

CITY OF SALEM, MASSACHUSETTS

**REPORT ON EXAMINATION OF
GENERAL PURPOSE FINANCIAL STATEMENTS
AND ADDITIONAL INFORMATION
YEAR ENDED JUNE 30, 2001**

**REPORT ON COMPLIANCE
AND INTERNAL CONTROL OVER
COMPLIANCE APPLICABLE TO
MASSACHUSETTS SCHOOL DISTRICTS
YEAR ENDED JUNE 30, 2001**

**CITY OF SALEM, MASSACHUSETTS
REPORT ON EXAMINATION OF
GENERAL PURPOSE FINANCIAL STATEMENTS AND ADDITIONAL
INFORMATION
YEAR ENDED JUNE 30, 2001**

CONTENTS

<u>FINANCIAL SECTION</u>	<u>Page</u>
Independent Auditors' Report	1-2
General Purpose Financial Statements:	
Combined balance sheet - all fund types and account group	3-4
Combined statement of revenues, expenditures and changes in fund balances (deficit) - all governmental fund types and expendable trust funds	5
Statement of revenues and expenditures - budget and actual - general fund budgetary basis	6
Combined statement of revenues, expenses and changes in retained earnings/fund balances - nonexpendable trust funds and proprietary fund types	7
Combined statement of cash flows - nonexpendable trust funds and proprietary fund types	8
Notes to general purpose financial statements	9-33
 <u>REQUIRED SUPPLEMENTARY INFORMATION</u>	
Pension Trust Funds:	
Statement of Plan Net Assets	34
Statement of Changes in Plan Net Assets	35
Other Required Pension Disclosures	36
 <u>OTHER REPORT</u>	
Independent Auditors' Report on Compliance and Internal Control Over Compliance Applicable to Massachusetts School Districts – Unqualified Opinion on Compliance	37-38

TUCCI & ROSELLI

CERTIFIED PUBLIC ACCOUNTANTS
MANAGEMENT CONSULTANTS

INDEPENDENT AUDITORS' REPORT

To the City Council and Mayor
City of Salem, Massachusetts

We have audited the accompanying general purpose financial statements of the City of Salem, Massachusetts, as of and for the year ended June 30, 2001, as listed in the accompanying table of contents, except for the Pension Trust Fund which is as of and for the year ended December 31, 2000. These general purpose financial statements are the responsibility of the City of Salem's management. Our responsibility is to express an opinion on these general purpose financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and *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 general purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The general purpose financial statements referred to above do not include a statement of general fixed assets, which should be included to conform with generally accepted accounting principles. Inasmuch as the Commonwealth of Massachusetts does not require, and the City has not capitalized fixed assets, the amount that should be recorded in the general fixed asset account group is not known.

The financial statements referred to above do not include an estimate of compensated absences, which should be included to conform with generally accepted accounting principles. Inasmuch as the Commonwealth of Massachusetts does not require, and the City has not calculated, compensated absences, the amount that should be recorded in the general purpose financial statements long term-debt account group is not known.

As more fully described in Note 2 (c), the City maintains their enterprise funds on a comprehensive basis of accounting other than generally accepted accounting principles. Accordingly, the enterprise funds are not intended to present the financial position and results of operations in conformity with generally accepted accounting principles.

In our opinion, except for the effects on the financial statements of the matters described in the preceding three paragraphs, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the City of Salem, Massachusetts, at June 30, 2001, except for the Pension Trust Fund which is as of and for the year ended December 31, 2000, and the results of its operations and cash flows of its nonexpendable trust funds and proprietary fund types for the year then ended, in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 12, 2001, on our consideration of the City of Salem's internal control structure and its compliance with laws and regulations.

In accordance with the Massachusetts Department of Education's Compliance Supplement for Massachusetts School Districts, we have also issued a report dated October 12, 2001 on our consideration of the City of Salem's internal control structure over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants applicable to Massachusetts School Districts.

Our audit was conducted for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The required supplementary information is also the responsibility of the City's management, and in our opinion, except for the effect of matters described in paragraphs three and four is fairly stated in all material respects when considered in relation to the general purpose financial statements taken as a whole.



Tucci & Roselli
Certified Public Accountants

October 12, 2001

CITY OF SALEM, MASSACHUSETTS
COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUP
JUNE 30, 2001

(Except for the Pension Trust which is for the year ended December 31, 2000)
(General Fund 2000 amounts are shown for comparative purposes only.)

	Governmental Fund Types					Fiduciary Fund Types		Proprietary Fund Type	Account Group	Combined Total (Memorandum Only)
	General Fund		Special Revenue Funds	Capital Projects Funds	Trust and Agency Funds	Pension Trust Fund	Enterprise Fund	General Long-Term Obligations		
	2001	2000								
ASSETS AND OTHER DEBITS										
CASH AND EQUIVALENTS	\$9,995,057	\$8,460,697	\$6,457,895	\$3,945,936	\$3,398,501	\$3,893,754	\$3,650,403			\$31,341,546
INVESTMENTS				8,045,050	5,035,620	69,336,252				82,416,922
RECEIVABLES:										
Property taxes (Note 4)	1,296,425	811,117								1,296,425
Other (Note 6)	1,691,582	1,945,358	2,029,373		165,000	497,918	1,805,912			6,189,785
Allowance for doubtful accounts	(295,307)		(854,724)							(1,150,031)
Due from other non-government	48,680				120,439					169,119
Due from other government	593,261	621,189	1,109,574		3,510	190,443				1,896,788
Due from Commonwealth - Chapter 645	32,058,000									32,058,000
INVESTMENT IN JOINT VENTURE							2,688,366			2,688,366
AMOUNTS TO BE PROVIDED:										
For Retirement of General Long-Term Obligations									\$44,343,124	44,343,124
Total Assets and Other Debits	\$45,387,698	\$11,838,361	\$8,742,118	\$11,990,986	\$8,723,070	\$73,918,367	\$8,144,681		\$44,343,124	\$201,250,044

See notes to general purpose financial statements.

Continued

CITY OF SALEM, MASSACHUSETTS
COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUP
JUNE 30, 2001

(Except for the Pension Trust which is for the year ended December 31, 2000)
(General Fund 2000 amounts are shown for comparative purposes only.)

	Governmental Fund Types				Fiduciary Fund Types		Proprietary Fund Type	Account Group	Combined Total (Memorandum Only)
	General Fund		Special Revenue Funds	Capital Projects Funds	Trust and Agency Funds	Pension Trust Fund			
	2001	2000							
LIABILITIES, FUND EQUITY, AND OTHER CREDITS									
LIABILITIES:									
Warrants and accounts payable	\$3,013,631	\$2,270,183	\$657,384	\$1,116,890	\$24,961	\$84,735	\$122,091	General	\$5,019,692
Accrued expenses	271,646	298,758					6,943	Long-Term Obligations	278,589
Retainage payable				757,041					757,041
Due to other government	291,238	291,238				25,618			25,618
Allowance for abatements									291,238
Other liabilities					319,165				319,165
Deferred revenues	34,476,964	2,247,924	1,174,649				1,805,912		37,457,525
Bond anticipation notes payable				28,000,000				\$369,009	28,000,000
Risk financing activities								1,929,115	369,009
Capital lease obligations								42,045,000	1,929,115
Bond indebtedness									42,045,000
Total Liabilities	38,053,479	5,108,103	1,832,033	29,873,931	344,126	110,353	1,934,946	44,343,124	116,491,992
FUND EQUITY (DEFICIT) AND OTHER CREDITS:									
Reserved for encumbrances	1,432,723	966,088			579,604	73,808,014			1,432,723
Reserved for health claims									579,604
Reserved for pension benefits									73,808,014
Designated for special revenue			6,910,085	(17,882,945)					6,910,085
Designated for capital projects									(17,882,945)
Designated for expendable trust					6,001,494				6,001,494
Designated for nonexpendable trust					1,797,846				1,797,846
Designated for joint venture investment							2,688,366		2,688,366
Retained earnings	5,901,496	5,422,548					3,521,369		3,521,369
Undesignated fund balances (as restated note 16)									5,901,496
Total Fund Equity (Deficit) as restated note 16	7,334,219	6,388,636	6,910,085	(17,882,945)	8,378,944	73,808,014	6,209,735		84,758,052
Total Liabilities, Fund Equity, and Other Credits	\$45,387,698	\$11,496,739	\$8,742,118	\$11,990,986	\$8,723,070	\$73,918,367	\$8,144,681	\$44,343,124	\$201,250,044

See notes to general purpose financial statements.

Concluded

**COMBINED STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES (DEFICIT)
ALL GOVERNMENTAL FUND TYPES AND EXPENDABLE TRUST FUNDS
YEAR ENDED JUNE 30, 2001
(General Fund 2000 amounts are shown for comparative purposes only.)**

	Governmental Fund Types			Fiduciary Fund Types	
	General Fund	Special Revenue Funds	Capital Projects Funds	Expendable Trust Funds	Combined Total (Memorandum Only)
	2001	2,000			
REVENUES:					
Real and personal property taxes, net	\$48,802,188	\$45,824,415			\$48,802,188
Motor vehicle and other excise	3,178,682	2,686,784			3,178,682
Intergovernmental	25,246,053	22,419,156	\$12,038,823		37,284,876
Departmental and other revenue	2,265,388	1,522,195	2,296,795		4,562,183
Licenses and permits	430,487	451,973			430,487
Fines and forfeitures	720,339	732,667			720,339
Investment income	1,021,933	736,266	2,959	(\$304,469)	720,423
On-behalf payments by Commonwealth	4,505,009				4,505,009
Miscellaneous income	1,342,099	2,153,602	1,417,955		2,760,054
Health claims contribution				7,067,744	7,067,744
Total Revenues	87,512,178	76,527,058	15,756,532	6,763,275	110,031,985
EXPENDITURES:					
General government	3,759,509	3,590,845	2,042,207		5,801,716
Public safety	14,180,506	13,538,961	408,765	3,457	14,592,728
Education	38,100,865	33,797,724	7,751,687	5,000	45,857,552
Public works	5,529,433	4,858,955	475,135	72,541	6,077,109
Health and human services	927,024	920,083			927,024
Culture and recreation	2,809,798	2,610,027	528,704		3,338,502
Pension and fringe benefits	10,161,390	9,312,340			10,161,390
Massachusetts teachers' retirement	4,505,009				4,505,009
State and county assessments	2,183,362	3,495,301			2,183,362
Debt service:					
Principal	3,220,000	2,835,050			3,220,000
Interest	2,482,795	2,482,071			2,482,795
Health claims					0
Community development and capital outlay			2,462,534	\$17,106,792	6,857,914
Total Expenditures	87,859,691	77,441,357	13,669,032	6,938,912	125,574,427
Excess (deficiency) of revenues over (under) expenditures	(347,513)	(914,299)	2,087,500	(17,106,792)	(175,637)
					(15,542,442)
OTHER FINANCING SOURCES (USES):					
Loan proceeds				13,300,000	13,300,000
Operating transfers in	1,795,599	1,942,558	17,503	500,000	2,313,102
Operating transfers out	(502,503)	(14,734)	(933,009)	(15,000)	(1,450,512)
Total Other Financing Sources (Uses)	1,293,096	1,927,824	(915,506)	485,000	14,162,590
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other uses (Note 3)	945,583	1,013,525	1,171,994	(3,806,792)	309,363
					(1,379,852)
FUND BALANCES (DEFICIT), JULY 1, 2000	6,730,258	5,716,733	5,738,091	(14,076,153)	4,663,930
prior period adjustment (note 16)	(341,622)				(341,622)
FUND BALANCES, (DEFICIT), July 1, 2000 as restated	6,388,636	5,716,733	5,738,091	(14,076,153)	4,322,308
FUND BALANCES (DEFICIT), JUNE 30, 2001	\$7,334,219	\$6,730,258	\$6,910,085	(\$17,882,945)	\$6,581,097
					\$2,942,456

See notes to general purpose financial statements.

CITY OF SALEM, MASSACHUSETTS
STATEMENT OF REVENUES AND EXPENDITURES-
BUDGET AND ACTUAL - GENERAL FUND BUDGETARY BASIS
YEAR ENDED JUNE 30, 2001

	Budget	Actual	Variance Favorable (Unfavorable)
REVENUES:			
Real and personal property taxes, net	\$48,083,231	\$48,192,427	\$109,196
Motor vehicle and other excise	2,863,429	3,178,682	315,253
Intergovernmental	24,413,259	25,246,053	832,794
Departmental and other revenue	1,488,887	1,805,006	316,119
Licenses and permits	378,280	430,487	52,207
Fines and forfeitures	687,676	720,339	32,663
Investment income	457,913	1,021,933	564,020
Miscellaneous income	2,055,730	1,802,481	(253,249)
Total Revenues	80,428,405	82,397,408	1,969,003
OTHER FINANCING SOURCES :			
Operating transfers (net)	1,506,563	1,506,563	
Transfers from free cash	2,663,366	2,663,366	
Total Other Financing Sources	4,169,929	4,169,929	
Total Revenue and Other Financing Sources	84,598,334	86,567,337	1,969,003
EXPENDITURES:			
General government	3,899,542	3,762,697	136,845
Public safety	14,353,989	14,218,811	135,178
Education	38,641,829	38,498,649	143,180
Public works	5,594,347	5,535,826	58,521
Health and human services	946,837	929,137	17,700
Culture and recreation	2,860,454	2,828,641	31,813
Pension and fringe benefits	10,357,509	10,161,390	196,119
State and county assessments	2,048,667	2,183,362	(134,695)
Debt service	5,895,160	5,702,795	192,365
Total Expenditures	84,598,334	83,821,308	777,026
Excess of Revenues and Other Financing Sources Over Expenditures (Note 3)		\$2,746,029	

See notes to general purpose financial statements.

**CITY OF SALEM, MASSACHUSETTS
COMBINED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN
RETAINED EARNINGS / FUND BALANCES - NONEXPENDABLE TRUST FUNDS AND
PROPRIETARY FUND TYPES
YEAR ENDED JUNE 30, 2001**

	Proprietary Fund Type		Combined Total (Memorandum Only)
	Enterprise Fund	Nonexpendable Trust	
REVENUES:			
Charges for services	\$9,842,627		\$9,842,627
Net activity of joint venture	141,174		141,174
	<hr/>	<hr/>	<hr/>
Total Revenues	9,983,801	0	9,983,801
EXPENSES:			
Operating expenses	8,851,071		8,851,071
	<hr/>	<hr/>	<hr/>
Total Expenses	8,851,071		8,851,071
	<hr/>	<hr/>	<hr/>
Income before transfers	1,132,730	0	1,132,730
OTHER FINANCING SOURCES/(USES) - Net:			
Transfers	(862,590)		(862,590)
	<hr/>	<hr/>	<hr/>
NET INCOME	270,140	0	270,140
RETAINED EARNINGS / FUND EQUITY:			
July 1, 2000	5,939,595	1,797,846	7,737,441
	<hr/>	<hr/>	<hr/>
June 30, 2001	\$6,209,735	\$1,797,846	\$8,007,581
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

See notes to general purpose financial statements.

**CITY OF SALEM, MASSACHUSETTS
COMBINED STATEMENT OF CASH FLOWS
NONEXPENDABLE TRUST FUNDS AND PROPRIETARY FUND TYPES
YEAR ENDED JUNE 30, 2001**

	<u>Proprietary Fund Type</u>		<u>Combined Total (Memorandum Only)</u>
	<u>Enterprise Fund</u>	<u>Nonexpendable Trust</u>	
CASH FLOWS FROM OPERATING ACTIVITIES AND NONOPERATING REVENUE:			
Net income from operations	\$270,140	\$0	\$270,140
Effects of changes in assets and liabilities:			
Warrants and accounts payable	47,406		47,406
Investment in joint venture (net)	<u>(141,174)</u>		<u>(141,174)</u>
Net cash provided by operating activities	<u>176,372</u>	<u>0</u>	<u>176,372</u>
 INCREASE / (DECREASE) IN CASH AND EQUIVALENTS	 176,372	 0	 176,372
 CASH AND EQUIVALENTS:			
July 1, 2000	<u>3,474,031</u>	<u>1,797,846</u>	<u>5,271,877</u>
June 30, 2001	<u><u>\$3,650,403</u></u>	<u><u>\$1,797,846</u></u>	<u><u>\$5,448,249</u></u>

See notes to general purpose financial statements.

**CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2001**

1. Definition of Reporting Entity:

The City of Salem is governed by an elected Mayor and City Council. Generally Accepted Accounting Principles ("GAAP") require that the accompanying general purpose financial statements present the City of Salem (the primary government) and its component units. Component units are included in the City's reporting entity if their operational and financial relationships with the City are significant. Pursuant to this criteria, the following entities have been excluded from the accompanying general purpose financial statements:

- Salem Housing Authority
- North Shore Regional School District

The City of Salem's Retirement System (the "system") has been identified as a component unit. The system was established under the authority of Chapter 32 of the Massachusetts General Laws, as amended, and is an independent contributory retirement system available to employees of the City. The powers of the system are vested in the Retirement Board. The system has been blended into the City's Fiduciary Fund Types for reporting purposes.

The City is a member of the South Essex Sewerage District (the District), a joint venture with several neighboring communities, for the operation of a septage disposal facility. Each member is responsible for its proportionate share of the operational costs of the District, which are paid in the form of assessments. At June 30, 2001 the City has an equity unreserved and undesignated in the operations of the District of \$2,688,366, whose activity is reflected in the City's Enterprise Fund.

2. Summary of Significant Accounting Policies:

The accounting policies of the City of Salem, Massachusetts, conform to generally accepted accounting principles as applicable to governmental units, except that the City (1) does not include a statement of general fixed assets, (2) does not include a liability for compensated absences, and (3) maintains its enterprise funds on a modified accrual basis of accounting which is other than the basis prescribed by generally accepted accounting principles. The following summarizes the more significant policies.

The activities of the City are accounted for through the use of several funds and an account group, each of which is a separate accounting entity. The operations of each fund and account group are accounted for through a separate set of self-balancing accounts which are summarized by type in the financial statements. The following fund types and account group are used by the City.

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

2. Summary of Significant Accounting Policies - continued:

(a) Basis of Presentation-Fund Accounting:

Governmental Fund Types:

Government Funds are those through which most governmental functions of the City are financed. The acquisition, use and balances of the City's expendable financial resources and the related liabilities are accounted for through Governmental Funds. The measurement focus is based upon determination of changes in financial position, rather than upon net income. The following are the City's Governmental Fund types:

General Fund - The General Fund is the general operating fund of the City. It is used to account for all financial resources except those required to be accounted for in another fund.

Special Revenue Funds - Special Revenue Funds are used to account for the proceeds of specific revenue sources (other than expendable trusts or major capital projects) that are legally restricted to specified purposes.

Capital Project Funds - Capital Project Funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by trust funds).

Fiduciary Fund Types:

Trust and Agency Funds - Fiduciary Funds are used to account for assets held by the City in a trustee capacity or as an agent. Trust Funds include Expendable Trust Funds and Non-expendable Trust Funds. Non-Expendable Trust Funds are reported as Proprietary Funds. Expendable Trust Funds are reported as Governmental Funds. Agency Funds are custodial in nature and do not involve measurements of results of operations.

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

2. Summary of Significant Accounting Policies - continued:

(a) Basis of Presentation-Fund Accounting - continued:

Fiduciary Fund Types - continued:

Pension Trust Fund - The Pension Trust Fund is used to account for the assets of the City of Salem Retirement System (the System) available for the payment of retired employees' benefits and administrative expenses of the System.

Proprietary Fund Types:

Enterprise Funds - The Enterprise Funds are used to account for operations that are financed and operated in a manner similar to private business enterprises, where net income and capital maintenance are measured. Costs of providing services to the general public on a continuing basis, including depreciation, are financed or recovered primarily through user charges.

Account Group:

General Long-term Obligations Account Group - This account group is used to account for all long-term obligations of the City.

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

2. Summary of Significant Accounting Policies - continued:

(b) Measurement Focus:

All Governmental Funds and Expendable Trust Funds are accounted for on a spending or "financial flow" measurement focus. With this measurement focus, only current assets and current liabilities are generally included on the balance sheets. The reported fund balance (net current assets) is considered a measure of "available spendable resources". Governmental Fund operating statements present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets. Accordingly, such statements present a summary of sources and uses of "available spendable resources" during a period. Noncurrent portions of long-term receivables due to Governmental Funds are reported on their balance sheets notwithstanding their measurement focus. Special reporting treatments are used to indicate, however, that they should not be considered "available spendable resources", since they do not represent net current assets. Recognition of Governmental Fund type revenues represented by noncurrent receivables is deferred until they become current receivables.

Because of their spending measurement focus, expenditure recognition for Governmental Fund types is limited to exclude amounts represented by noncurrent liabilities. Since they do not affect net current assets, such long-term amounts are not recognized as Governmental Fund type expenditures or fund liabilities, but are reported as liabilities in the General Long-Term Obligations Account Group.

(c) Basis of Accounting:

The modified accrual basis of accounting is followed by Governmental Funds and Expendable Trust Funds. Under the modified accrual basis, revenue is recognized that is both measurable and available to pay liabilities of the current period. Revenues not considered available are recorded as deferred revenues. Expenditures are recorded when the liability is incurred, except for interest on general long-term obligations, which is recorded when due.

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

2. Summary of Significant Accounting Policies - continued:

(c) *Basis of Accounting-continued:*

In applying the susceptible to accrual concept to intergovernmental revenues, these are essentially two types of revenues. In one, monies must be expended for the specific purpose or project before any amounts will be paid to the City; therefore, revenues are recognized based upon the expenditures incurred. In the other, monies are virtually unrestricted and are usually revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenues at the time of receipt or earlier if the susceptible to accrual criteria are met.

Property taxes are recognized as revenue in the year for which taxes have been levied, provided they are collected within 60 days after year-end. Licenses and permits, fines and forfeitures and miscellaneous revenues are recorded as revenues when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned.

The City utilizes the accrued basis of accounting with respect to expense recognition, of the Enterprise funds. The City has not maintained adequate records to properly account for other Enterprise Funds activities such as revenue recognition, the recognition of fixed assets, depreciation, and contributed capital. The above deviations as well as other modifications are necessary for the Enterprise funds to be in accordance with generally accepted accounting principles.

The accrual basis of accounting is used by trust funds.

(d) *Encumbrances:*

Encumbrance accounting, is employed by Governmental Funds. With encumbrance accounting purchase orders, contracts and other commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation. Open encumbrances at year-end are reported as reservations of fund balances. Encumbrances do not constitute expenditures or liabilities except for budget purposes.

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

2. Summary of Significant Accounting Policies - continued:

(e) Investments:

Investments in bonds and stocks for the Retirement System and Trust Fund investments are carried at current fair value. Deferred compensation plan assets are invested in mutual funds, which are also carried at current fair value.

(f) Inventory:

Inventory items (materials and supplies), which are not material to the general purpose financial statements are recorded as expenditures when purchased (purchase method).

(g) General Fixed Assets:

General fixed assets are recorded as expenditures in applicable Governmental Funds. The City does not capitalize the cost of general fixed assets in a General Fixed Asset Group, as is required by generally accepted accounting principles. Since the Commonwealth of Massachusetts does not require the capitalization of fixed assets, this is consistent with the practice of many municipalities in the Commonwealth of Massachusetts.

(h) Compensated Absences:

GAAP requires the accrual of a liability for vested or accumulated vacation and sick leave. Compensated absences expected to be liquidated with expendable available financial resources are reported as expenditures and fund liabilities. Accounts that are not expected to be liquidated with expendable available financial resources are reported in the General Long-Term Obligations Account Group. Employees earn vacation as they provide services. Except in certain circumstances, (i.e. pursuant to certain collective bargaining agreements), vacation time earned must be used annually and shall not be cumulative from year to year. In the case of estimated sick leave benefits only a portion of benefits calculated based on termination benefits are to be accrued. These estimated liabilities at June 30, 2001, are not readily determinable and accordingly have not been recorded.

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

2. Summary of Significant Accounting Policies - continued:

(i) Post Retirement/Health Care and Life Insurance Benefits:

The City provides certain health care and life insurance benefits for retired employees. Substantially all of the City's employees may become eligible for those benefits if they reach normal retirement age while working for the City. Benefits paid by the City are on a pay-as-you go basis, and there is no actuarial valuation available as of June 30, 2001, which would permit an estimation of the unfunded past service cost liability, the future costs of current participants in the plan and the annual amounts needed to fund such costs.

(j) Total Columns:

Total columns on the combined statements are captioned "Memorandum Only" to indicate that they are presented only to facilitate financial analysis. Data in these columns do not present financial position, results of operations or changes in financial position in conformity with generally accepted accounting principles. Such data is not comparable to a consolidation since interfund elimination's have not been made.

(k) Comparative Data:

Summaries of comparative data, which is not required, for the prior year general fund have been presented in the accompanying general purpose financial statements to provide an understanding of changes in the general fund financial position and operations.

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

3. Budgetary Accounting:

The City must establish its property tax rate each year so that the resulting property tax levy will comply with the limits required by Proposition 2-1/2 and also constitute that amount which will equal the sum of (a) the aggregate of all annual appropriations for expenditures and transfers, plus (b) a provision for the prior fiscal year's deficits, if any, less (c) the aggregate of all non-property tax revenue and transfers projected to be received by the City, including available surplus funds.

An annual budget is legally adopted for the General Fund and the Enterprise Funds. Council orders are initiated or recommended by the Mayor. Expenditures may not legally exceed appropriations at the department level. Department heads may transfer, with the Mayor's approval, appropriation balances from one expenditure account to another within their department or budget. The City Council and the Mayor must approve any transfer of unencumbered appropriation balances between departments or agencies.

At the close of each fiscal year, unencumbered appropriation balances (appropriation less expenditures and encumbrances) revert to the unreserved fund balance. Unencumbered appropriation balances in the capital project fund, however, do not lapse at the end of the fiscal year.

The budgets are prepared on a basis of accounting other than generally accepted accounting principles (GAAP). The "actual" results columns of the Statement of Revenues and Expenditures - Budget and Actual - General Fund - Budgetary Basis is presented on a "budget basis" to provide a meaningful comparison with the budget.

The major differences between the budget and GAAP basis are that:

- (a) Budgeted revenues are recorded when cash is received, except for real estate and personal property taxes, which are recorded as revenue when levied (budget), as opposed to when susceptible to accrual (GAAP).
- (b) Encumbrances and continuing appropriations are recorded as the equivalent of expenditures (budget), as opposed to a reservation of fund balances (GAAP).
- (c) Reserve fund transfers are recorded as sources (budget) as opposed to not recorded (GAAP).

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

3. Budgetary Accounting - continued:

A reconciliation of budgetary-basis to GAAP-basis results is presented below:

GAAP Basis:

Excess of revenues and other financing sources over expenditures and other financing uses	\$ 945,583
--	------------

Reconciling Items:

Transfer from unreserved fund balance	2,663,366
Transfer recognition	213,467
Revenue recognition	(609,761)
Encumbrance/expenditure recognition	<u>(466,626)</u>

Budgetary Basis:

Excess of revenues and other financing sources over expenditures and other financing uses	<u>\$2,746,029</u>
--	--------------------

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

4. Cash and Investments:

Statutes authorize the City to invest in obligations of the U.S. Treasury, agencies, and instrumentalities, certificates of deposit, repurchase agreements, money market accounts, bank deposits and the State Treasurer's investment pool. In addition, there are various restrictions limiting the amount and length of deposits and investments.

In addition, the City's Fiduciary Fund types have additional investment powers, most notably the ability to invest in common stocks, corporate bonds and other specified investments.

At year-end, the carrying amount of the City's deposits was \$17,029,579 and the bank balance was \$18,433,688. Of the bank balance, \$349,702 was covered by federal depository insurance, \$5,796,756 was covered by state depository insurance, and the remaining \$12,287,230 was collateralized.

At December 31, 2000, the carrying amount deposits for the Pension Trust Fund was (\$23,962) and the bank balance was \$250,000. Of the bank balance, \$250,000 was covered by federal depository insurance.

Investments are categorized into these three categories of credit risk:

- (1) Insured or registered, or securities held by the government or its agent in the government's name.
- (2) Uninsured or unregistered, with securities held by counterparty's trust department or agent in the government's name.
- (3) Uninsured or unregistered, with securities held by counterparty's trust department or agent but not in the government's name.

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

5. Cash and Investments - continued:

The following schedule categorizes the City's investments:

	<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>	<u>Fair Value</u>
The City at June 30, 2001:				
Equity securities	\$2,682,707			\$2,682,707
Fixed income securities	2,241,214			2,241,214
Government securities	8,045,050			8,045,050
	<u>12,968,971</u>			<u>12,968,971</u>
Investments not subject to categorization:				
State treasurer's investment pool				3,044,133
Mutual funds				111,699
Certificates of deposit				2,050,085
Money markets				<u>5,323,995</u>
Total City funds				23,498,883
Pension Trust Fund at December 31, 2000:				
Equity securities		\$17,085,352		17,085,352
Fixed income securities		16,647,831		16,647,831
Government securities		7,827,908		7,827,908
		<u>41,561,091</u>		<u>41,561,091</u>
Investments not subject to categorization:				
Money markets				3,917,716
Mutual funds				15,219,589
Real estate				5,009,729
Venture capital				<u>7,545,843</u>
Total Pension Trust Fund				<u>73,253,968</u>
Total				<u><u>\$96,752,851</u></u>

The 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	\$96,752,851	\$17,005,617
Reclass: Short-term investments reported in the combined balance sheet as cash and equivalents as follows:		
State treasurer's investment pool	(3,044,133)	3,044,133
Certificates of deposit (short-term)	(2,050,085)	2,050,085
Money markets	<u>(9,241,711)</u>	<u>9,241,711</u>
Total	<u><u>\$82,416,922</u></u>	<u><u>\$31,341,546</u></u>

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

5. Property Taxes:

Real and personal property taxes are based on values assessed as of each January 1, and are normally due on August 1, November 1, February 1, and May 1, or thirty days subsequent to mailing date. By law, all taxable property in the Commonwealth must be assessed at 100% of fair cash value. Taxes due and unpaid after the respective due dates are subject to interest and penalties. The City has an ultimate right to foreclose on property for which taxes have not been paid. Property taxes levied are recorded as receivables, net of estimated uncollectibles, in the fiscal year of the levy. Property tax revenues are recorded in accordance with the modified accrual basis of accounting described in Note 2 (c).

A statewide tax limitation statute known as "Proposition 2 1/2" limits the property tax levy to an amount equal to 2-1/2% of the value of all taxable property in the City. A secondary limitation is that no levy in a fiscal year may exceed the preceding year's allowable tax levy by more than 2-1/2%, plus taxes levied on certain property newly added to the tax rolls. Certain Proposition 2-1/2 taxing limitations can be overridden by a City wide referendum vote.

The following schedule is a breakdown of real estate and personal property tax receivables by year:

	<u>Outstanding</u>
Real Estate:	
2002	(\$ 25,692)
2001	640,120
2000 & Prior	481,098
Chapter 59 in Lieu of tax	<u>193,939</u>
Total Real Estate	1,289,465
Personal Property:	
2001	(10,967)
2000 & Prior	<u>17,927</u>
Total Personal Property	6,960
Total Property Tax Receivables	<u>\$ 1,296,425</u>

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

6. Other Receivables:

The principal amounts classified as Other Receivables at June 30, 2001 include:

	General Fund	Special Revenue Fund	Trust & Agency Fund	Pension Trust Fund
Motor Vehicle and Boat Excise	\$ 680,940			
Tax Liens and Foreclosures	482,436			
Lien Property Repairs	493,270			
Accrued Interest				\$ 410,144
Notes / Accounts Receivable	34,936	\$2,029,373		87,774
Deposits			\$ 165,000	
	<u>\$1,691,582</u>	<u>\$2,029,373</u>	<u>\$ 165,000</u>	<u>\$ 497,918</u>

(a) Community Development Loans:

The City has retained two banks to service various term loans executed by the City 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 \$2,029,373 has been reflected as a receivable in the Special Revenue Fund. The interest on these loans varies between 0-8% and the loans mature on various dates through 2031.

(b) Sale of Hospital:

The hospital's building and land were sold by the City on December 16, 1996. The negotiated purchase price was \$4.8 million after netting off undepreciated assets. Lease payments in the amount of \$316,215 were applied to the purchase price. The payment schedule to the City was made retroactive to January 1, 1996, accordingly the City received proceeds for \$1,058,003, which represents eleven monthly installments of principle, at the time of the sale. The City is to receive monthly installments of \$96,182 plus interest accruing at 7.5% until January 1, 2001. As of June 30, 2001, all payments with respect to this note had been fully paid.

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

7. Bond Indebtedness:

As of June 30, 2001, the City had the following outstanding long-term debt:

	Date of Issue	Fiscal Year Of Maturity	Original Principal	Interest Rate (%)	Amount Outstanding
<u>City Operational</u>					
<u>Inside Debt Limit:</u>					
Police Station	9/1/92	1/15/12	5,450,000	4.6-7.25	\$ 3,110,000
Police Station	1/15/94	1/15/04	200,000	4.15-5.25	60,000
Golf Course	9/15/00	6/30/17	470,000	4.50-6.75	470,000
Swimming Pool	9/15/00	6/30/17	450,000	4.50-6.75	450,000
Computer Hardware & Software	9/15/00	6/30/03	990,000	6.75	990,000
Total inside debt limit					<u>5,080,000</u>
<u>Outside Debt Limit:</u>					
School	7/15/91	2/15/11	9,500,000	5.7-8.5	\$ 5,000,000
School	9/1/92	1/15/12	12,000,000	4.6-7.25	6,880,000
School	1/15/94	1/15/13	9,000,000	4.15-5.25	5,675,000
School	7/1/96	8/15/15	7,000,000	5.125-5.75	5,955,000
School	7/1/96	8/15/15	1,800,000	5.125-5.75	1,405,000
School	9/15/00	6/30/20	10,705,000	4.50-6.75	10,705,000
Total outside debt limit					<u>35,620,000</u>
Total City Operational					<u>40,700,000</u>
<u>Enterprise</u>					
<u>Outside Debt Limit:</u>					
Water supply	7/15/91	2/15/02	690,000	5.7-8.5	\$ 65,000
Water supply	1/15/94	1/15/04	1,050,000	4.15-5.25	315,000
Total Enterprise					<u>380,000</u>
<u>Community Development</u>					
<u>Outside Debt Limit:</u>					
HUD 108 1989-A	8/1/99	8/1/09	540,000	Variable	\$ 485,000
HUD 108 1995-A	2/1/95	8/1/14	600,000	9.0	480,000
Total Community Development					<u>965,000</u>
TOTAL DEBT					<u>\$42,045,000</u> ✓

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

7. Bond Indebtedness - continued:

During the year ended June 30, 2001, the following changes occurred in liabilities reported in the General Long-Term Obligations Account Group:

	<u>Bonds</u>	<u>Capital Lease Obligations</u>	<u>Risk Financing Activities</u>	<u>Totals</u>
Payable at July 1, 2000, as restated	\$ 32,220,000	\$ 2,517,607	\$ 234,921	\$ 34,972,528
Additions	12,615,000	453,700	6,992,002	20,060,702
Reductions	<u>(2,790,000)</u>	<u>(1,042,192)</u>	<u>(6,857,914)</u>	<u>(10,690,106)</u>
Payable at June 30, 2001	<u>\$ 42,045,000</u>	<u>\$ 1,929,115</u>	<u>\$ 369,009</u>	<u>\$ 44,343,124</u>

Payments on general long term obligation bonds due in future years consist of the following for the years ending June 30:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2002	\$ 3,455,000	\$ 2,206,193	\$ 5,661,193
2003	3,430,000	2,012,156	5,442,156
2004	2,975,000	1,836,102	4,811,102
2005	2,895,000	1,679,981	4,574,981
2006	2,935,000	1,521,809	4,456,809
Thereafter	<u>26,355,000</u>	<u>7,027,116</u>	<u>33,382,116</u>
	<u>\$ 42,045,000</u>	<u>\$16,283,357</u>	<u>\$ 58,328,357</u>

At June 30, 2001, the City has authorized and unissued debt as follows:

School Construction (outside debt)	<u>\$ 82,537,000</u>
Total Authorized and Unissued	<u>\$ 82,537,000</u>

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

7. Bond Indebtedness - continued:

(a) Legal Debt Margin

The City is subject to the General Laws of the Commonwealth of Massachusetts which limits the amount of bonded debt (exclusive of several categories of general obligation debt issues exempt from the debt limit) the City may have outstanding up to 2 ½% of the valuation of taxable property as last equalized by the Commonwealth's Department of Revenue. The following is a computation of the legal debt margin as of June 30, 2001 (in thousands of dollars):

Equalized Valuation - Real Estate and Personal Property		<u>\$ 2,701,854</u>
Debt Limit - 2 ½% of Equalized Valuation		67,546
Total Debt (including authorized and unissued)	\$124,582	
Less: Debt Exempt from Limit	(119,502)	<u>(5,080)</u>
Legal Debt Margin		<u>\$ 62,466</u>

(b) 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 (unaudited):

<u>Related Entity</u>	<u>Principal (thousands)</u>	<u>Percent</u>	<u>Amount</u>
North Shore Regional Vocational	\$3,730	24.7%	\$921,310
MBTA	3,602,360	.74%	26,657,464
South Essex Sewerage District	190,714	19.99%	<u>38,124,142</u>
			<u>\$65,702,916</u>

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

8. Temporary Borrowing:

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

- Current operating costs prior to the collection of revenues through the issuance of revenue or tax anticipation notes (RANS or TANS).
- Capital project costs and other approved expenditures incurred prior to obtaining permanent financing through issuance of bond anticipation notes (BANS) or grant anticipation notes (GANS).

Temporary loans are general obligations of the City and carry maturity dates, which are limited by statute. Interest expenditures for temporary borrowings are accounted for in the general fund. The City has a single BAN totaling \$28,000,000; it has an interest rate of 3.2% and maturity date of January 18, 2002.

9. Leases:

Payments on leases due in future years consist of the following:

	Principal	Interest	Total
June 30,			
2002	\$ 827,991	\$ 115,546	\$ 943,537
2003	703,697	65,620	769,317
2004	112,666	22,829	135,495
2005	89,710	16,230	105,940
2006	94,823	11,117	105,940
Thereafter	<u>100,228</u>	<u>5,712</u>	<u>105,940</u>
	<u>\$ 1,929,115</u>	<u>\$ 237,054</u>	<u>\$ 2,166,169</u>

The above amounts are specific to vehicle and equipment leases primarily attributable to the Public Works, Cemetery, and Fire Departments; furthermore, the remaining portion is for computer leases held in the City's name by the School Department.

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

10. State Grants:

As of June 30, 2001, 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 \$46,018,000 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 (currently estimated at 20 years) of the related bond issues and are subject to appropriation only by the State Legislature. \$32,058,000 represents the principal balance to be received and is presented under the caption Due from Commonwealth – Chapter 645 in the General Fund balance sheet.

11. Contingencies:

Various legal actions and claims are pending against the City. Litigation is subject to many uncertainties, and the outcome of individual litigated matters is not always predictable. Although the amount of liability, if any, at June 30, 2001, cannot be ascertained, management believes any resulting liability should not materially affect the financial position of the City at June 30, 2001.

The City participates in a number of federal financial assistance programs. Although the City grant programs have been audited in accordance with the provisions of the Single Audit Act Amendments of 1996, these programs are still subject to financial and compliance audits. The amount, if any, of expenditures which may be disallowed by the granting agencies 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 its long-term borrowings. 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.

In March 1993, the City was awarded approximately \$1,800,000 in damages as a result of a lawsuit against the Commonwealth of Massachusetts. The state has filed an appeal, and no judgment has been rendered by the Appeals Court. Accordingly, this judgment has not been recognized in the City's general purpose financial statements.

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

12. Retirement System:

(a) Plan Description

The City contributes to the City of Salem Contributory Retirement System (the Plan), a multiple employer defined benefit pension plan, established under Chapter 32 of the General Laws of the Commonwealth of Massachusetts. The Plan is administered by the City of Salem and is part of the reporting entity. A stand alone annual statement was issued for the year ended December 31, 2000. This report is available at the Retirement Office, 93 Washington Street, Salem, Massachusetts.

Substantially all full-time employees of the City, except teachers and certain administrative personnel employed by the School Department, participate in the Plan. The members of the retirement system do not participate in the Social Security System. Benefits paid under the Plan, 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 City's payroll for employees covered by the Plan for the year ended December 31, 2000, was approximately \$25,400,000.

Teachers and certain administrative employees of the School Department participate in a contributory retirement plan administered by the Massachusetts Teachers Retirement Board. Contributions to this plan totaled \$4,505,009 and were made entirely by the Commonwealth of Massachusetts on behalf of the City does not contribute directly to this plan.

Membership

Current membership in the Plan as of December 31, 2000, is as follows:

Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits but not yet receiving them	611
Active employees	895
Inactive employees	<u>53</u>
	<u>1,559</u>

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

12. Retirement System - continued:

(b) 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 a portion of the interest they generate constitute the annuity. The differential between the total retirement benefit and annuity is the pension.

In previous years, the Legislature granted cost-of-living increases to benefits being paid to retirees. These increases were 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 individual communities. These communities are responsible for the full 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 previously granted to those who received support under the old method, but only for the duration of the retirees' 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 either 0%, 50% or 100% of the regular interest which 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.

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

12. Retirement System - continued:

(b) Benefits - continued

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.

(c) 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 GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

12. Retirement System - continued:

(d) Contribution Requirements and Contributions Made

The Plan'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 Plan 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.

The employer contribution to the Plan for the year ended December 31, 2000, 1999, and 1998 were \$3,813,000; \$3,474,477; and \$3,365,633 respectively, which equaled its required contribution for each year.

(e) 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.

Required disclosures under Governmental Accounting Standards Board's Statements No. 25 and 27 are included in this report under the caption "Required Supplementary Information".

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

13. Risk Financing:

The City has established a self-insured medical program which is accounted for in the Health Claims Trust Fund, an expendable trust fund. Both employees and the City contribute to the payment of medical claims based upon 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 expendable trust 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, 2001.

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.

The City engages an independent insurance carrier for all casualty insurance.

Activity regarding these accounts for the year ended June 30, 2001 is as follows:

Liability at beginning of year	\$ 234,921
Provision for losses	6,992,002
Payment for claims	<u>(6,857,914)</u>
Balance at end of year	<u>\$ 369,009</u>

**CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001**

14. Fund Deficits:

The City incurred legal deficits in its Capital Projects Fund in the amount of \$17,882,945 which will be raised through future bond issuances and in state and county assessments in the amount of \$134,695, which is anticipated to be raised on future tax recapitulation sheets.

15. Stabilization:

In accordance with Massachusetts General Laws, the City has established a stabilization fund to be utilized as an additional reserve fund. The fund is subject to appropriation at the discretion of the Emergency Finance Board and a two-thirds vote of the City Council. The activities of this fund, which had a balance of approximately \$1,713,800 as of June 30, 2001, is accounted for as an Expendable Trust Fund.

16. Prior Period Adjustment:

Prior period beginning General Fund balance amounts were adjusted to reflect a change in accounting treatment for certain receivables. Additionally, the beginning long-term debt balances were restated lower by \$96,400 to conform to the current year presentation.

CITY OF SALEM, MASSACHUSETTS
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - CONTINUED
YEAR ENDED JUNE 30, 2001

16. Segment Information for Enterprise Funds:

The City maintains Enterprise funds which provide water and sewer services. Segment information not including joint venture activity for the year ended June 30, 2001 follows:

	Water	Sewer	Total
Revenues	\$ 3,315,709	\$ 6,526,918	\$ 9,842,627
Expenses	(2,464,000)	(6,194,922)	(8,658,922)
Debt Expense:			
Principal	(170,000)		(170,000)
Interest	(22,149)		(22,149)
Transfer(s) In			
Indirect Costs Paid to the General Fund	(431,295)	(431,295)	(862,590)
Transfer(s) Out	_____	_____	_____
Net Income (Deficit)	228,265	(99,299)	128,966
Retained Earnings July 1, 2000	<u>1,864,024</u>	<u>1,528,379</u>	<u>3,392,403</u>
Retained Earnings June 30, 2001	<u>\$ 2,092,289</u>	<u>\$ 1,429,080</u>	<u>\$ 3,521,369</u>

**CITY OF SALEM, MASSACHUSETTS
REQUIRED SUPPLEMENTARY INFORMATION
STATEMENT OF PLAN NET ASSETS
DECEMBER 31, 2000**

ASSETS

CASH AND CASH EQUIVALENTS	<u>\$3,893,754</u>
INVESTMENTS (at fair value):	
Bonds	24,475,739
Stocks	17,085,352
Pooled funds:	
Domestic Equity	8,553,791
International Equity	6,665,798
Real Estate	5,009,729
Venture Capital	<u>7,545,843</u>
Total Investments	<u>69,336,252</u>
RECEIVABLES:	
Dividends and interest	410,144
Employer contributions	87,774
Commonwealth of Massachusetts	<u>190,443</u>
Total Receivables	<u>688,361</u>
Total Assets	<u>73,918,367</u>

LIABILITIES

PAYABLES:	
Accounts payable and accrued expenses	84,735
Due to other government	<u>25,618</u>
Total Liabilities	<u>110,353</u>

<u>PLAN NET ASSETS HELD IN TRUST FOR PENSION BENEFITS</u>	<u><u>\$73,808,014</u></u>
--	----------------------------

**CITY OF SALEM, MASSACHUSETTS
REQUIRED SUPPLEMENTARY INFORMATION
STATEMENT OF CHANGES IN PLAN NET ASSETS
YEAR ENDED DECEMBER 31, 2000**

ADDITIONS

Contributions:	
Employer	\$4,603,981
Employee	2,222,256
From Commonwealth of Massachusetts	686,830
From Federal grant	28,063
Transfers from other systems	213,779
Reimbursements from other systems	86,821
Investment Income	4,142,596
Net gain (loss) on investments (including realized and unrealized gains and losses)	<u>(1,753,601)</u>
Total Additions	<u>10,230,725</u>

DEDUCTIONS

Benefit payments to retirees and surviving spouses	7,897,742
Refunds:	
Members leaving	234,190
Option B	106,872
Reimbursement to other systems	174,608
Transfers to other systems	206,448
Payroll expenses of the System	162,386
Other administrative expenses	<u>423,662</u>
Total Deductions	<u>9,205,908</u>

INCREASE IN NET ASSETS	<u>1,024,817</u>
------------------------	------------------

NET ASSETS HELD IN TRUST FOR PENSION BENEFITS

Beginning of year	<u>\$72,783,197</u>
End of year	<u><u>\$73,808,014</u></u>

**CITY OF SALEM, MASSACHUSETTS
REQUIRED SUPPLEMENTARY INFORMATION
OTHER REQUIRED PENSION DISCLOSURES
YEAR ENDED DECEMBER 31, 2000**

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)
01/01/99	\$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 FROM EMPLOYERS:

Year Ended December 31,	Annual Required Contribution	Percentage Contributed
2000	\$4,452,134	100%
1999	4,410,289	100%
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%

NOTE TO SCHEDULES:

Additional information as of the latest actuarial valuation follows:

Valuation date:	January 1, 1997
Actuarial cost method:	Individual entry age normal actuarial cost
Amortization method:	Required payments increase at 4.5% per year
Remaining amortization period:	24 years
Asset valuation method:	Fair value
Investment rate of return:	8.5%
Projected salary increases:	6.0%
Cost-of-living adjustments:	None

TUCCI & ROSELLI

CERTIFIED PUBLIC ACCOUNTANTS
MANAGEMENT CONSULTANTS

**Independent Auditors' Report on Compliance and Internal Control Over
Compliance Applicable to Massachusetts School Districts –
Unqualified Opinion on Compliance**

To the City Council and Mayor
City of Salem, Massachusetts

Compliance

We have audited the compliance of City of Salem, Massachusetts, with the types of compliance requirements described in the Massachusetts Department of Education's Compliance Supplement applicable to Massachusetts School Districts for the year ended June 30, 2001. Compliance with the requirements of laws, regulations, contracts, and grants applicable to Massachusetts School Districts is the responsibility of City of Salem, Massachusetts' management. Our responsibility is to express an opinion on City of Salem, Massachusetts' compliance based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States and the Massachusetts Department of Education Compliance Supplement. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on Massachusetts School Districts programs occurred. An audit includes examining, on a test basis, evidence about City of Salem, Massachusetts' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit department does not provide a legal determination on City of Salem, Massachusetts' compliance with those requirements.

In our opinion, City of Salem, Massachusetts complied, in all material respects, with the requirements referred to above that are applicable to Massachusetts School Districts for the year ended June 30, 2001.

Internal Control Over Compliance

The management of City of Salem, Massachusetts, is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contract, and grants applicable to Massachusetts School Districts. In planning and performing our audit, we considered City of Salem, Massachusetts' internal control over compliance with requirements that could have a direct and material effect on its ability to accurately report year-end information in accordance with Massachusetts DOE requirements in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of law, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the audit committee, management, state funding agencies, and the Massachusetts Department of Education. However, this report is a matter of public record and its distribution is not limited.

Tucci & Roselli

Tucci & Roselli
Certified Public Accountants
October 12, 2001