2006, known as the "Taxpayer's Justice Act of 2006", which may be levied discretionary through municipal legislation, on food and food ingredients and to provide for the collection by the Secretary of the Treasury of the remaining .5% without including food and food ingredients to be used in accordance with the purposes established in the Act; to provide for the establishment of the of the Municipal Development Fund, The Municipal Redemption Fund and the Municipal Improvement Fund, as well as for matters relative to the purposes, implementation and administration of said funds and to provide for the establishment of the necessary mechanics for the collection of the municipal tax. Section 6189 of the Puerto Rico Internal Revenue Code of 1994, as amended, authorizes the Municipalities in Puerto Rico to impose a sale and use tax to consumers. The tax must be imposed in conformity with the base, exemptions and limitations contained in Subtitle BB of the Code. The Municipal Sales Tax is specifically imposed over all sales transactions of taxable items and combined transactions (as defined by the municipal internal regulation) taken place within municipal limits. The Municipal Sales Tax is also specifically imposed over the purchase price of the use, storage, or consumption of taxable transactions (as defined by the municipal internal regulation) taken place within municipal limits.

END OF NOTES

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	Budget Amounts		Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues				
Property Taxes.....	\$ 2,042,893	\$ 2,042,893	\$ 2,187,051	\$ 144,158.00
Municipal License Taxes.....	938,251	938,251	934,434	(3,817)
Licenses, Permits and Other Local Taxes.....	1,833,921	1,833,921	933,378	(900,543)
Intergovernmental Revenues.....	4,985,047	4,985,047	5,048,588	63,541
Charges for Services.....	372,000	372,000	225,037	(146,963)
Sales Tax.....	1,300,000	1,300,000	854,360	(445,640)
Rent of Property.....	110,000	110,000	59,907	(50,093)
Fines and Forfeitures.....	15,000	15,000	12,404	(2,596)
Miscellaneous.....	312,500	312,500	20,762	(291,738)
Total Revenues.....	11,909,612	11,909,612	10,275,921	(1,633,691)
Expenditures				
General Government.....	4,482,283	4,498,190	5,971,600	(1,473,410)
Public Safety.....	1,006,161	1,006,161	924,352	81,809
Public Work.....	3,412,905	3,334,748	2,726,593	608,155
Culture and Recreation.....	922,400	997,650	1,088,647	(90,997)
Human Services and Welfare.....	1,560,522	1,547,522	1,332,282	215,240
Transfer to Other Funds.....	525,341	525,341	399,403	125,938
Total Expenditures.....	11,909,612	11,909,612	12,442,877	(533,265)
Excess (Deficiency) of Revenues over Expenditures	\$ -	\$ -	\$ (2,166,956)	\$ (2,166,956)

See accompanying notes to required supplementary information.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
NOTE TO REQUIRED SUPPLEMENTARY INFORMATION
June 30, 2007**

NOTE A Explanation of Differences between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures

	<u>GENERAL FUND</u>
Sources/Inflows of Resources:	
Actual Amounts (Budgetary Basis) "Available for Appropriation" from the Budgetary Comparison Schedule (Page 45).....	\$ 10,275,921
Difference – Budget to GAAP:	
Current Adjustments to Revenues.....	<u>102,000</u>
Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (Page 15).....	<u>\$ 10,377,921</u>
Uses/Outflows of Resources:	
Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (Page 45).....	\$ 12,442,877
Difference – Budget to GAAP:	
Prior Year expenditures are not outflows of budgetary resources but are expenditures For financial reporting purposes.....	243,593
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary reporting purposes.....	(1,001,206)
Transfers to other funds are outflows of Budgetary Resources but are not Expenditures For Financial Reporting Purpose.....	(399,403)
Current Adjustment to Expenditures.....	<u>374,208</u>
Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (Page 15).....	<u>\$ 11,660,069</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS, PUERTO RICO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	TOTAL EXPENDITURES
U.S. Department of Housing and Urban Development:			
Direct Programs:			
Section 8 Housing Choices Vouchers.....	14.871		\$ 333,744
Indirect Programs:			
Pass Through State – Office of the Commissioner of Municipal Affairs			
Community Development Block Grant (CDBG)...	14.228	06-AB 05-FC-AB 04-FC-AB 03-FC-AB 02-FC-AB 01-FD 00-FD 97-FD	<u>1,284,341</u>
Total U.S. Department of Housing and Urban Development			<u>1,618,085</u>
U.S. Department of Homeland Security:			
Pass-Through Office of the Governor: Public Assistant Grant	97.036	N/AV	<u>225,581</u>
U.S. Department of Health and Human Services			
Pass-Through Administration of Children and Families:			
Child Care and Development Block Grant	93.575	N/AV	<u>110,033</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$1,953,699</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS, PUERTO RICO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

NOTE 1 GENERAL

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Salinas, Puerto Rico (Municipality) and is presented on the modified accrual basis. 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*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the general-purpose financial statements. The reporting entity is defined in Note (1) (A) to the general-purpose combined financial statements.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- A. The accompanying Schedule of Expenditures of Federal Awards is prepared from Municipality's accounting records and is not intended to present financial position or the results of operations.
- B. The Municipality in accordance with the terms records the financial transactions and conditions of the grants, which are consistent with accounting principles generally accepted in the United States of America.
- C. Expenditures are recognized in the accounting period in which the liability is incurred, if measurable or when actually paid, whichever occurs first.

NOTE 3 FEDERAL CFDA NUMBER

The CFDA numbers included in this Schedule are determined based on the program name, review of grant contract information and the Office of Management and Budget's Catalogue of Federal Domestic Assistance.

NOTE 4 PASS-THROUGH GRANTOR'S NUMBER

State or local government redistribution of federal awards to the Municipality, treated as if they were received directly from the federal government, OMB Circular A-133 requires the schedule to include the name of the pass-through entity and identifying number assigned by the pass-through entity for federal awards received as a sub recipient. Numbers identified as N/AV are not available.

NOTE 5 MAJOR PROGRAMS

Major programs are identified in the Summary of Auditor's Results Section of the Schedule of Findings and Questioned Costs.

END OF NOTES

Pedro C. Ortiz Ledée

Certified Public Accountant

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
Members of the Municipal Legislature
Municipality of Salinas, Puerto Rico

I have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Municipality of Salinas, Puerto Rico (Municipality), as of and for the fiscal year ended June 30, 2007, which collectively comprise the Municipality's basic financial statements and have issued my report thereon dated December 21, 2007. The report on the Governmental Activities has an adverse opinion because I was unable to obtain sufficient evidence related to the capital assets reported in the government wide financial statements and the report on Governmental Funds was qualified because the interfund transactions reported in the fund financial statements were not properly supported in the accounting records. The auditor's report includes an explanatory paragraph related to going concern because the Municipality during several years has increased the General Fund's deficit by exceeding its expenditures over its revenues. I conducted my 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 my audit, I considered the Municipality's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Municipality's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of the Municipality's internal control over financial reporting.

My consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, I identified certain deficiencies in internal control over financial reporting that I consider to be significant deficiencies.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the Municipality's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Municipality's financial statements that is more than inconsequential will not be prevented or detected by the Municipality's internal control. I consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs to be significant deficiencies in internal control over financial reporting. 07-III-01 through 07-III-03.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Municipality's internal control.

My consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, I consider items 07-III-01 through 07-III-03 to be 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

Page 2

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, I 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 my audit and, accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

I noted certain matters that I reported to management of the Municipality in a separate letter dated December 21, 2007.

The Municipality's responses to the findings identified in my audit are described in the accompanying Schedule of Findings and Questioned Costs. I did not audit the Municipality's response and, accordingly, I express no opinion on it.

This report is intended solely for the information and use of the management, the Honorable Mayor and Members of the Municipal Legislature, Office of the Commissioner of Municipal Affairs, 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.


CPA Pedro C. Ortiz Ledée
License Number 5200
Expires on December 1, 2008

Guayama, Puerto Rico
December 21, 2007



Pedro C. Ortiz Ledée

Certified Public Accountant

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
Member of the Municipal Legislature
Municipality of Salinas, Puerto Rico**

Compliance

I have audited the compliance of the Municipality of **Salinas**, Puerto Rico (Municipality) with the types of compliance requirements described in the OMB *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the fiscal year ended June 30, 2007. The Municipality's major federal programs are identified in the summary of auditor's 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's management. My responsibility is to express an opinion on the Municipality's compliance based on my audit.

I conducted my audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that I 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's compliance with those requirements and performing such other procedures as I considered necessary in the circumstances. I believe that my audit provides a reasonable basis for my opinion. My audit does not provide a legal determination on the Municipality's compliance with those requirements.

As described in items 07-III-04 and 07-III-05 in the accompanying Schedule of Findings and Questioned Costs, the Municipality did not comply with requirements regarding Cash Management and Procurement, Suspension and Debarment that are applicable to its Community Development Block Grant. Compliance with such requirements is necessary, in my opinion, for the Municipality to comply with the requirements applicable to that program.

As described in items 07-III-06 through 07-III-10 in the accompanying Schedule of Findings and Questioned Costs, the Municipality did not comply with requirements regarding Activities Allowed or Unallowed, Allowable Cost, Eligibility, Reporting, Special Test- Waiting List and Special Test- Utility Allowance Schedule that are applicable to its Section 8 Housing Choice Voucher. Compliance with such requirements is necessary, in my opinion, for the Municipality to comply with the requirements applicable to that program.

In my opinion, except for the noncompliance described in the preceding paragraphs, the Municipality complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2007.

Internal Control Over Compliance

The management of the Municipality 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 my audit, I considered the Municipality's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine my auditing procedures for the purpose of expressing my opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, I do not express an opinion on the effectiveness of the Municipality's internal control over compliance.

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133
Page 2

My consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, I identified certain deficiencies in internal control over compliance that I consider to be significant deficiencies and others that I consider to be material weaknesses.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. I consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 07-III-04 through 07-III-10 to be significant deficiencies.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs, I considered items 07-III-06, 07-III-08, 07-III-09 and 07-III-10 to be material weaknesses.

The Municipality's responses to the findings identified in my audit are described in the accompanying Schedule of Findings and Questioned Costs. I did not audit the Municipality's response and, accordingly, I express no opinion on it.

This report is intended solely for the information and use of the management, the Honorable Mayor and Members of the Municipal Legislature, Office of the Commissioner of Municipal Affairs, 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.



CPA Pedro C. Ortiz Ledée
License Number 5200
Expires on December 1, 2008

Guayama, Puerto Rico
December 21, 2007



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS, PUERTO RICO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

Section I – Summary of Auditors' Results

Financial Statements

- Type of auditors' report issued: Unqualified Opinion
 Qualified Opinion- Governmental Funds
 Adverse Opinion- Governmental Activities
 Disclaimer Opinion
- Internal control over financial reporting:
- Material Weaknesses identified? Yes None Reported
 - Significant Deficiencies identified that are not considered to be Material Weaknesses? Yes No
- Noncompliance material to financial statements noted? Yes No

Federal Awards

- Internal control over major programs:
- Material Weaknesses identified? Yes None Reported
 - Significant Deficiencies identified that are not considered to be material weaknesses? Yes No
- Type of auditors' report issued on compliance for Major Programs: Unqualified Opinion Qualified Opinion
 Adverse Opinion Disclaimer Opinion
- Any audit finding disclosed that are required to be reported in accordance with OMB Circular A-133? Yes No

Identification of Major Program:

CFDA NUMBER	NAME OF FEDERAL PROGRAM OR CLUSTER
14.228	Community Development Block Grants
14.871	Section 8 Housing Choice Vouchers

- Dollar threshold used to distinguish between Type A and Type B Programs: \$300,000
- Auditee qualified as low-risk auditee? Yes No

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

Section II- Financial Statements Finding

FINDING	NUMBER 07-II-01
REQUIREMENT	ACCOUNTING RECORDS- INTERFUND TRANSACTIONS
CONDITION	During my examination of the accounting records, I noted that the Municipality does not maintain an accurate record over the Special Funds transactions. In addition the Municipality did not maintained proper records of the interfund cash transactions and the corresponding due from and due to accounts balances, for the Fiscal Year 2006-2007 and previous balances.
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 funds controls.
CAUSE	The Municipality did not maintain an adequate control of the accountability of the Special Funds transactions and the due from and due to account balances.
EFFECT	The Municipality is not in compliance with Article 8.010 (C) (2) and (3) of the State Law Number 81 of August 30, 1991.
RECOMMENDATION	I recommend management to implement procedures in order to obtain and maintain all the required documentation regards the interfund transactions.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Municipality's Finance Department completed in Fiscal Year 2006-2007 a study of the interfund transactions related to the State Assignments (RC's). In addition the Municipality's management gave instructions to the accountants, to determine the actual balances of the interfund transactions of the Special Revenue Funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

Section II- Financial Statements Finding

FINDING	NUMBER 07-II-02
REQUIREMENT	ACCOUNTING RECORDS- PROPERTY, PLANT AND EQUIPMENT
CONDITION	During my examination of the property records, I noted that the Municipality does not have an effective system to account for capital assets, including the infrastructure assets. The Municipality does not have adequate internal controls and procedures to ensure that all capitalizable expenditures and dispositions are recorded in the capital assets subsidiary ledger. Also, the Municipality has not recorded depreciation expense for the infrastructure not reported in the subsidiary ledger. These infrastructure assets should be reported as part of the capital assets of the Municipality according to Statement No. 34 of the Governmental Accounting Standards Board (GASB 34). In addition, the Municipality has not performed periodical physical inventories of its capital assets during fiscal year 2006-2007.
CRITERIA	Article 10.002 of State Law Number 81- <i>Ley de Municipios Autonomos del Estado Libre Asociado de Puerto Rico</i> of August 30, 1991 (as amendment as of January 2004), stated that Municipality should maintain updated property accounting records.
CAUSE	The Municipality did not maintain an adequate control of the accountability of the capital assets.
EFFECT	The Municipality is not in compliance with Article 10.002 of State Law Number 81- <i>Ley de Municipios Autonomos del Estado Libre Asociado de Puerto Rico</i> of August 30, 1991 (as amendment as of January 2004).
RECOMMENDATION	I recommend management and the Property Division of the Municipality to make an inventory of the capital assets and reconcile with the capital assets subsidiary ledger. In addition the Municipality should implement adequate internal control procedures to improve the accountability of infrastructure assets.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Municipality's management gave instructions to the Property Division to make as soon as possible a physical inventory of capital assets and to reconcile the inventory with the property ledger.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SALINAS, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

Section II- Financial Statements Finding

FINDING	NUMBER 07-II-03
REQUIREMENT	EXPENDITURES FOR GOODS AND SERVICES
CONDITION	<p>During my examination of the Municipality's disbursement process, I examined sixty (60) disbursements of the General Fund and other Special Funds and found the following:</p> <ol style="list-style-type: none">1. In twenty (20) disbursements vouchers the supporting documents were not marked as paid or cancelled.2. In twelve (12) disbursements vouchers the receiving report from the supplier was not available for my examination.3. In nine (9) disbursements vouchers the original invoice from the supplier was not available for my examination.4. In sixteen (16) disbursements vouchers the purchase order was issued after the invoice.5. In twelve (12) disbursements vouchers there was no evidence of the procurement process.6. Four (4) disbursement vouchers were not available for my examination.
CRITERIA	<p>The Chapter Four (4) of the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico, established that the Finance Director will be responsible to account and prepare disbursements that includes sufficient evidential matter to support the transactions.</p>
CAUSE	<p>The Municipality's internal control failed to assure that the disbursement vouchers contains the documentation required by law.</p>
EFFECT	<p>The Municipality is not in compliance with Chapter Four of the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico.</p>
RECOMMENDATION	<p>I recommend management to improve the procedures in order to obtain and maintain all the required documentation and supporting documents related to the disbursements process.</p>
QUESTIONED COSTS	<p>None</p>
MANAGEMENT RESPONSE	<p>Municipality's management gave instructions to the Finance Department to assure that all disbursement vouchers should be marked as paid, supported by a receiving report, contained the original invoice and signed by the responsible persons.</p>

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Section III – Federal Award Findings and Questioned Costs

FINDING	07-III-04
FEDERAL PROGRAM	COMMUNITY DEVELOPMENT BLOCK GRANTS/STATE'S PROGRAM; (CFDA NO. 14.228) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE – OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS - OCAM
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	CASH MANAGEMENT
CONDITION	During my Cash Management test, I noted that during the Fiscal Year 2006-2007, the Municipality maintained average balances of approximately \$11,940 in CDBG books. In addition, I noted that sometimes the Municipality requested funds to the pass-through entity that were not disbursed on a reasonable lapse of time.
CRITERIA	Code of Federal Regulations 24, Subpart I, Section 570.489 (c) (1) stated that units of general local governments shall use procedures to minimize the time elapsing between the transfer of funds by the state and disbursement made by the grantee.
CAUSE	Federal Programs and Finance Department of the Municipality did not maintain appropriate cash management procedures in order to request funds to federal agencies only for immediate needs.
EFFECT	The Municipality is not in compliance with, Code of Federal Regulations 24, Subpart I, CFR 570.489 (c) (1).
RECOMMENDATION	I recommend management to improve the controls over the disbursement process to minimize the time elapsed between transfer of funds by the pass through agency and the disbursement made by the Municipality.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	The Municipality will establish more effective internal controls, which includes, instructions to the Federal Program's accountant, that funds should be reimbursed within five ^{three} (5) days after being received from the pass through agency.

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FINDING	07-III-05
FEDERAL PROGRAM	COMMUNITY DEVELOPMENT BLOCK GRANTS/STATE'S PROGRAM; (CFDA NO. 14.228) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE – OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS - OCAM
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	PROCUREMENT, SUSPENSION AND DEBARMENT
CONDITION	During my Contract Test, I examined one (1) construction contract and two (2) professional services contracts and noted the following: <ul style="list-style-type: none">• One (1) contract did not include a provision for contractual legal remedies when the contractor violates contract terms.• One (1) contract did not include a provision for granting access to GAO or other federal agency, to books or other documents.• One (1) contract did not include a provision for retention of all required records for three (3) years.• One (1) contract did not include a provision for compliance with Energy Policy and Conservation Act.
CRITERIA	Code of Federal Regulations 24, Part 570.489 (g) requires that all purchase orders and contracts include any clauses required by Federal Statutes, executive orders and implementing regulations.
CAUSE	The Municipality does not count with the necessary internal controls to assure that all contracts granted contains the required contract clauses.
EFFECT	The Municipality is not in compliance with, Code of Federal Regulations 24, Part, 570.489 (g).
RECOMMENDATION	I recommend management to update contract models according with the federal and state requirements.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Municipality's management gave instructions to the Contract Division to establish a checklist that includes all the necessary clauses required by a contract that will be paid with federal funds.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS
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Section III – Federal Award Findings and Questioned Costs

N/A

FINDING	NUMBER 07-III-06
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	ACTIVITIES ALLOWED OR UNALLOWED & ALLOWABLE COSTS/ COST PRINCIPLE
CONDITION	During my tests of internal control over the disbursement process, I noted that there was a professional service contract paid in fiscal year 2006-2007 with the program administrative reserve without HUD approval. This type of disbursement (contract) shall not be performed by the Municipality (Section 8 Program) since it has a troubled designation. This contract was formalized in Fiscal Year 2005-2006 when the Program was in trouble, for the amount of \$48,000. In Fiscal Year 2005-2006 the Municipality paid \$24,000 for six month of services and in 2006-2007 the Municipality paid the remaining \$24,000.
CRITERIA	Code of Federal Regulation, 24 CFR, Section 985.107 (e) established that any PHA assigned an overall performance rating of troubled may not use any part of the administrative fee reserve for other housing purposes. In addition, Code of Federal Regulation, 24 CFR, Section 982.155 (b) (3) established that if the PHA has not adequately administered any Section 8 Program, HUD may prohibited use of funds in the administrative fee reserve, and may direct the PHA to use funds in the reserve to improve administration of the program or to reimburse ineligible expenses.
CAUSE	The Municipality did not maintain an adequate control over the disbursement process, as per its troubled designation, in order to perform allowed activities and incurred allowable cost.
EFFECT	The Municipality is not in compliance with 24 CFR, Subtitle A, Section 985.107 (e) and 982.155 (b) (3).
RECOMMENDATION	I recommended management to assure to obtain the appropriate HUD's approval that justifies the disbursements.
QUESTIONED COSTS	\$24,000
MANAGEMENT RESPONSE	Federal Program Director states, that the Program used such funds to improve the administrative functions and that the Program presents a much better SEMAP results after such improvements.

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Section III – Federal Award Findings and Questioned Costs

NA

FINDING	NUMBER 07-III-07
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	ELIGIBILITY
CONDITION	During my Eligibility Test, I select a sample of 25 participant's files; and noted that seven (7) participant's files did not have evidence of the HUD-approved release and consent forms submitted by the family as required by federal regulation.
CRITERIA	Code of Federal Regulations, 24 CFR, Section 982.516 (g), states that as a condition of admission to or continued assistance under the program, the PHA shall require the family head, and such other family members as the PHA designates, to execute a HUD-approved release and consent form authorizing any depository or private source of income, or any federal, state or local agency, to furnish or release to the PHA or HUD such information as the PHA or HUD determines to be necessary.
CAUSE	The Municipality does not have consent forms that authorize the collection of income information from State Wages Information Collection Agencies (SWICA), and wages, net earnings from self-employment, payments of retirement income, and unearned income as referenced at 26 U.S.C. 6103. In addition consent form may authorize the collection of other information from applicants and participant to determine eligibility or level of benefits.
EFFECT	The Municipality is not in compliance with 24 CFR, Section 982.516 (g).
RECOMMENDATION	I recommended management to require each member of the family of an assistance applicant or participant who is at least 18 years of age, and each family head and spouse regardless of age, to sign a release form.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	The Municipality gave instructions to implement adequate internal control procedures to assure that the participants who are at least 18 years old sign the release form at the moment of reexamination.

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Section III – Federal Award Findings and Questioned Costs

MA

FINDING	07-III-08
FEDERAL PROGRAMS	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	REPORTING
CONDITION	During my Reporting test I noted that the amounts reported in the quarterly HUD Voucher Management System, submitted to HUD, does not agree by \$19,681 with the accounting records of the Program.
CRITERIA	Code of Federal Regulations, Subpart C, 24 CFR, Section 85.20 (a) (1) (OMB Common Rule) requires that fiscal control and accounting procedures must be sufficient to permit preparation of reports. Code of Federal Regulations, Subpart C, 24 CFR, Section 85.20 (b) (2) (OMB Common Rule) requires that grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially- assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.
CAUSE	Municipality did not submit accurate quarterly reports in order to comply with the federal regulation
EFFECT	The Municipality is not in compliance with Subpart C, 24 CFR, Section 85.20 (a) (1) and 85.20 (b) (2) of OMB Common Rule.
RECOMMENDATION	The Municipality should implement adequate procedures to ensure that financial information presented in its quarterly report agrees with the accounting records maintain by the Municipality.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	The Municipality gave instructions to implement adequate internal controls to assure that the amounts transmitted quarterly, in the Voucher Management System agrees with the Program's accounting records.

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MA

FINDING	NUMBER 07-III-09
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS – Waiting List
CONDITION	During my Waiting List test, I noted that during the applicant's selection from the waiting list in order to become tenants (participants) the Municipality was not considering the family's waiting list position. The waiting list or other documentation does not specify reasons to justify the fact that the Municipality was skipping applicants in order to approved vouchers to subsequent applicants.
CRITERIA	Code of Federal Regulations, 24 CFR, Section 982.204 (a) stated that except for special admissions, participants must be selected from the PHA waiting list. The PHA must select participants from the waiting list in accordance with admission policies in the PHA administrative plan.
CAUSE	The Municipality does not adequately document its applicant's selection from the waiting list. In addition the Municipality does not follow the policies for the selection of participants established in the administrative plan.
EFFECT	The Municipality is not in compliance with 24 CFR, Section 982.203 (a) (2).
RECOMMENDATION	I recommended management to maintain supporting documentation regards its applicant's selection from the waiting list in order to become tenants (participants).
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Federal Program Director states, that HUD informed the Program, that they can put the availability of vouchers in competence. The Municipality will include this option in its 2007-2008 Administrative Plan.

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N/A

FINDING	NUMBER 07-III-10
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS – Utility Allowance Schedule
CONDITION	During my Utility Allowance Schedule test I noted that the Municipality has not reviewed the utility rate data within the last twelve (12) months.
CRITERIA	Code of Federal Regulations, 24 CFR, Section 982.517 (4) (c) stated that the PHA must review its schedule of utility allowance each year, and must revise its allowance for a utility category if there has been a change of 10 percent (10%) or more in the utility rate since the last time the utility allowance schedule was revised. The PHA must maintain information supporting its annual review of utility allowance and any revisions made in its utility allowance schedule.
CAUSE	The Municipality does not established procedures to ensure the accuracy of its utility allowance schedule.
EFFECT	The Municipality is not in compliance with 24 CFR, Section 982.517 (4)(c).
RECOMMENDATION	I recommended management to revise and update annually (if necessary) its utility allowance schedule as required by this compliance requirement.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	The Municipality 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.

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(1) Audit Findings that have been fully corrected:

Finding Number	06-III-03	Procurement, Suspension and Debarment- Qualified quotations
CFDA Number	14.228	
Questioned Cost	None	
Auditee Comments		System and procedures corrected.
Finding Number	06-III-05	Special Test & Provisions- Housing Assistant Payment Register
CFDA Number	14.871	
Questioned Cost	None	
Auditee Comments		System and procedures corrected.
Finding Number	06-III-06	Special Test & Provisions- Reasonable Rent
CFDA Number	14.871	
Questioned Cost	None	
Auditee Comments		System and procedures corrected.
Finding Number	06-III-07	Special Test & Provisions- Housing Quality Standard (HQS) Enforcement
CFDA Number	14.871	
Questioned Cost	None	
Auditee Comments		System and procedures corrected.
Finding Number	06-III-08	Special Test & Provisions- Housing Quality Standard (HQS)
CFDA Number	14.871	
Questioned Cost	None	
Auditee Comments		System and procedures corrected.
Finding Number	05-08	Special Test & Provisions- Housing Assistant Payment Register
CFDA Number	14.871	
Questioned Cost	None	
Auditee Comments		System and procedures corrected.

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(2) Audit Findings that have been fully corrected:

Finding Number 05-09 Special Test- Reasonable Rent

CFDA Number 14.871

Questioned Cost None

Auditee Comments System and procedures corrected.

Finding Number 04-12 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.

CFDA Number 14.871

Questioned Cost None

Auditee Comments System and procedures corrected.

Finding Number 02-19 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 file.

CFDA Number 14.871

Questioned Cost None

Auditee Comments System and procedures corrected.

(2) Audit Findings not corrected or partially corrected:

Finding Number 06-III-03 Procurement, Suspension and Debarment- Qualified quotations (Professional Services)

CFDA Number 14.871

Questioned Cost None

Auditee Comments The Municipal Secretary can't accept or sign any contract without the compliance of competition for the professional services needed as established in the approved Municipal Procurement Regulation and the Commonwealth of Puerto Rico Office of the Comptroller Rules.

Finding Number 06-III-04 Activities Allowed or Unallowed & Allowable Cost/ Cost Principle

CFDA Number 14.871

Questioned Cost \$24,000

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(2) Audit Findings not corrected or partially corrected:

Finding Number	06-III-04	Activities Allowed or Unallowed & Allowable Cost/ Cost Principle
Auditee Comments		The Municipality of Salinas (PHA RQ-069) use such funds to improve our administrative functions. Our PHA presents a much better SEMAP results after such improvements. The municipality never uses the administrative reserve funds to pay for any additional HAP or increase vouchers inventory, nor for any additional or extension length of time. We comply with what the mentioned letter established and as the meaning of the Code of Federal Regulation in the above-mentioned Parts.

(3) Corrective action taken is significantly different from corrective action previously reported:

None

(4) Audit findings is no longer valid:

None

END OF SCHEDULE