

**CITY OF SALEM, MASSACHUSETTS  
AND ITS COMPONENT UNIT**

Report on Examination of  
Basic Financial Statements  
and Additional Information  
Year Ended June 30, 2004

CITY OF SALEM, MASSACHUSETTS

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YEAR ENDED JUNE 30, 2004

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CERTIFIED PUBLIC ACCOUNTANTS  
MANAGEMENT CONSULTANTS

## INDEPENDENT AUDITORS' REPORT

The Honorable Mayor and Members of the City Council  
City of Salem, Massachusetts

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Salem, Massachusetts, as of and for the year ended June 30, 2004 which collectively comprise the City of Salem, Massachusetts' basic financial statements as listed in the table of contents, (except for the Pension Trust Fund which is as of December 31, 2003). These financial statements are the responsibility of the management of the City of Salem, Massachusetts. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as, evaluating the overall basic financial statement presentation. We believe that our audit and the report of the other auditors provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of City of Salem, Massachusetts, as of June 30, 2004, (except for the Pension Trust Fund which is as of December 31, 2003) and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2-10 and the required supplementary information on pages 44-46 as listed in the table of contents, are not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 15, 2004, on our consideration of the City of Salem, Massachusetts' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

*Tucci & Roselli*

Tucci & Roselli  
Certified Public Accountants  
December 15, 2004

## Management's Discussion and Analysis

As the management of the City of Salem, Massachusetts (the City), we offer readers of the City's financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended June 30, 2004. We encourage readers to consider the information presented here in conjunction with their review of the basic financial statements and notes to the basic financial statements found on pages 13 – 45 and the required supplementary information and notes to the required supplementary information found on pages 46 - 48. All amounts in this Management's Discussion and Analysis, unless otherwise indicated, are expressed in thousands of dollars.

### Financial Highlights

- The assets of the City exceeded its liabilities at the close of the most recent fiscal year by approximately \$78.1 million (*total net assets*). Of this amount, approximately \$11.5 million (*total unrestricted net assets*) may be used to meet the government's ongoing obligations to citizens and creditors.
- The City has not capitalized infrastructure capital assets of the Governmental Activities. These are required to be capitalized by June 30, 2007. This information will be provided by the required implementation date or as the information becomes available, whichever is earlier.
- The government's total net assets experienced a net decrease of approximately \$2.2 million. This was mainly attributable to the City's need to use surplus balances (free cash) and stabilization reserves to supplement its budget during the year. In addition, the City's Health Insurance activities incurred an overall operating deficit of approximately \$1.0 million (see below) and also contributed to the overall decrease in net assets.
- As of the close of the current fiscal year, the City's governmental funds balance sheet reported a combined ending fund deficit of approximately \$9.4 million a decrease of approximately \$13.9 million. This included a deficit in Capital projects funds of approximately \$25.0 million attributable to expenditures associated with ongoing capital projects that the City expects to fund at a future date through bond issuances. These expenditures are currently financed with bond anticipation notes in the amount of approximately \$28.8 million. The combined ending fund balance without regard to this deficit was approximately \$15.6 million, a decrease of approximately \$3.0 million due to the need to appropriate free cash and stabilization fund reserves. Approximately \$4.6 million of the ending fund balance is *available for spending* at the government's discretion either as *unreserved fund balance* or *stabilization*. The remainder is earmarked for specific expenditures.
- The accounting treatment for certain items vary greatly between the Statement of Net Assets and the Governmental Fund Balance sheet thus the significant differences in equity and fund balance amounts between the two statements noted above. A reconciliation has been provided on page 15 of the accompanying basic financial statements to assist the reader to understand these differences.
- At the end of the current fiscal year, unreserved fund balance for the general fund was approximately \$3.4 million, or approximately 3.5% percent of total general fund expenditures.
- The City's total debt decreased by approximately \$4.0 million during the current fiscal year due to regular scheduled principal pay downs.
- Expenditures of the City's Health Insurance activities exceeded employee and City contributions by \$976,440 causing an overall deficit at the end of the year of \$824,160. In addition, the City carries a liability for claims incurred but not reported of approximately \$1.6 million. An increase in both cost per person and claims incurred have contributed to this occurrence.

## Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

**Government-wide financial statements.** The *government-wide financial statements* are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all of the City's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The *statement of activities* presents information showing how the government's net assets changed during the most recent fiscal year. 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 only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave.)

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenue (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include general government, public safety, highways and streets, sanitation, education, economic development, debt service, fringe benefits and culture and recreation. The business-type activities of the City include a water and sewer enterprise, parking activities and a golf course.

The government-wide financial statements can be found on pages 11-12 of this report.

**Fund financial statements.** 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 City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds. The basic governmental fund financial statements can be found on pages 13-14 of this report.

**Governmental Funds.** *Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the 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 government's near-term financing decisions. Reconciliations are provided on pages 15-16 to facilitate this comparison between *governmental funds* and *governmental activities*.

The City maintains five individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the general fund and the stabilization fund, both of which are considered to be major funds. Data from the other three governmental funds are presented combined.

The City adopts an annual appropriated budget for its general fund. A budgetary comparison schedule has been provided for the general fund to demonstrate compliance with this budget on page 45 as Required Supplementary information.

**Proprietary funds.** The City maintains one type of proprietary fund. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. The City uses enterprise funds to account for its water and sewer enterprise, parking activities and golf course.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the water and sewer enterprise, parking activities and for the golf course. The basic proprietary fund financial statements can be found on pages 17-19 of this report.

**Fiduciary funds.** Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statement because the resources of those funds are not available to support the City's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds. The basic fiduciary fund financial statements can be found of pages 20 - 21 of this report.

**Notes to the financial statements.** The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found of pages 22-43 of this report.

**Other information.** In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning the City's progress in funding its obligation to provide pension benefits to its employees as well as the Schedule of Revenues, Expenditures and Changes in Fund Balances – Budget and Actual – General Fund. Required supplementary information can be found on page 44-46 of this report.

#### Government-wide Financial Analysis

	Net Assets					
	Governmental activities		Business - type activities		Total	
	2004	2003	2004	2003	2004	2003
<b>Assets</b>						
Current and other assets	\$ 75,443	\$ 92,822	\$ 5,267	\$ 4,421	\$ 80,710	\$ 97,243
Capital assets	<u>92,410</u>	<u>83,047</u>	<u>5,760</u>	<u>5,835</u>	<u>98,170</u>	<u>88,882</u>
Total assets	167,853	175,869	11,027	10,256	178,880	186,125
<b>Liabilities</b>						
Long-term liabilities outstanding	60,883	64,925	585	614	61,468	65,539
Other liabilities	<u>38,890</u>	<u>39,933</u>	<u>404</u>	<u>321</u>	<u>39,294</u>	<u>40,254</u>
Total liabilities	99,773	104,858	989	935	100,762	105,793
<b>Net Assets</b>						
Invested in capital assets, net of						
related debt	50,545	45,924	5,380	5,320	55,925	51,244
Restricted	8,760	14,687	1,968	2,173	10,728	16,860
Unrestricted	<u>8,775</u>	<u>10,400</u>	<u>2,690</u>	<u>1,828</u>	<u>11,465</u>	<u>12,228</u>
Total net assets	<u>\$ 68,080</u>	<u>\$ 71,011</u>	<u>\$ 10,038</u>	<u>\$ 9,321</u>	<u>\$ 78,118</u>	<u>\$ 80,332</u>

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by approximately \$78.1 million at the close of the most recent fiscal year.

By far the largest portion (approximately 64%) of the City's net assets reflects its investment in capital assets (e.g. land, buildings, machinery, and equipment), less any related debt (netted down by those amounts expected to be reimbursed by the Commonwealth) used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City'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 other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the City's net assets (approximately 13.7%) represents resources that are subject to external restriction on how they may be used. The remaining balance of *unrestricted net assets*, approximately \$11.5 million, may be used to meet the government's ongoing obligations to citizens and creditors.

Changes in Net Assets						
	Governmental activities		Business – type activities		Total	
	2004	2003	2004	2003	2004	2003
<b>Revenues</b>						
Program revenues:						
Charges for services	\$ 5,062	\$ 4,100	\$ 13,789	\$ 12,329	\$ 18,851	\$ 16,429
Operating grants and contributions	37,164	45,726			37,164	45,726
Capital grants and contributions	271	421			271	421
General revenues:						
Property taxes	54,856	52,118			54,856	52,118
Other taxes	3,479	3,793			3,479	3,793
Other	8,255	5,520			8,255	5,520
Total revenues	109,087	111,678	13,789	12,329	122,876	124,007
<b>Expenses</b>						
General government	4,774	4,505			4,774	4,505
Public safety	14,992	15,183			14,992	15,183
Education	49,864	47,965			49,864	47,965
Public works	5,182	5,418			5,182	5,418
Health and human services	929	1,011			929	1,011
Culture and recreation	2,828	2,958			2,828	2,958
Fringe and pension benefits	22,798	19,709			22,798	19,709
State and County charges	4,213	3,912			4,213	3,912
Debt service	3,137	3,366			3,137	3,366
Community development	5,767	4,954			5,767	4,954
Water and sewer			9,619	10,197	9,619	10,197
Parking			666	679	665	679
Golf			321	334	321	334
Total expenses	114,484	108,981	10,606	11,210	125,089	120,191
Increase in net assets before transfers	( 5,397)	2,697	3,183	1,119	( 2,214)	3,816
Transfers	2,466	2,687	( 2,466)	( 2,687)		
Increase in net assets	( 2,931)	5,384	717	( 1,568)	( 2,214)	3,816
Net assets, beginning of year	71,011	65,627	9,321	10,889	80,332	76,516
Net assets, end of year	\$ 68,080	\$ 71,011	\$ 10,038	\$ 9,321	\$ 78,118	\$ 80,332

- **Governmental Activities.** Governmental activities reduced the City's net assets by approximately \$2.9 million. This was mainly attributable to the City's need to use surplus balances (free cash) and stabilization reserves to supplement its budget during the year. In addition, the City's Health Insurance activities incurred an overall operating deficit of approximately \$1.0 million and also contributed to the overall decrease in net assets. Major revenue sources consist of revenue from Operating Grants, which comprise a form of Intergovernmental revenues and represent 34% of the total revenues of the City. Additionally, the City relies on 50.3% of its revenues to come from property taxes.
- Operating grants for governmental activities decreased by approximately \$8.6 million (approximately 18.8%). This was a result of the prior year balance including additional reimbursements granted under Chapter 645 School building Assistance related to the City's debt offering in that year. Such transactions did not occur during 2004.
- Depreciation expense is not factored into the City's budgetary process accordingly the calculated expense amount will always have a negative impact on net assets. Net assets were decreased by approximately \$2.8 million for depreciation expense during the year.
- The City incurred increases in health insurance of approximately \$1.3 million which decreased net assets.
- Other increases in expenses and revenues for the most part closely paralleled inflation and the growth in demand for services as well as property tax ceilings under proposition 2 ½.

**Business-type Activities.** Business-type activities increase the City's net assets by approximately \$0.7 million. The key element to this increase was a raise in user charge rates for water and sewer over the prior year.

#### Financial Analysis of the Government's Funds

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

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

#### Summary Information

Governmental funds			Proprietary funds			Fiduciary funds		
	2004	2003		2004	2003		2004	2003
Assets	\$ 75,444	\$ 92,822	Assets	\$ 11,027	\$ 10,256	Assets	\$ 74,748	\$ 65,014
Liabilities	84,837	88,305	Liabilities	989	935	Liabilities	288	116
Fund balances	\$( 9,393)	\$ 4,517	Net assets	\$ 10,038	\$ 9,321	Net assets	\$ 74,459	\$ 64,898

  

Governmental funds			Proprietary funds			Fiduciary funds		
	2004	2003		2004	2003		2004	2003
Revenues	\$ 111,535	\$ 107,993	Revenues	\$ 13,494	\$ 12,052	Additions	\$ 20,187	\$ 2,626
Expenditures	127,911	127,003	Expenses	10,605	11,181	Expenditures	10,625	9,810
Transfers	\$ 2,466	\$ 2,332	Transfers	\$( 2,446)	\$( 2,332)	Transfers	\$ -	\$ -



As of the close of the current fiscal year, the City's governmental funds balance sheet reported a combined ending fund deficit of approximately \$9.4 million a decrease of approximately \$13.9 million. This included a deficit in Capital projects funds of approximately \$25.0 million attributable to expenditures associated with ongoing capital projects that the City expects to fund at a future date through bond issuances. These expenditures are currently financed with bond anticipation notes in the amount of approximately \$28.8 million. The combined ending fund balance without regard to this deficit was approximately \$15.6 million, a decrease of approximately \$3.0 million due to the need to appropriate free cash and stabilization fund reserves. Approximately \$4.6 million of the ending fund balance is *available for spending* at the government's discretion either as *unreserved fund balance* or *stabilization*. The remainder is earmarked for specific expenditures.

The general fund is the chief operating fund of the City. At the end of the current fiscal year, unreserved fund balance of the general fund was approximately \$3.4 million, while total fund balance reached approximately \$4.6 million. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents approximately 3.5 percent of total general fund expenditures, while total fund balance represents approximately 4.7 percent of that same amount.

The fund balance of the City's general fund decreased by approximately \$0.8 million during the current fiscal year mostly as a result of:

- The need to use surplus balances from the previous year to supplement the budget and offset cuts to State Aid from the previous years.

The stabilization fund has a total fund balance of approximately \$1.3 million. These are unencumbered accumulated financial resources that are subject to appropriation as directed by the City's legislative branch. These funds are typically used for nonrecurring expenditures, usually capital in nature or unexpected items that may arise during the year. The net decrease in this fund balance during the current year was as a result of using \$1.0 million to supplement the City's budget during 2004.

**Proprietary funds.** The City's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

Unrestricted net assets of the water and sewer fund at the end of the year amounted to approximately \$4.7 million those for the golf course operation amounted to approximately \$0.4 million and those of the parking program amounted to approximately \$4.9 million. The total change in net assets for these funds have already been addressed in the discussion of the City's business-type activities.

### **General Fund Budgetary Highlights**

Approximately \$1.9 million in differences between the original budget and the final amended budget can be briefly summarized as follows:

- \$0.7 million in miscellaneous increases in general government activities
- \$0.7 million increases allocated to the public safety
- \$0.1 million increases allocated to health and human services
- \$0.1 million increases allocated to culture and recreation
- \$0.3 million increases allocated to other various departments

## Capital Asset and Debt Administration

**Capital Assets.** The City's investment in capital assets for its governmental and business type activities as of June 30, 2004, amounts to approximately \$98.2 million (net of accumulated depreciation). This investment in capital assets includes land, buildings and system, improvements, machinery and equipment (The City has elected not to present infrastructure information until the mandated deadline in 2007 or when it becomes available, whichever is earlier). The total increase in the City's investment in capital assets for the current fiscal year was approximately 10.4 percent (approximately 11.3 percent increase for governmental activities and approximately 1.3 percent decrease for business-type activities).

Capital Assets						
	Governmental activities		Business - type activities		Total	
	2004	2003	2004	2003	2004	2003
Land	\$ 4,685	\$ 4,685	\$ 276	\$ 276	\$ 4,961	\$ 4,960
Buildings and improvements	108,288	73,150	8,367	8,213	116,655	81,363
Improvements other than buildings	2,402	2,242	438	438	2,840	2,440
Construction in process	-	23,767	-	-	-	23,767
Machinery and equipment	3,135	3,048	219	219	3,354	3,267
Vehicles	6,386	6,078	136	136	6,522	6,214
	124,896	112,969	9,436	9,282	134,332	122,251
Less: Accumulated depreciation	( 32,486)	(29,922)	( 3,676)	(3,447)	( 36,162)	(33,369)
Total capital assets	\$ 92,410	\$ 83,047	\$ 5,760	\$ 5,835	\$ 98,170	\$ 88,882

The City is undergoing major renovations and building of its educational facilities. Final costs will approximate \$100 million. Under Chapter 645 (School Building Assistance Reimbursement) of the Massachusetts General Laws the City is allowed to recoup a percentage of the construction costs including interest over the period of time in which the City is to pay back bonds undertaken for the various projects. The City's projects qualify to receive 90% reimbursements for such costs and the City is currently on a waiting list pending grant approval.

Additional information on the City capital assets can be found in note III. D on pages 32-33 of this report.

**Long-term debt.** At the end of the current fiscal year, the City had total debt outstanding of \$60.8 million. The entire amount comprises debt backed by the full faith and credit of the government.

Outstanding debt						
	Governmental activities		Business - type activities		Total	
	2004	2003	2004	2003	2004	2003
General obligation bonds	\$ 59,840	\$ 63,730	\$ 380	\$ 515	\$ 60,220	\$ 64,245
Notes payable	570	795	-	-	570	795
Total debt	\$ 60,410	\$ 64,525	\$ 380	\$ 515	\$ 60,790	\$ 65,040

The City's total debt decreased by approximately \$4.1 million (approximately 6.4 percent) during the current fiscal year. This was due to scheduled pay downs of principal during the year.

The City maintains an "A+" rating from Standard & Poor and an "A1" rating from Moody's for general obligation debt.

State statutes limit the amount of general obligation debt a governmental entity may issue to 2.5% percent of its total assessed valuation. The current debt limitation for the City is approximately \$99.2 million based on an equalized valuation of approximately \$4.0 billion, which is significantly in excess of the City's outstanding general obligation debt.

The City also holds a proportionate share of debt of other governmental units that provide services within the City's boundaries. The debt service from such arrangements is assessed annually to the City.

The City has also entered into various lease agreements and minor notes payable agreements whose outstanding principal approximates \$0.4 million.

Bond anticipation notes payable balances outstanding at year-end, that have not been converted to long-term amount to \$23.5 million and all relate to school construction projects.

Additional information on the City's long-term debt can be found in note III.E., F. and G. on pages 34-38 of this report.

#### **Economic Factors and Next Year's Budgets and Rates**

- The unemployment rate for the City as of October 31, 2004 was 4.7%. This was greater than the Commonwealth rate of 4.3% but lower than the national average of 5.5%.
- The occupancy rate of the government's central business district has remained at 65 – 70 percent for the past three years.
- Inflationary trends in the region are consistent with state and national indices.

All of these factors were considered in preparing the City's budget for the 2005 fiscal year.

During the current fiscal year, unreserved fund balance in the general fund decreased to approximately \$3.4 million from approximately \$4.0 million. The City has appropriated approximately \$0.3 million of this amount for spending in the 2005 fiscal year budget. Additionally, the City will use approximately \$0.8 million from recreation revolving funds, approximately \$0.3 million from stabilization, and approximately \$1.3 million from water and sewer enterprise to cover indirect costs. The City also has the ability to levy additional taxes without the need for an override or exemption, due to nearly \$0.3 million in excess levy capacity. As a result, the City's budget was in balance for the fiscal year 2004. Accordingly, the Commonwealth certified the tax-rate for 2005 in December 2004.

Water and Sewer rates were increased to more adequately fund the costs of this business activity. This is the third step of a three-year step increase in which the City anticipates accumulating funds for future capital maintenance of the system.

In the City's General Operating fund, property taxes and local-aid from the Commonwealth represent approximately 59.9% and 25.3% respectively of the annual operating budget. The Commonwealth's recent economic downfall has begun to stabilize. After reaching a peak in local aid of approximately \$25.2 million in 2002 and a reduction in each of the last two years to a low of approximately \$23.2 million in 2004, the expected local aid receipts for 2005 will increase to approximately \$24.1 million. The City has prepared its 2005 budget based on these assumptions:

**Requests for Information**

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or request for additional financial information should be addressed to the Office of the Finance Director, 93 Washington Street Salem, Massachusetts, 01970.

## CITY OF SALEM, MASSACHUSETTS

STATEMENT OF NET ASSETS  
JUNE 30, 2004

	Governmental Activities	Business-Type Activities	Total
<b>ASSETS</b>			
<b>CURRENT:</b>			
Cash and cash equivalents	\$ 17,365,623	\$ 831,321	\$ 18,196,944
Investments			-
Receivables, net of allowance for uncollectibles:			
Real estate and personal property taxes	559,846		559,846
Tax liens	980,992		980,992
Motor vehicle and boat excise	712,839		712,839
User fees		1,967,625	1,967,625
Departmental and other	54,141	500,000	554,141
Intergovernmental	4,068,169		4,068,169
Other non-governmental	494,417		494,417
Deposit - held by others	165,000		165,000
<b>Total Current Assets</b>	<b>24,401,027</b>	<b>3,298,946</b>	<b>27,699,973</b>
<b>NONCURRENT:</b>			
Restricted:			
Cash			-
Investments	4,364,112		4,364,112
Investment in joint venture		1,967,994	1,967,994
Receivables, net of allowance for uncollectibles:			
Intergovernmental	45,330,696		45,330,696
Long term portion of loans	1,347,839		1,347,839
Capital assets, net of accumulated depreciation	92,409,692	5,759,606	98,169,298
<b>TOTAL ASSETS</b>	<b>167,853,366</b>	<b>11,026,546</b>	<b>178,879,912</b>
<b>LIABILITIES</b>			
<b>CURRENT:</b>			
Warrants and accounts payable	3,293,724	311,403	3,605,127
Accrued expense	1,051,046	36,694	1,087,740
Interest expense	389,952		389,952
Retainage	429,430		429,430
Planning board deposits	260,093		260,093
Compensated absences	324,314	26,063	350,377
Risk financing	158,847		158,847
Bond anticipation notes payable	28,800,000		28,800,000
Current maturities of long term debt	4,070,000	30,000	4,100,000
Capital leases	112,309		112,309
<b>Total Current Liabilities</b>	<b>38,889,715</b>	<b>404,160</b>	<b>39,293,875</b>
<b>NONCURRENT:</b>			
Compensated absences	2,918,830	234,564	3,153,394
Risk financing	1,429,625		1,429,625
Bond and note indebtedness	56,340,000	350,000	56,690,000
Capital leases	195,051		195,051
<b>TOTAL LIABILITIES</b>	<b>99,773,221</b>	<b>988,724</b>	<b>100,761,945</b>
<b>NET ASSETS</b>			
Invested in capital assets, net of related debt	50,545,329	5,379,606	55,924,935
Restricted for			
Health Insurance (deficit)	(824,160)		(824,160)
Capital projects	3,836,343		3,836,343
Perpetual funds			
Expendable	2,555,014		2,555,014
Nonexpendable	1,844,725		1,844,725
Loans	1,347,839		1,347,839
Other purposes		1,967,994	1,967,994
Unrestricted	8,775,055	2,690,222	11,465,277
<b>NET ASSETS</b>	<b>\$ 68,080,145</b>	<b>\$ 10,037,822</b>	<b>\$ 78,117,967</b>

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

CITY OF SALEM, MASSACHUSETTS

STATEMENT OF ACTIVITIES  
FISCAL YEAR ENDED JUNE 30, 2004

	Program Revenues			Net (Expenses) Revenues and Changes in Net Assets		
	Expenses	Indirect Expenses Allocation	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Total
FUNCTIONS/PROGRAMS						
Governmental Activities:						
General government	\$ 4,774,176		\$ 466,994	\$ 54,688		\$ (4,252,494)
Public safety	14,991,944		1,865,270	569,028		(12,557,646)
Education	49,863,891		1,141,196	18,568,041		(30,154,654)
Public works	5,182,084		55,450	149,442	\$ 271,350	(4,705,842)
Health and human services	929,260		178,093	3,237,428		2,486,261
Culture and recreation	2,827,652		506,873	154,722		(2,166,057)
Pension benefits	11,911,247			5,345,441		(6,565,806)
Fringe benefits	10,886,947			3,294,604		(7,592,343)
Intergovernmental	4,212,549					(4,212,549)
Debt service	3,136,763		848,087	2,858,471		(278,292)
Community development	5,767,362			2,931,955		(1,987,320)
Total Governmental Activities	114,483,875	\$ -	5,061,963	37,163,820	271,350	(71,986,742)
Business-Type Activities:						
Water and sewer services	9,619,356		11,708,715			2,089,359
Golf course	320,632		543,467			222,835
Parking	665,458		1,536,390			870,932
Total Primary Government	\$ 125,089,321		\$ 18,850,535	\$ 37,163,820	\$ 271,350	(68,803,616)
General Revenues:						
Real and personal property taxes						54,855,784
Motor vehicle and other excise						3,478,999
Penalties and interest on taxes						322,003
Intergovernmental						6,932,546
Investment income						568,503
Other						431,558
Transfers (net)						2,466,477
Total general revenues and transfers						69,055,870
Change in Net Assets						(2,930,872)
Net Assets:						71,011,017
Beginning of year						80,332,190
End of year						\$ 78,117,967

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

## CITY OF SALEM, MASSACHUSETTS

GOVERNMENTAL FUNDS  
BALANCE SHEET

JUNE 30, 2004

	General	Stabilization	Nonmajor Governmental Funds	Total Governmental Funds
<b>ASSETS</b>				
Cash and short-term investments	\$ 6,911,174	\$ 1,297,417	\$ 9,157,032	\$ 17,365,623
Investments				-
Receivables, net of allowance for uncollectibles				
Real estate and personal property taxes	559,846			559,846
Other	1,693,831		1,347,839	3,041,670
Due from other government	48,243,579		54,141	48,297,720
Due from other non-government	494,417		1,155,286	1,649,703
Deposit - held by others			165,000	165,000
Cash - restricted				-
Investments - restricted			4,364,112	4,364,112
<b>Total Assets</b>	<b>\$ 57,902,847</b>	<b>\$ 1,297,417</b>	<b>\$ 16,243,410</b>	<b>\$ 75,443,674</b>
<b>LIABILITIES AND FUND BALANCES</b>				
<b>LIABILITIES:</b>				
Warrants and accounts payable	\$ 2,384,814		\$ 908,910	\$ 3,293,724
Accrued expenses	389,952			389,952
Retainage payable			429,430	429,430
Deposits and escrow	260,093			260,093
Tax refunds payable				-
Deferred revenues	50,315,582		1,347,839	51,663,421
Bond anticipation notes payable			28,800,000	28,800,000
<b>Total Liabilities</b>	<b>53,350,441</b>	<b>\$ -</b>	<b>31,486,179</b>	<b>84,836,620</b>
<b>FUND BALANCES (DEFICITS):</b>				
Reserved for:				
Encumbrances	1,153,872			1,153,872
Stabilization		1,297,417		1,297,417
Health insurance deficit			(824,160)	(824,160)
Unreserved:				
Undesignated, reported in:				
General fund	3,398,534			3,398,534
Special revenue funds			6,145,309	6,145,309
Capital projects funds			(24,963,657)	(24,963,657)
Permanent funds			4,399,739	4,399,739
<b>Total Fund Balances</b>	<b>4,552,406</b>	<b>1,297,417</b>	<b>(15,242,769)</b>	<b>(9,392,946)</b>
<b>Total Liabilities and Fund Balances</b>	<b>\$ 57,902,847</b>	<b>\$ 1,297,417</b>	<b>\$ 16,243,410</b>	<b>\$ 75,443,674</b>

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

**CITY OF SALEM, MASSACHUSETTS**  
**GOVERNMENTAL FUNDS**  
**STATEMENT OF REVENUES, EXPENDITURES,**  
**AND CHANGES IN FUND BALANCES**  
**JUNE 30, 2004**

	General	Stabilization	Nonmajor Governmental Funds	Total Governmental Funds
<b>REVENUES</b>				
Real estate and personal property taxes, net	\$ 55,603,719			\$ 55,603,719
Intergovernmental	28,897,611		\$ 13,753,375	42,650,986
Motor vehicle and other excises	3,387,266			3,387,266
Departmental and other revenue	1,296,431		2,082,920	3,379,351
License and permits	461,982			461,982
Penalties and interest on taxes	322,003			322,003
Fines and forfeitures	827,151			827,151
Investment income	253,944	\$ 18,594	295,965	568,503
Contributions and donations			3,902,147	3,902,147
Miscellaneous	408,559		23,000	431,559
<b>Total Revenues</b>	<b>91,458,666</b>	<b>18,594</b>	<b>20,057,407</b>	<b>111,534,667</b>
<b>OTHER FINANCING SOURCES</b>				
Transfers in	4,384,565		6,309,350	10,693,915
Sale of capital assets				-
Proceeds from debt issuance				-
<b>Total Other Financing Sources</b>	<b>4,384,565</b>	<b>-</b>	<b>6,309,350</b>	<b>10,693,915</b>
<b>Total Revenues and Other Financing Sources</b>	<b>95,843,231</b>	<b>18,594</b>	<b>26,366,757</b>	<b>122,228,582</b>
<b>EXPENDITURES</b>				
General government	4,485,186		142,516	4,627,702
Public safety	14,577,078		422,837	14,999,915
Education	39,737,980		19,878,613	59,616,593
Public works	4,978,696		230,903	5,209,599
Health and human services	855,553			855,553
Culture and recreation	2,093,901		662,165	2,756,066
Fringe Benefits	11,911,247		10,580,395	22,491,642
State and county tax assessments	4,212,549			4,212,549
Community development			5,992,362	5,992,362
Debt service	7,149,021			7,149,021
<b>Total Expenditures</b>	<b>90,001,211</b>	<b>-</b>	<b>37,909,791</b>	<b>127,911,002</b>
<b>OTHER FINANCING USES</b>				
Transfers out	6,653,063	1,000,000	574,375	8,227,438
<b>Total Expenditures and Other Financing Uses</b>	<b>96,654,274</b>	<b>1,000,000</b>	<b>38,484,166</b>	<b>136,138,440</b>
<b>EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES</b>				
	(811,043)	(981,406)	(12,117,409)	(13,909,858)
<b>FUND BALANCES, JULY 1, 2003</b>	<b>5,363,449</b>	<b>2,278,823</b>	<b>(3,125,360)</b>	<b>4,516,912</b>
<b>FUND BALANCES, JUNE 30, 2004</b>	<b>\$ 4,552,406</b>	<b>\$ 1,297,417</b>	<b>\$ (15,242,769)</b>	<b>\$ (9,392,946)</b>

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



CITY OF SALEM, MASSACHUSETTS

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET

TOTAL FUND BALANCES TO THE STATEMENT OF NET ASSETS

JUNE 30, 2004

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<b>Total Governmental Fund Balances</b>	<b>\$ (9,392,946)</b>
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.	92,409,692
Other long-term assets are not available to pay for current-period expenditures and are therefore deferred on funds.	51,663,421
In the statement of activities, interest is accrued on outstanding long-term debt, whereas in governmental funds interest is not reported until due.	(1,051,046)
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the government funds:	
Bonds and notes payable	(60,410,000)
Capital leases	(307,360)
Compensated absences	(3,243,144)
Risk financing activities	<u>(1,588,472)</u>
<b>Net Assets of Governmental Activities</b>	<b><u>\$ 68,080,145</u></b>

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

**CITY OF SALEM, MASSACHUSETTS**

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES  
IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES**

**JUNE 30, 2004**

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**Net Change in Fund Balances - Total Governmental Fund Balances** **\$ (13,909,858)**

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. Capital outlays amounted to \$11,926,126 and depreciation expense totaled \$2,563,562. The net amount is reflected here as a reconciling item. 9,362,564

The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the financial resources of governmental funds. Neither has any effect on net assets. Also governmental funds report the effect of issuance costs, premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the Statement of Activities. Debt repayments were \$4,115,000, refunding premium charges were \$0, and proceeds were \$0. The net amount is reflected here as a reconciling item. 4,115,000

Revenues in the Statement of Activities that do not provide current financial resources are fully deferred in the Statement of Revenues, Expenditures and Changes in Fund Balances. Therefore, the recognition of revenue for various types of accounts receivable differ between the two statements. The amount presented represents the difference in deferred revenue. (2,448,140)

In the statement of activities, interest is accrued on outstanding long-term debt, whereas in governmental funds interest is not reported until due. This represents the difference between the accruals between this year and the prior year. 122,258

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 the governmental funds:

Capital leases	133,856
Compensated absences	-
Risk financing	(306,552)

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**Change in Net Assets of Governmental Activities** **\$ (2,930,872)**

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

## CITY OF SALEM, MASSACHUSETTS

**PROPRIETARY FUNDS**  
**STATEMENT OF NET ASSETS**  
**JUNE 30, 2004**

	Business-type Activities - Enterprise Funds			
	Water and Sewer	Golf Course	Parking Activities	Totals
<b>ASSETS</b>				
CURRENT:				
Cash and cash equivalents	\$ 558,019	\$ 273,302		\$ 831,321
Intergovernmental	500,000			500,000
User fees, net of allowance for uncollectibles	1,967,625			1,967,625
<b>Total Current Assets</b>	<b>3,025,644</b>	<b>273,302</b>	<b>\$ -</b>	<b>3,298,946</b>
NONCURRENT:				
Capital assets, net of accumulated depreciation	211,119	568,413	4,980,074	5,759,606
Investment in joint venture	1,967,994			1,967,994
<b>TOTAL ASSETS</b>	<b>5,204,757</b>	<b>841,715</b>	<b>4,980,074</b>	<b>11,026,546</b>
<b>LIABILITIES</b>				
CURRENT:				
Warrants and accounts payable	348,097			348,097
Compensated absences	14,483	6,522	5,028	26,033
Current portion of debt		30,000		30,000
<b>Total Current Liabilities</b>	<b>362,580</b>	<b>36,522</b>	<b>5,028</b>	<b>404,130</b>
NONCURRENT:				
Compensated absences	130,343	58,966	45,255	234,564
Long term portion of debt		350,000		350,000
<b>TOTAL LIABILITIES</b>	<b>492,923</b>	<b>445,488</b>	<b>50,283</b>	<b>988,694</b>
<b>NET ASSETS</b>				
Invested in capital assets, net of related debt	211,119	188,413	4,980,074	5,379,606
Investment in joint venture	1,967,994			1,967,994
Unrestricted	2,532,721	207,784	(50,283)	2,690,222
<b>NET ASSETS</b>	<b>\$ 4,711,834</b>	<b>\$ 396,197</b>	<b>\$ 4,929,791</b>	<b>\$ 10,037,822</b>

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

**CITY OF SALEM, MASSACHUSETTS**

**PROPRIETARY FUNDS  
STATEMENT OF REVENUES, EXPENSES,  
AND CHANGES IN FUND NET ASSETS  
YEAR ENDED JUNE 30, 2004**

	Business-type Activities - Enterprise Funds			
	Water and Sewer	Golf Course	Parking Activities	Totals
<b>OPERATING REVENUES</b>				
Charges for services	\$ 11,413,703	\$ 543,467	\$ 1,536,390	\$ 13,493,560
<b>Total Operating Revenues</b>	<u>11,413,703</u>	<u>543,467</u>	<u>1,536,390</u>	<u>13,493,560</u>
<b>OPERATING EXPENSES</b>				
Operating costs	9,594,505	294,725	468,442	10,357,672
Depreciation	5,863	25,907	197,016	228,786
<b>Total Operating Expenses</b>	<u>9,600,368</u>	<u>320,632</u>	<u>665,458</u>	<u>10,586,458</u>
<b>OPERATING INCOME</b>	<u>1,813,335</u>	<u>222,835</u>	<u>870,932</u>	<u>2,907,102</u>
<b>NONOPERATING REVENUES (EXPENSES):</b>				
Interest expense		(18,988)		(18,988)
Transfers in				-
Transfers out	(1,362,432)	(189,587)	(914,458)	(2,466,477)
Net activity of joint venture	295,012			295,012
<b>Total Nonoperating Revenues (Expenses), net</b>	<u>(1,067,420)</u>	<u>(208,575)</u>	<u>(914,458)</u>	<u>(2,190,453)</u>
<b>CHANGE IN NET ASSETS</b>	<u>745,915</u>	<u>14,260</u>	<u>(43,526)</u>	<u>716,649</u>
<b>NET ASSETS AT BEGINNING OF YEAR</b>	<u>3,965,919</u>	<u>381,937</u>	<u>4,973,317</u>	<u>9,321,173</u>
<b>NET ASSETS AT END OF YEAR</b>	<u>\$ 4,711,834</u>	<u>\$ 396,197</u>	<u>\$ 4,929,791</u>	<u>\$ 10,037,822</u>

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

## CITY OF SALEM, MASSACHUSETTS

**PROPRIETARY FUNDS**  
**STATEMENT OF CASH FLOWS -**  
**YEAR ENDED JUNE 30, 2004**

	Business-type Activities - Enterprise Funds			
	Water and Sewer	Golf Course	Parking Activities	Totals
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>				
Receipts from users	\$ 11,031,013	\$ 543,467	\$ 1,536,390	\$ 13,110,870
Payments to vendors and employees	(9,405,729)	(294,725)	(468,442)	(10,168,896)
<b>Net Cash Provided by (Used for) Operating Activities</b>	<b>1,625,284</b>	<b>248,742</b>	<b>1,067,948</b>	<b>2,941,974</b>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>				
Transfers, net	(1,362,432)	(189,587)	(914,458)	(2,466,477)
Other	-	-	-	-
<b>Net Cash Used for Noncapital Related Financing Activities</b>	<b>(1,362,432)</b>	<b>(189,587)</b>	<b>(914,458)</b>	<b>(2,466,477)</b>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>				
Principal payments on bonds and notes	(105,000)	(30,000)	-	(135,000)
Capital asset purchases	-	-	(153,490)	(153,490)
Interest expense	-	(18,988)	-	(18,988)
<b>Net Cash Used for Capital and Related Financing Activities</b>	<b>(105,000)</b>	<b>(48,988)</b>	<b>(153,490)</b>	<b>(307,478)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>				
Subsidized from joint venture	-	-	-	-
<b>Net Cash Provided by Investing Activities</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>NET CHANGE IN CASH AND EQUIVALENTS</b>	<b>157,852</b>	<b>10,167</b>	<b>-</b>	<b>168,019</b>
<b>CASH AND EQUIVALENTS:</b>				
July 1, 2003	400,167	263,135	-	663,302
June 30, 2004	<u>\$ 558,019</u>	<u>\$ 273,302</u>	<u>\$ -</u>	<u>\$ 831,321</u>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES:</b>				
Operating income (loss)	\$ 1,813,335	\$ 222,835	\$ 870,932	\$ 2,907,102
Depreciation	5,863	25,907	197,016	228,786
Provision for compensated absences	-	-	-	-
Changes in assets and liabilities:				
Receivables (net)	(382,690)	-	-	(382,690)
Accounts payable	188,776	-	-	188,776
<b>Net Cash Provided From Operating Activities</b>	<b>\$ 1,625,284</b>	<b>\$ 248,742</b>	<b>\$ 1,067,948</b>	<b>\$ 2,941,974</b>
<b>NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES:</b>				
Borrowing under capital leases	-	-	-	-
Contributions of capital assets from General Fund	-	-	-	-
Purchase of equipment on account	-	-	-	-
Increase in fair value of investments	-	-	-	-
Capital asset trade-ins	-	-	-	-

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

**CITY OF SALEM, MASSACHUSETTS**

**FIDUCIARY FUNDS  
STATEMENT OF FIDUCIARY NET ASSETS  
JUNE 30, 2004**

	Pension Trust Fund (As of December 31, 2003)	Private Purpose Trust Funds
<b>ASSETS</b>		
<b>CURRENT:</b>		
Cash and Cash Equivalents	\$ 3,488,865	\$ 46,955
Investments (at fair value):		
Fixed income securities	12,910,113	
Equity securities	6,431,733	
Pooled Funds:		
Domestic Equity	32,662,393	
International Equity	5,900,550	
Real Estate	4,504,898	
Venture Capital	7,276,838	
Mutual funds		1,242,165
Total Investments	69,686,525	1,242,165
Receivables:		
Dividends and interest	171,367	
Employer contributions		
Member deductions	15,601	
Investments	96,135	
Total Receivables	283,103	-
<b>Total Assets</b>	<b>73,458,493</b>	<b>1,289,120</b>
<b>LIABILITIES</b>		
<b>CURRENT:</b>		
Accounts payable and accrued expenses	45,900	
Investments	242,527	
<b>Total Liabilities</b>	<b>288,427</b>	<b>-</b>
<b>NET ASSETS</b>		
Held in trust for pension benefits and other purposes	73,170,066	1,289,120
<b>Net Assets</b>	<b>\$ 73,170,066</b>	<b>\$ 1,289,120</b>

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

**CITY OF SALEM, MASSACHUSETTS**

**FIDUCIARY FUNDS  
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS  
YEAR ENDED JUNE 30, 2004**

	Pension Trust Fund (As of December 31, 2003)	Private Purpose Trust Funds
<b>ADDITIONS:</b>		
Contributions:		
Employer	\$ 5,655,234	
Employee	2,613,469	
From Commonwealth of Massachusetts	428,680	
Transfers from other systems	53,991	
Reimbursements from other systems	95,603	
From federal grant	31,120	
Investment Income	2,694,596	\$134,910
Net gain (loss) on investments (including realized and unrealized gains and losses)	<u>8,478,014</u>	
<b>Total Additions</b>	<u>20,050,707</u>	<u>134,910</u>
<b>EXPENDITURES:</b>		
Benefit payments to retirees and surviving spouses	9,334,264	
Refunds:		
Members	161,048	
Option B	11,750	
Reimbursements to other systems	169,129	
Transfers to other systems	241,360	
Payroll expenses of the System	155,207	
Other administrative expenses	506,954	
Scholarships and assistance		<u>45,061</u>
<b>Total Deductions</b>	<u>10,579,712</u>	<u>45,061</u>
<b>CHANGE IN NET ASSETS</b>	9,470,995	89,849
<b>NET ASSETS AT BEGINNING OF YEAR</b>	<u>63,699,071</u>	<u>1,199,271</u>
<b>NET ASSETS AT END OF YEAR</b>	<u><u>\$ 73,170,066</u></u>	<u><u>\$ 1,289,120</u></u>

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

## CITY OF SALEM, MASSACHUSETTS

### NOTES TO BASIC FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2004

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#### I. Summary of Significant Accounting Policies

The basic financial statements of the City, have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to state and local governments. GAAP is prescribed by the Governmental Accounting Standards Board (GASB), which is the primary standard-setting body for state and local government entities. The following is a summary of the more significant policies and practices used by the City:

- A. Reporting Entity** - The City of Salem is located in Essex County, sixteen miles northeast of the City of Boston. Salem was incorporated as a town in 1630 and established as a city in 1836. An elected Mayor who serves a four-year term and an eleven-member City Council who are elected biennially govern the City. The City provides governmental services for the territory within its boundaries, including police and fire protection, disposal of garbage and rubbish, public education in grades K-12, water and sewer services, street maintenance, parks and recreational facilities. Water and sewer services, funded almost entirely with user charges are provided via connections to the Salem and Beverly Water Supply Board (the Supply Board) and the South Essex Sewerage District (the District).
- B. Individual Component Unit Disclosures** - The following component unit is, while a separate entity, in substance part of the governmental operations of the City due to the significance of its operations and financial relationship with the City. Data is blended with City data as the primary government.

South Essex Sewerage District - The District is a joint venture servicing Salem, Peabody, Beverly, Danvers, Marblehead and Ferncroft Village in Middleton. The District was established for the operation of a septic disposal facility. Each member community is responsible for their proportionate share of the operational costs of the District, which are paid in the form of assessments. At June 30, 2004, the City has an equity unreserved and undesignated in the operations of the District of \$1,967,994. This activity is reflected in the City's Business-Type activities.

- C. Government-Wide and Fund Financial Statements** - The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the non-fiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. *Governmental activities*, which normally are supported by taxes and intergovernmental revenues, are reported separately from *business-type activities*, which rely to a significant extent on fees and charges for support. Likewise, the *primary government* is reported separately from certain legal *component units* for which the primary government is financially accountable. The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods or services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as *general revenues*. Separate financial statements are provided for Governmental Funds, proprietary funds, and fiduciary funds, even though the latter are excluded from government-wide financial statements. Major individual Governmental Funds are reported as separate columns in the fund financial statements.



CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS  
YEAR ENDED JUNE 30, 2004

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**I. Summary of Significant Accounting Policies (continued)**

- D. Measurement Focus, Basis of Accounting, and Financial Statement Presentation** – The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, as are proprietary funds and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. Governmental Fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However expenditures related to debt service, compensated absences, claims and judgments, and risk financing, are recorded only when payment is due. Property taxes, licenses, and interest associated with the current fiscal period are all considered being susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when the government receives cash.

The government reports the following major Governmental Funds:

General Fund – is the government’s primary operating fund. It accounts for all financial resources of the general government except those required to be accounted for in another fund.

Stabilization Fund – is used to account for certain unencumbered accumulated financial resources that are subject to appropriation as directed by the City’s Legislative branch. These funds are typically used for nonrecurring expenditures, usually capital in nature or unexpected items that may arise during the year.

The government reports the following major proprietary funds:

Enterprise Fund – uses the “economic resources” measurement focus to account for the following specific operations in a manner similar to private business enterprises:

Water and Sewer – accounts for user charges collected to finance costs associated with maintaining the related infrastructure within the City boundaries, and fund the assessments charged by the Salem and Beverly Water Board and South Essex Sewerage District for maintaining the facilities by which the water and sewage is processed.

Golf Course – accounts for the operations of the City’s 9-hole golf course facility, which is maintained through the collection of user fees. Certain receipts are utilized to supplement the Parks and Recreation appropriation in the General Fund.

Parking Activities – accounts for the activities associated with maintaining the City’s parking garages, lots, and metered spaces through the collection of parking fees.

CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS  
YEAR ENDED JUNE 30, 2004

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I. Summary of Significant Accounting Policies (continued)

D. Measurement Focus, Basis of Accounting, and Financial Statement Presentation (continued)

Additionally, the government reports the following fund types:

Private-Purpose Trust Fund – is used to account for resources legally held in trust for use in funding scholarships and energy support for qualified citizens. There is a requirement that a portion of these resources be preserved as capital.

Pension Trust Fund – substantially all employees of the City, except teachers and certain administrative personnel employed by the School Department participate in the Salem Contributory Retirement System (the Retirement System). The Retirement System functions for the benefit of these employees.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent to the extent that those standards do not conflict with or contradict guidance of the GASB. Governments also have the *option* of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to the same limitation. The City has elected not to follow private-sector guidance. As a general rule the *effect* of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are payments in lieu of taxes and other charges between the City's water and sewer function and various other functions of the government. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned. Amounts reported as *program revenues* include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as *general revenues* rather than as program revenues. Likewise general revenues include all taxes. Proprietary funds distinguish *operating* revenues and expenses from *non-operating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the enterprise funds are charges to customers for sales and services. Operating expenses for the enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues not meeting this definition are reported as non-operating revenues and expenses. When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources, as they are needed.

CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS  
YEAR ENDED JUNE 30, 2004

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I. Summary of Significant Accounting Policies (continued)

E. **Assets, Liabilities, and Net Assets or Equity**

Deposits and Investments – The City's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

State statutes authorize the City to invest in obligations of the United States Treasury, commercial paper, corporate bonds, repurchase agreements and the State Treasurer's Investment Pool. Investments for the City, the Retirement System, and its component units are reported at fair value. The State Treasurer's Investment Pool operates in accordance with state laws and regulations. The reported value of the pool is the same as the fair value of the pool shares.

Interfund Balances – Activity between funds that are representative of lending arrangements outstanding at the end of the fiscal year are referred to as either *due to/from other funds* or *advances to/from other funds*. All other outstanding balances between funds are reported as due to/from other funds.

Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as *internal balances*.

Receivables – All property tax and trade receivables are shown net of an allowance for doubtful collections comprised of those outstanding amounts greater than five years old. Real estate and personal property taxes are assessed on January 1 every year. Bills are sent quarterly and are due on July 1, October 1, January 1, and April 1, or thirty days subsequent to the mailing date. Interest accrues on delinquent taxes to the rate of 14% per annum. The City is allowed to take delinquent tax accounts into tax title fourteen days subsequent to the mailing of demand of delinquent taxes.

Mortgage receivables are principally comprised of funds advanced to developers under various Urban Development Action Grants (UDAG) and Residential Rehabilitation agreements. The City loans funds to owners of commercial and residential properties for the purpose of rehabilitating these properties. The City receives these funds from the U.S. Department of Housing and Urban Development (HUD) under Community Development Block Grant (CDBG) programs for the City, and from loan repayments. These loans are repaid to the City under various terms and conditions stipulated by each mortgage agreement. The collected proceeds of these loans may be used for any eligible activity relevant to the community development program.

Inventories and Prepaid Items – Inventories, which are not material to the basic financial statements, are considered to be expenditures at the time of purchase.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

Restricted Assets – Certain cash and investment balances are classified as restricted assets on the balance sheet because they are maintained in separate bank accounts and their use is limited by the provisions of certain trust documents.

CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS  
YEAR ENDED JUNE 30, 2004

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I. Summary of Significant Accounting Policies (continued)

E. Assets, Liabilities, and Net Assets or Equity (continued)

Capital Assets – Capital assets, which include property, plant, and equipment are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the City as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. The City has elected not to capitalize infrastructure assets until required in 2006.

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

Major outlays for capital assets and improvements are capitalized as projects are constructed. Net interest incurred during the construction phase of capital assets of business-type activities is included as part of the capitalized value of the assets constructed.

Property, plant and equipment of the primary government as well as the component units is depreciated using the straight line method over the following estimated useful lives:

Structures and improvements	40 years
Equipment, furniture, fixtures and vehicles	5 years

Compensated Absences – It is the City's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. Amounts related to these benefits are accrued when incurred in the government-wide, proprietary, and fiduciary fund financial statements. A liability for these amounts is reported in Governmental Funds only if they have matured.

Long-term Obligations – In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. Bond premiums and discounts, as well as issuance costs are deferred and amortized over the life of the bonds. Bond anticipation notes payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, Governmental Fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on a debt issuance are reported as other financing sources while discounts as other financing uses. Issuance costs are exclusively reported as debt service expenditures regardless of whether they are withheld from the actual proceeds.

CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS  
YEAR ENDED JUNE 30, 2004

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**I. Summary of Significant Accounting Policies (continued)**

**E. Assets, Liabilities, and Net Assets or Equity (continued)**

Deferred Mortgage Revenue – Deferred mortgage revenue of the City is recorded when loans collateralized by real estate are originated. Such amounts are reclassified to revenue upon repayment.

Risk Financing – The City does not insure for workers' compensation, health, or unemployment benefits. The City does insure for casualty, theft, or other losses. Uninsured losses are recorded as expenditures when incurred. Amounts determined to be incurred but not reported are reflected as liabilities of the Government-Wide Statement of Net Assets.

Encumbrances – Encumbrance accounting, under which purchase orders, contracts and other commitments for expenditure of funds are recorded in order to reserve that portion of the applicable appropriation, is employed as a significant aspect of budgetary control in the Governmental Fund types. Encumbrances outstanding at year-end are reported as reservations of fund balances, since they do not constitute expenditures or liabilities.

Fund Equity – In the fund financial statements, Governmental Funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

**II. Stewardship, Compliance and Accountability**

- A. Budgetary Information** – An annual budget is legally adopted for the General Fund and the Enterprise Fund. Financial orders are initiated by department heads, recommended by the Mayor and approved by the City Council at the City's annual meeting in June. Expenditures may legally exceed appropriations at the department level. Department heads may transfer, without City Council approval, appropriation balances from one expenditure account to another within their department or budget. The City Council and the department head however must approve any transfer of unencumbered appropriation balances between departments or agencies. At the close of each fiscal year, unencumbered appropriation balances lapse or reverts to unreserved fund balance. The City made several supplemental budgetary appropriations throughout the year approximating \$1.9million. The majority of these were to supplement the City's individual appropriations.
- B. Excess of Expenditures Over Appropriations** – During the fiscal year ended, there were no instances in which the City's expenditures exceeded appropriations.
- C. Deficit Fund Equity** – The City incurred legal deficits in its Capital Projects Fund in the amount of \$24,963,657 that will be raised through future bond issuance. In addition, the City reports a deficit of \$824,160 in its Health Insurance Fund. Amounts available as free cash have been reduced to reflect this deficit, however there is no plan in place currently to directly fund this deficit.

**CITY OF SALEM, MASSACHUSETTS**

**NOTES TO BASIC FINANCIAL STATEMENTS  
YEAR ENDED JUNE 30, 2004**

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**III. Detailed Notes to All Funds**

- A. Deposits and Investments** – Cash and equivalents include cash on hand and certificates of deposit with maturities of three months or less.

The City maintains separate cash accounts for all funds, except the Pension Trust Fund. In addition, certificates of deposit and investments are held separately by the Permanent Funds. The deposits and investments of the Pension Trust Fund are held separately from those of other funds and are covered by federal depository insurance and government securities.

At year-end, the carrying amount of the City's deposits was \$14,104,524 and the bank balance was \$11,335,520. Of the City's bank balance, \$300,000 was covered by either the federal depository insurance or by depositors insurance fund; and the remaining \$11,035,520 was collateralized.

At December 31, 2003, the carrying amount of deposits for the Pension Trust Fund was \$2,202,719 and the bank balance was \$2,011,098. Of the bank balance, \$100,000 was covered by federal depository insurance and the remaining \$1,911,098 by depositors insurance fund.

Statutes require the Treasurer to invest City funds in bonds or notes which are legal investments for savings banks, including U.S. obligations, certificates of deposit, money market accounts, bank deposits, repurchase agreements and the State Treasurer's investment pool. In addition, the statutes impose various limitations on the amount and length of investments and deposits. Repurchase agreements cannot be for a period of over ninety days, and the underlying security must be an U.S. obligation. During the fiscal year, the City did not enter into any repurchase agreements. The Retirement System has received a waiver from the Commonwealth of Massachusetts relative to these statutes.

The fair value of bonds and government obligations were determined, based on quoted market prices. The fair values of stocks were determined by closing prices for those securities traded on national stock exchanges and at the average of bid-and-asked quotations for these securities traded in the over-the-counter market.

From time to time, the Pension Trust Fund may invest in derivative products, mainly currency hedges, to minimize currency risk on international investments. Professional money managers whose investment performance is subject to periodic review manage these investments. The City believes its exposure to derivatives to be insignificant.

In accordance with GAAP, investments as detailed in the following paragraphs are classified as to credit risk by the three categories described below:

Category 1: Insured or registered, or securities held by the City or its agent in the City's name.

Category 2: Uninsured and unregistered, with securities held by the counter party's trust department or agent in the City's name.

Category 3: Uninsured and unregistered, with securities held by the counter party or by its trust department or agent but not in the City's name.

CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED  
YEAR ENDED JUNE 30, 2004

III. Detailed Notes to All Funds (continued)

A. Deposits and Investments (continued)

	Category 1	Category 2	Category 3	Fair Value
<b>City at June 30, 2004:</b>				
U.S. Government obligations	\$ 2,895,883			\$ 2,895,883
Fixed income securities	1,947,397			1,947,397
Equity securities	100,938			100,938
	<u>4,944,218</u>			<u>4,944,218</u>
Investments not subject to categorization:				
State Treasurer's Investment Pool				1,327,636
Money Markets				2,947,715
Mutual Fund				526,084
Certificates of Deposit				<u>-</u>
Total City funds				<u>9,745,653</u>
<b>Pension Trust Fund at December 31, 2003:</b>				
U.S. Government obligations		2,066,225		2,066,225
Fixed income securities		10,843,888		10,843,888
Equity securities		<u>44,994,676</u>		<u>44,994,676.00</u>
		57,904,789		57,904,789
Investments not subject to categorization:				
Money Markets				1,286,146
Real estate				54,504,898
Venture capital				<u>7,276,838</u>
Total Pension Trust Fund				<u>120,972,671</u>
Total				<u>\$ 130,718,324</u>

Following is a reconciliation of investments and cash and equivalents as summarized above to the balance as recorded in the combined balance sheet:

	<u>Investments</u>	<u>Cash and Equivalents</u>
As presented above	\$ 80,718,324	\$ 16,307,243
Reclass: Short-term investments reported in the combined balance sheet as cash and short-term investments; As follows:		
Money Market investments	(4,233,861)	4,233,861
State Treasurer's Investment Pool	<u>(1,327,636)</u>	<u>1,327,636</u>
Totals	<u>\$ 75,156,827</u>	<u>\$ 21,868,740</u>

CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS  
YEAR ENDED JUNE 30, 2004

III. Detailed Notes to All Funds (continued)

B. Receivables

Presentation Breakdown – Receivables as of year-end for the government's individual major, proprietary and fiduciary funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	<u>General</u>	<u>Nonmajor</u>	<u>Water and Sewer</u>	<u>Retirement System</u>	<u>Total</u>
Property taxes	\$ 636,188				\$ 636,188
Tax liens	980,992				980,992
Excise	795,713				795,713
User fees			\$ 1,967,625		1,967,625
Intergovernmental	48,243,579	\$ 1,155,286			49,398,865
Mortgages		1,936,847			1,936,847
Interest				\$ 171,367	171,367
Pension contributions				15,601	15,601
Other	494,417	54,141	500,000	96,135	1,144,693
Gross receivables	51,150,889	3,146,274	2,467,625	283,103	57,047,891
Allowance for Uncollectible accounts	( 159,216)	( 589,008)			( 748,224)
Net receivables	<u>\$ 50,991,673</u>	<u>\$ 2,557,266</u>	<u>\$ 2,467,625</u>	<u>\$ 283,103</u>	<u>\$ 56,299,667</u>

Governmental Funds report *deferred revenue* in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental Funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, deferred revenue reported in Governmental Funds amounted to \$51,663,421. The City does not have any unearned revenue as of the end of the fiscal year.

School Building Assistance Reimbursement – As of June 30, 2004, the City expects to receive as the balance of grants from the Commonwealth of Massachusetts under Chapter 645 of the Acts of 1948, as amended, approximately \$72,607,489 applicable to approved school construction costs which includes both principal and interest. Such costs are reimbursed to the City in equal installments over the life of the related bond issues and are subject to appropriation only by the State Legislature. In the Governmental funds under General Fund and in the Statement of Net Assets under Governmental Activities a receivable of \$47,345,637 under the caption Intergovernmental includes the reimbursable portion of the principal balance and the reimbursable portion of the accrued interest expense as of June 30, 2004.



CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED  
YEAR ENDED JUNE 30, 2004

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III. Detailed Notes to All Funds (continued)

B. Receivables (continued)

Mortgage Notes – The City has retained two banks to service various term loans executed as part of its business loan program for local economic development and its housing improvement program. The funding for the loans was through the United States Office of Housing and Urban Development. To date, approximately 70 loans have been issued, estimating a principal amount of \$4,600,000. The remaining outstanding balance of \$1,936,847 has been reflected as a receivable in the Nonmajor Governmental Funds. The interest on these loans varies between 0-8% and the loans mature on various dates through 2031.

C. Interfund Receivables, Payables and Transfers – Interfund transfers during the year were as follows:

	<u>Transfers In</u>	<u>Transfers Out</u>
General	\$ 4,384,565	\$ 6,653,063
Stabilization		1,000,000
Non major Governmental	6,309,350	574,375
Business-Type	<u>                    </u>	<u>2,466,477</u>
Totals	<u>\$ 10,693,915</u>	<u>\$ 10,693,915</u>

## CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED  
YEAR ENDED JUNE 30, 2004III. Detailed Notes to All Funds (continued)

## D. Capital Assets

Capital asset activity for the year ended June 30, 2004 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
<u>Governmental Activities:</u>				
Capital assets not being depreciated:				
Land	\$ 4,684,753			\$ 4,684,753
Construction in progress	23,766,910	(23,766,910)		-
Total capital assets not being depreciated	28,451,663	(23,766,910)	-	4,684,753
Capital assets being depreciated:				
Buildings and improvements	73,149,633	35,138,425		108,288,058
Improvements other than buildings	2,241,591	160,271		2,401,862
Machinery and equipment	3,048,402	86,720		3,135,122
Vehicles	6,078,036	307,620		6,385,656
Total capital assets being depreciated	84,517,662	35,693,036	-	120,210,698
Less accumulated depreciation for:				
Buildings and improvements	(22,414,854)	(1,880,809)		(24,295,663)
Improvements other than buildings	(1,008,942)	(86,912)		(1,095,854)
Machinery and equipment	(2,133,613)	(194,174)		(2,327,787)
Vehicles	(4,364,787)	(401,667)		(4,766,454)
Total accumulated depreciation	(29,922,196)	(2,563,562)	-	(32,485,758)
Total capital assets being depreciated, net	54,595,466	33,129,474	-	87,724,940
Governmental activities capital assets, net	\$ 83,047,129	\$ 9,362,564	\$ -	\$ 92,409,693

Depreciation expense was charged to functions/programs as follows:

General government	\$ 146,474
Public safety	354,546
Education	1,640,004
Public works	116,974
Health and human services	98,611
Culture and recreation	206,953
	<u>\$ 2,563,562</u>

## CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED  
YEAR ENDED JUNE 30, 2004III. Detailed Notes to All Funds (continued)

## D. Capital Assets (continued)

	Beginning Balance	Increases	Decreases	Ending Balance
<u>Business Activities:</u>				
Capital assets not being depreciated:				
Land	\$ 276,422	\$ -	\$ -	\$ 276,422
Capital assets being depreciated:				
Buildings and improvements	8,213,465	153,490		8,366,955
Improvement other than buildings	437,660			437,660
Machinery and equipment	218,844			218,844
Vehicles	136,154			136,154
Total capital assets being depreciated	9,006,123	153,490	-	9,159,613
Less accumulated depreciation for:				
Buildings and improvements	(2,831,881)	(202,743)		(3,034,624)
Improvement other than buildings	(276,573)	(21,997)		(298,570)
Machinery and equipment	(202,497)	(4,588)		(207,085)
Vehicles	(136,154)			(136,154)
Total accumulated depreciation	(3,447,105)	(229,328)	-	(3,676,433)
Total capital assets being depreciated, net	5,559,018	(75,838)	-	5,483,180
Business activities capital assets, net	\$ 5,835,440	\$ (75,838)	\$ -	\$ 5,759,602
Depreciation expense was charged to functions/programs as follows:				
Water and sewer	\$ 5,863			
Golf course	25,907			
Parking activities	197,016			
	\$ 228,786			

CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED  
YEAR ENDED JUNE 30, 2004

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III. Detailed Notes to All Funds (continued)

E. Leases

Lessee Agreements – The following significant capital leases relate to the City acting as the lessee. These leases are primarily attributable to vehicles and equipment of the Public Works, Cemetery, and Fire Departments, and the remainder is for computer leases associated with the School Department future payments on leases consist of the following:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
June 30,			
2005	112,309	17,731	130,040
2006	94,823	11,117	105,940
2007	<u>100,228</u>	<u>5,712</u>	<u>105,940</u>
Totals	<u>\$ 307,360</u>	<u>\$ 34,560</u>	<u>\$ 341,920</u>

F. Temporary Debt

The City is authorized to borrow on a temporary basis to fund the following:

Current Operating Costs – Prior to the collection of revenues, expenditures may be financed through the issuance of revenue or tax anticipation notes (RANS or TANS).

Capital Projects and Other Approved Costs – Projects may be temporarily funded through the issuance of bond anticipation notes (BANS) or grant anticipation notes (GANS). In certain cases, prior to the issuance of these temporary notes, the governing body must take the necessary legal steps to authorize the issuance of the general obligation bonds. Temporary notes may not exceed the aggregate amount of bonds authorized or the grant award amount.

Temporary notes are general obligations of the City and carry maturity dates not in excess of one year and are interest bearing and will be paid through future issuance of general obligation bonds. Temporary notes outstanding at June 30, 2004, recorded in the Governmental Funds are payable as follows:

<u>Project</u>	<u>Type</u>	<u>Interest Rate</u>	<u>Maturity Date</u>	<u>Amount</u>
School construction	BAN	1.5%	1/15/05	<u>\$ 28,800,000</u>

CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED  
YEAR ENDED JUNE 30, 2004

III. Other Information (continued)

G. Long-Term Debt

The City issues general obligation bonds and notes to provide funds for the acquisition and construction of major capital facilities. General obligation bonds and notes have been issued for both governmental and business-type activities. Additionally, the City incurs various other long-term obligations relative to associated personnel costs. During the year ended June 30, 2004, the following reflects the activity in the long-term liability accounts:

	Balance July 1, 2003	Additions	Reductions	Balance June 30, 2004
<i>Governmental Activities:</i>				
Notes payable	\$ 795,000		\$( 225,000)	\$ 570,000
Capital leases	441,217		( 133,857)	307,360
Compensated absences	3,243,144			3,243,144
Risk financing	1,281,920	11,073,893	( 10,767,341)	1,588,472
Bond indebtedness	<u>63,730,000</u>		<u>( 3,890,000)</u>	<u>59,840,000</u>
Total Governmental	\$ 69,491,281	\$ 11,073,893	\$( 15,016,198)	\$ 65,548,976
<i>Business-type Activities:</i>				
Compensated absences	\$ 260,597			\$ 260,597
Bond indebtedness	<u>515,000</u>		<u>\$( 135,000)</u>	<u>380,000</u>
Total Business-type	<u>\$ 775,597</u>		<u>\$( 135,000)</u>	<u>\$ 640,597</u>

Notes Payable –

1. On June 29, 1989, the City borrowed \$600,000 from the Federal Housing and Urban Development Department (HUD) under the Section 108 CDBG program. Upon its maturity date of August 1, 1999, the City renegotiated the loan with HUD for \$540,000 after an initial up-front payment of \$60,000 and extended the maturity date to August 1, 2009. The City's future entitlements of community development block grants have been pledged as security for repayments of this loan. Principal payments are due annually commencing on August 1, 2000. Interest is due in quarterly payments at a rate of LIBOR + .2% on the unpaid principal beginning on August 1, 1999. As of June 30, 2004, \$220,000 remained outstanding.

2. On February 1, 1995, the City, borrowed a total of \$600,000 from HUD under Section 108 CDBG Program. This loan package consists of 8 separate promissory notes at \$55,000 and one at \$60,000, aggregating \$500,000, guaranteed by HUD. The notes are secured by future City entitlement of community development block grants funds. Principal payments are due annually commencing on August 1, 1997, and ending August 1, 2014. Beginning August 1, 1995, interest is payable semi-annually on February 1 and August 1 at a rate of 9.0%. As of June 30, 2004, \$350,000 remained outstanding.

## CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED  
YEAR ENDED JUNE 30, 2004III. Detailed Notes to All Funds (continued)

## G. Long-Term Debt (continued)

Bonded Debt -

Description of Issue	Year of Issue	Maturity Date	Interest Rate	Original Amounts	Amounts Outstanding
<i>Governmental Activities:</i>					
Inside the debt limit:					
School Renovation	07/01/96	08/15/15	5.125 - 5.75%	1,800,000	1,120,000
Swimming Pool	09/15/00	06/30/17	4.50 - 6.75%	450,000	320,000
Police Station	08/01/01	07/15/11	3.50 - 4.00%	2,935,000	2,347,000
Total inside the debt limit					3,787,000
Outside the debt limit:					
School Remodeling	07/01/96	08/15/15	5.125 - 5.75%	7,000,000	4,950,000
School Construction	09/15/00	06/30/20	4.50 - 6.75%	10,705,000	9,715,000
School Construction	08/01/01	07/15/11	3.50 - 4.00%	6,495,000	5,388,000
School Construction	08/01/01	07/15/11	3.50 - 4.00%	4,710,000	3,795,000
School Construction	01/15/03	01/15/23	3.00 - 5.00%	17,646,075	17,070,000
School Construction	01/15/03	01/15/23	3.00 - 5.00%	9,523,925	9,215,000
School Construction	01/15/03	01/15/20	3.00 - 5.00%	1,500,000	1,440,000
GO refunding	06/11/03	07/15/12	2.25 - 4.50%	4,480,000	4,480,000
Total outside the debt limit					56,053,000
Total Governmental Activities					<u>\$ 59,840,000</u>
<i>Business-type Activities:</i>					
Inside the debt limit:					
Golf Course	09/15/00	06/30/17	4.50 - 6.75%	470,000	\$ 380,000
Total inside the debt limit					380,000
Total Business-type Activities					<u>\$ 380,000</u>

CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED  
YEAR ENDED JUNE 30, 2004

III. Detailed Notes to All Funds (continued)

G. Long-Term Debt (continued)

Future Debt Payoff - Payments on general long-term debt obligation bonds due in future years consist of the following:

Year Ending June 30	Governmental Activities		Business-type Activities	
	Principal	Interest	Principal	Interest
2005	\$ 4,070,000	\$ 2,515,007	\$ 30,000	\$ 17,563
2006	4,165,000	2,352,710	30,000	16,175
2007	4,220,000	2,196,527	30,000	14,825
2008	4,265,000	2,040,610	30,000	13,475
2009	4,265,000	1,878,235	30,000	11,938
Thereafter	39,425,000	11,445,639	230,000	43,612
Total	<u>\$ 60,410,000</u>	<u>\$ 22,428,728</u>	<u>\$ 380,000</u>	<u>\$ 117,588</u>

Authorized and Unissued Debt - At June 30, 2004, the City had authorized and unissued debt as follows:

Project	Amount
School Construction (outside debt)	\$ 57,236,913
Parking garage (outside debt - business)	\$ 1,100,000
Water systems (outside debt - business)	12,000,000
Total authorized and unissued	<u>\$ 70,336,913</u>

CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED  
YEAR ENDED JUNE 30, 2004

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III. Detailed Notes on All Funds (continued)

G. Long-Term Debt (continued)

Legal Debt Margin – State law permits a city, under the provisions of Chapter 44, Section 10, to authorize indebtedness up to a limit of 2.5% of its equalized valuation. Debt issued in accordance with this section of the law is designated as being “inside the debt limit.” In addition, a City may authorize debt in excess of that limit for specific purposes. Such debt, when issued, is designated as being “outside the debt limit.” The following is a computation of the legal debt margin as of June 30, 2004:

Equalized Valuation –		
Real Estate and Personal Property		<u>\$ 3,971,301,437</u>
Debt Limit – 2 ½% of Equalized Valuation		99,282,536
Total Debt (including authorized and unissued)	\$ 131,126,913	
Less: Debt exempt from Limit	( 126,389,913)	<u>( 4,737,000)</u>
Legal Debt Margin		<u><u>\$ 94,545,536</u></u>

Overlapping Debt – The City’s proportionate share of debt of other governmental units which provide services within the City’s boundaries, and which is annually assessed to the City, is approximated below using the latest actual information which is provided as of June 30, 2004 (unaudited):

<u>Related Entity</u>	<u>Principal</u>	<u>Percent</u>	<u>June 30, 2004 Assessment</u>
North Shore Regional Vocational School	\$ 3,460,000	24.70%	\$ 1,316,245
Massachusetts Bay Transportation Authority	2,300,000,000	.74%	884,178
South Essex Sewerage District (net of subsidy)	103,588,974	19.99%	<u>7,526,997</u>
			\$ 9,727,420



## CITY OF SALEM, MASSACHUSETTS

### NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED YEAR ENDED JUNE 30, 2004

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#### IV. Other Information

##### A. Retirement System

System Description – The City contributes to the City of Salem Contributory Retirement System (the System), an agency multiple-employer defined benefit pension plan for the City, Salem Housing Authority, Salem and Beverly Water Board, South Essex Sewerage District, and North Shore Regional Vocational School. The System was established under Chapter 32 of the General Laws of the Commonwealth of Massachusetts. The System is administered by the City of Salem and is part of the reporting entity. A stand-alone financial report for the year ended December 31, 2003, was issued and is available at the Retirement Office, 93 Washington Street, Salem, Massachusetts.

Substantially all employees of the City, except teachers and certain administrative personnel employed by the School Department, participate in the System. The members of the System do not participate in the Social Security System. Benefits paid under the System, referred to as "retirement allowances," include both an annuity portion, funded principally from amounts contributed by the participants, and a pension portion, funded by the City. The payroll for employees covered by the System for the latest actuarial information which is for the year ended December 31, 2002, was approximately \$31,089,195.

Teachers and certain administrative employees of the School Department participate in a contributory retirement system administered by the Massachusetts Teachers Retirement Board. Contributions to that system totaled approximately \$5,345,441 the year and were made entirely by the Commonwealth of Massachusetts, on behalf of the City, which does not contribute directly to this system.

Membership – Current membership in the System as of December 31, 2003, is as follows:

Retirees and beneficiaries currently receiving	
benefits and terminated employees entitled to	
benefits but not yet receiving them	589
Active employees	924
Inactive employees	84
Total	<u>1,597</u>

Benefits – Massachusetts Contributory Retirement System benefits are uniform from system to system. The System provides for retirement allowance benefits up to a maximum of 80% of a participant's highest three-year average annual rate of regular compensation. Benefit payments are based upon a participant's age, length of creditable service, level of compensation and group classification.

The retirement allowance consists of two parts: an annuity and a pension. Participants' accumulated total deductions and portions of the interest they generate constitute the annuity. The differential between the total retirement benefit and annuity is the pension.

CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED  
YEAR ENDED JUNE 30, 2004

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IV. Other Information (continued)

A. Retirement System (continued)

Benefits (continued) - From time to time, the Legislature may grant cost-of-living increases to benefits being paid to retirees. These increases are expressed as a percentage of the retiree's allowance subject to a maximum dollar increase. Since 1982, cost-of-living increases granted to members of local retirement systems have been the financial responsibility of the State. However, beginning in 1998, the funding of future cost-of-living amounts became the responsibility of the participating units. These units are responsible for the full cost-of-living amounts for all new retirees beginning that year, and for any additional cost-of-living increases granted to individuals who retired before 1998. The State shall continue to fund the cost-of-living amounts granted to retirees prior to 1998 for the duration of their selected retirement option.

Participants who resign from service and who are not eligible to receive a retirement allowance or are under the age of 55 are entitled to request a refund of their accumulated total contributions. In addition, depending upon the number of years of creditable service, such employees are entitled to receive 0%, 50% or 100% of the regular interest that has accrued upon those contributions. A vested employee under the age of 55 who elects to leave his accumulation on deposit may apply for benefits upon reaching that age.

Survivor benefits are extended to eligible beneficiaries of participants whose death occurs prior to or following retirement.

The System may be amended or terminated in whole or in part at any time by the Massachusetts Legislature, provided that no such modification, amendment or termination shall be made that would deprive a current member of superannuation pension rights or benefits provided under applicable laws of Massachusetts, if such member has paid the stipulated contributions specified in sections or provisions of such laws.

Normal Retirement - Normal retirement occurs at age 65; however, participants may retire after twenty years of service or at any time after attaining age 55. Participants with hire dates subsequent to January 1, 1978 must have minimum of ten years' creditable service in order to retire at age 55. Participants become vested after ten years of service. Benefits commencing before age 65 are provided at a reduced rate. Members working in certain occupations may retire with full benefits earlier than age 65.

Disability Retirement - The System provides for both an ordinary disability retirement, where a participant is permanently incapacitated from a cause unrelated to employment, and an accidental disability retirement, where the disability is the result of an injury or illness received or aggravated in the performance of duty. The amount of benefits to be received in such cases is dependent upon several factors, including the age at which the disability retirement occurs, the years of service, average compensation and veteran status.

Funding Status and Progress - The City has elected provisions of Chapter 32, Section 22D of Massachusetts General Laws, which require that a funding schedule be established to fully fund the accrued liability by June 30, 2021. Under provisions of this law, participating employers are assessed their share of the total retirement cost based on the entry age, normal actuarial cost method. Amortization of the unfunded actuarial liability is determined using the level dollar amortization method over a 27-year period.

CITY OF SALEM, MASSACHUSETTS

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED  
YEAR ENDED JUNE 30, 2004

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IV. Other Information (continued)

A. Retirement System (continued)

Contribution Requirements and Contributions Made – The System’s funding policies have been established by Chapter 32 of the Massachusetts General Laws. The annuity portion of the retirement allowance is funded by employees who contribute a percentage of their regular compensation. Employees whose creditable service began prior to January 1, 1975, contribute 5% of their base salary or wage; those whose service date is subsequent to January 1, 1975, and prior to January 1, 1984, contribute 7%; those whose service date is subsequent to January 1, 1984, and prior to July 1, 1996, contribute 8%, and those whose service date is subsequent to July 1, 1996, contribute 9%. Additionally, employees hired after January 1979 contribute an additional 2% on earnings in excess of \$30,000.

In accordance with Massachusetts General Laws, employer contributions to the System have historically been determined on a pay-as-you-go basis. GAAP requires that the annual minimum provision for pension costs should include normal cost, interest on unfunded past service cost liability, and amortization of unfunded vested benefits, based on an acceptable actuarial cost method.

The Pension Reform Act of 1987 was enacted by the State Legislature in January 1988. The Act amends Chapter 32 of the General Laws and requires amortization of the unfunded pension liability over a forty-year period.

Investment Concentration – There were no investments (other than those issued or guaranteed by the United States Government) in any one organization that represents 5% or more of the System’s net assets.

Disclosures – Required disclosures under Governmental Accounting Standards Board’s Statements No. 25 and 27 are included in this report under the caption “Required Supplementary Information”.

- B. **Risk Financing** – The City has established a self-insured medical program which is accounted for in the Health Claims Trust Fund in the Governmental Funds Permanent Fund. Both employees and the City contribute to the payment of medical claims based upon a primary care premium formula. The percentage is dependent upon the plan that is selected. The employee portion is paid into the Health Claims Trust Fund. The City’s portion is appropriated in the General Fund and transferred out to be expended from the Governmental Funds Permanent Fund. The purpose of this program is to pay medical claims of the City’s employees and their covered dependents. The City carries insurance on individual medical claims in excess of \$100,000 annually. Estimated losses on claims are charged to expenditures in the period the claim is determinable. The City accrues claims submitted for medical services rendered prior to June 30, 2004.

Activity regarding this account for the year ended June 30, 2004 is as follows:

Liability at beginning of year	\$ 1,281,920
Provision for losses	11,073,893
Payments for claims	( 10,767,341)
Liability at end of year	<u>\$ 1,588,472</u>

**CITY OF SALEM, MASSACHUSETTS**

**NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED**  
**YEAR ENDED JUNE 30, 2004**

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**IV. Other Information (continued)**

**B. Risk Financing (continued)**

The City has also established self-insurance programs for unemployment and workers' compensation claims. Workers' compensation claims are appropriated for as part of the annual budget. Unemployment claims are paid to employees by the Commonwealth of Massachusetts, for which the City is billed on a monthly basis.

- C. Post Employment Benefits** – In addition to providing pension benefits, the City provides the majority of retired employees with payments for a portion of their health care and life insurance benefits. These benefits are provided through various health maintenance organizations. Benefits paid by the City are on a pay-as-you-go basis. There is no actuarial valuation available as of June 30, 2004, which would permit an estimation of the unfunded past service cost liability, future costs of current participants in the system and annual amounts needed to fund such costs. The cost to fund these benefits amounted to approximately \$1,250,000, \$1,020,000 and \$800,000 respectively for the years ended June 30, 2004, 2003 and 2002.

- D. Contingencies** – The City is party to certain legal claims, which are subject to many uncertainties, and the outcome of individual litigation matters is not always predictable with assurance. Although the amount of liability, if any, at June 30, 2004, cannot be ascertained, management believes that any resulting liability, if any, should not materially affect the basic financial statements of the City at June 30, 2004.

Amounts received or receivable from grantor agencies are subject to audit and adjustment by grantor agencies, principally the federal and state governments. Any disallowed claims, including amounts already collected, may constitute a liability of the applicable funds. The amount, if any, of expenditures which may be disallowed by the grantor cannot be determined at this time, although the City expects such amounts, if any, to be immaterial.

The City is subject to certain Federal arbitrage laws in accordance with long-term borrowing agreements. Failure to comply with the rules could result in the payment of penalties. The amount of penalties, if any, cannot be determined at this time, although the City expects such amounts, if any, to be immaterial.

**V. Certain Segment Information**

The following segment information is provided for the Water and Sewer Business-type activities:

	<b>Water</b>	<b>Sewer</b>	<b>District</b>	<b>Total</b>
Revenues	4,731,280	6,682,423		11,413,703
Expenses	( 2,792,236)	( 6,802,269)		( 9,594,505)
Indirect costs	( 681,216)	( 681,216)		( 1,362,432)
Transfers		500,000	( 500,000)	-
District activity (net)			295,012	295,012
Depreciation	( 5,863)			( 5,863)
Net income	1,257,828	( 301,062)		745,915
Net assets, June 30, 2004	2,030,891	712,949	1,967,994	4,711,834

**CITY OF SALEM, MASSACHUSETTS**

**NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED**  
**YEAR ENDED JUNE 30, 2004**

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**VI. Implementation of New GASB Pronouncements**

During the year ended June 30, 2004 the following GASB pronouncement was implemented:

- Statement No. 39, *Determining Whether Certain Organizations are Component Units*. This pronouncement amends GASB Statement No.14 – The effect on the basic financial statements was not significant.

The following GASB pronouncements will be implemented in future years as their dates become effective:

Effective date; fiscal year ended June 30, 2005.

- GASB Statement No. 40 , *Deposit and Investment Risk Disclosures*. This pronouncement amends GASB Statement No. 3.

Effective date; fiscal year ended June 30, 2006.

- GASB Statement No. 42, *Accounting and Financial Reporting for impairment of Capital Assets and for Insurance Recoveries*.
- GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section*. This pronouncement amends NCGA Statement No. 1.

Effective date; fiscal year ended June 30, 2008.

- GASB Statement No. 43, *Financial Reporting for Post employment Benefit Plans Other Than Pension Plans*.

Effective date; fiscal year ended June 30, 2009.

- GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Post Employment Benefits Other Than Pensions*

GASB Statements No. 43 and No. 45 could have a significant impact on the financial statements. The other Statements are not expected to have a significant impact.

**CITY OF SALEM, MASSACHUSETTS**

**REQUIRED SUPPLEMENTARY INFORMATION - RETIREMENT SYSTEM**  
**YEAR ENDED DECEMBER 31, 2003**

**Schedule of Funding Progress**

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll (b-a/c)
01/01/03	\$76,438,885	\$137,111,559	\$60,672,674	55.7%	\$31,089,195	195%
01/01/01	73,727,923	117,334,727	43,606,804	62.8%	29,072,197	150%
01/01/99	68,563,143	111,294,953	42,731,810	61.6%	25,411,629	168%
01/01/97	51,236,360	82,440,774	31,204,414	62.1%	22,930,939	136%
01/01/94	41,074,617	71,831,709	30,757,092	57.2%	17,753,129	173%
01/01/92	33,180,956	76,039,158	42,858,202	43.6%	16,993,481	252%

**Schedule of Contributions Made by Employers**

Year Ended December 31,	Annual Required Contribution	Percentage Contributed	Additional Advance Contributions
2003	\$5,505,234	100%	150,000
2002	4,775,312	100%	150,000
2001	4,610,788	100%	150,000
2000	4,452,134	100%	150,000
1999	4,410,289	100%	500,000
1998	4,268,352	100%	-
1997	4,003,864	100%	-
1996	3,943,853	100%	-
1995	3,887,240	100%	-
1994	4,347,948	100%	-
1993	5,233,797	100%	-
1992	5,091,808	100%	-

**Notes to Schedules**

Additional information as of the latest actuarial valuation follows:

Valuation date:	January 1, 2003
Actuarial cost method:	Individual entry age normal
Amortization method:	Required payments increase of 4.5% per year
Remaining amortization period:	22 Years
Asset valuation method:	Fair Value
Investment rate of return:	8.5%
Projected salary increases:	5.5%
Cost-of-living adjustments	3.0% of the lesser of the pension amount and \$12,000 per year

**CITY OF SALEM, MASSACHUSETTS**

**SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE  
BUDGET AND ACTUAL - GENERAL FUND  
YEAR ENDED JUNE 30, 2004**

	<u>Budgeted Amounts</u>		<u>Actual</u>	<u>Variance</u>
	<u>Original</u>	<u>Final</u>	<u>Budgetary</u>	<u>Favorable</u>
	<u>Budget</u>	<u>Budget</u>	<u>Amounts</u>	<u>(Unfavorable)</u>
<b>REVENUES</b>				
Real estate and personal property taxes, net	\$ 54,667,887	\$ 54,667,887	\$ 55,603,719	\$ 935,832
Intergovernmental	23,171,176	23,171,176	23,552,170	380,994
Motor vehicle and other excises	3,360,000	3,360,000	3,387,266	27,266
Departmental and other revenue	2,525,000	2,525,000	2,832,821	307,821
Licenses and permits	440,000	440,000	461,982	21,982
Penalties and interest on taxes	380,000	380,000	322,003	(57,997)
Fines and forfeitures	875,000	875,000	827,151	(47,849)
Investment income	350,000	350,000	253,944	(96,056)
Miscellaneous	722,650	722,650	408,559	(314,091)
<b>Total Revenues</b>	<u>86,491,713</u>	<u>86,491,713</u>	<u>87,649,615</u>	<u>1,157,902</u>
<b>EXPENDITURES</b>				
General government	3,915,877	4,641,302	4,485,187	156,115
Public safety	14,128,044	14,845,371	14,577,078	268,293
Education	40,706,903	40,731,903	39,737,980	993,923
Public works	5,440,512	5,582,512	5,447,138	135,374
Health and human services	782,168	883,286	855,553	27,733
Culture and recreation	2,505,770	2,576,700	2,388,626	188,074
Fringe Benefits	1,539,956	1,539,956	1,512,770	27,186
Intergovernmental	4,134,102	4,212,549	4,212,549	0
Pensions	5,095,580	5,095,580	5,053,036	42,544
Debt service	7,418,830	7,418,830	7,198,008	220,822
<b>Total Expenditures</b>	<u>85,667,742</u>	<u>87,527,989</u>	<u>85,467,925</u>	<u>2,060,064</u>
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers in	3,446,749	3,446,749	3,316,617	(130,132)
Transfers out	(6,309,350)	(6,309,350)	(6,309,350)	-
<b>Total Other Financing Sources (Uses)</b>	<u>(2,862,601)</u>	<u>(2,862,601)</u>	<u>(2,992,733)</u>	<u>(130,132)</u>
<b>EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES/USE OF PRIOR YEAR BUDGETARY FUND BALANCE</b>	<u>(2,038,630)</u>	<u>(3,898,877)</u>	<u>(811,043)</u>	<u>3,087,834</u>
<b>BUDGETARY FUND BALANCES, JULY 1, 2003</b>	<u>5,363,449</u>	<u>5,363,449</u>	<u>5,363,449</u>	<u>-</u>
<b>BUDGETARY FUND BALANCES, JUNE 30, 2004</b>	<u><u>\$ 3,324,819</u></u>	<u><u>\$ 1,464,572</u></u>	<u><u>\$ 4,552,406</u></u>	<u><u>\$ 3,087,834</u></u>

The notes to the required supplementary information are an integral part of this schedule.

**CITY OF SALEM, MASSACHUSETTS**

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION  
YEAR ENDED JUNE 30, 2004**

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**I. Budgetary Basis of Accounting**

An annual budget is legally adopted for the General Fund and the Enterprise Fund. Financial orders are initiated by department heads, recommended by the Mayor and approved by the City Council at the City's annual meeting in June. Expenditures may legally exceed appropriations at the department level. Department heads may transfer, without City Council approval, appropriation balances from one expenditure account to another within their department or budget. The City Council and the department head however must approve any transfer of unencumbered appropriation balances between departments or agencies. At the close of each fiscal year, unencumbered appropriation balances lapse or reverts to unreserved fund balance. The City made several supplemental budgetary appropriations throughout the year approximating \$1.9million. The majority of these were to supplement the City's individual appropriations.

The City's general fund is prepared on a basis other than GAAP. The "actual" results column of the Schedule of Revenues, Expenditures and Changes in Fund Equity – Budgetary Basis is presented on a budgetary basis to provide a meaningful comparison with the budget. Primary differences include the recognition of parking and golf as a business enterprises for GAAP but as a governmental function for budget, and the grossing up of revenues and expenditures to reflect On Behalf Teacher's Retirement paid by the Commonwealth. A reconciliation is provided below.

Revenues on a GAAP basis	\$ 91,458,666
On Behalf Teacher's receipts	( 5,345,441)
Parking receipts	1,536,390
Revenues on a Budgetary basis	\$ 87,649,615

Expenditures on a GAAP basis	\$ 90,001,211
On Behalf Teacher's expenditures	( 5,345,441)
Parking expenditures	468,442
Golf expenditures	343,713
Expenditures on a Budgetary basis	\$ 85,467,925