

**OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES**

**AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL**

**AREA DE ARCHIVO DIGITAL**

**MUNICIPIO DE HATILLO**

**AUDITORIA 2003-2004**

**30 DE JUNIO DE 2004**

RECIBO DEL COMISIONADO  
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**MUNICIPALITY OF HATILLO, PUERTO RICO**  
**BASIC FINANCIAL STATEMENTS AND SUPPLEMENTAL SCHEDULES**  
**"SINGLE AUDIT REPORT"**  
**YEAR ENDED JUNE 30, 2004**  
**(WITH INDEPENDENT AUDITORS REPORT THEREON)**

**GONZÁLEZ TORRES & CO., PSC**  
**Certified Public Accountants & Consultants**

# MUNICIPALITY OF HATILLO

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**MANAGEMENT DISCUSSION AND ANALYSIS**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of the Municipality of Hatillo (the "Municipality") implemented Statement No. 34 ("Statement") of the Governmental Accounting Standards Board ("GASB"), Basic Financial Statements and Management's Discussion and Analysis for States and Local Governments, for the fiscal year ended on June 30, 2004. This Management's Discussion and Analysis (MD&A) is prepared as a result of the requirements of such Statement, and it has been designed accordingly with the following goals:

- a) Assist the reader in focusing on significant financial issues
- b) Provide an overview of the Municipality's financial activity
- c) Identify changes in the Municipality's financial position (its ability to address the next and subsequent year challenges)
- d) Identify any material deviations from the financial plan (the approved budget), and identify individual fund issues or concerns.

Since the MD&A is designed to focus on the current year activities, resulting changes and currently known facts, please read it in conjunction with the Municipality's financial statements.

### FINANCIAL HIGHLIGHTS

- The Municipality net assets increased by \$223,457.
- In the fund financial statements, the governmental activities revenue decreased \$2,060,402 (or 11.34%) while governmental activities expenditures decreased \$2,444,862 (or 12.58%).
- On a budgetary basis, actual revenues exceeded actual expenditures by \$274,676.
- The business-type activity closed with net assets of \$762,954.
- The Municipality issued bonds amounting to \$800,000 to finance business type activities operations.

### USING THIS ANNUAL REPORT

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

#### Government-wide Financial Statements

The Government-wide Financial Statements are designed to provide users of the financial statements with a broad overview of the Municipality's finances in a manner similar to private-sector companies.

The Statement of Net Assets presents information on all of the Municipality's assets and liabilities, with the difference both reported as net assets. Overtime, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Municipality is improving or deteriorating.

The Statement of Activities presents information showing how the Municipality'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 the related cash flows. Thus, revenues and expenses are reported in the Statement of Activities that will only result in cash flows in future fiscal periods. The Statement of Activities is focused on both the gross and net cost of various activities, which are provided by the government's general tax and other revenues. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS CONTINUES**

### **Fund Financial Statements**

The Fund Financial Statements provide detailed information about the Municipality's most significant funds, not the Municipality as a whole. The Municipality has only one kind of fund which is the governmental fund.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the Government Wide Financial Statements focus on near term inflows and outflows of expendable resources, as well as on balances of expendable resources available at the end of the fiscal year. Such information is useful in evaluating the Municipality's near term financial 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, users of the basic financial statements may better understand the long-term impact of the Municipality's near term financial decisions. Both of the Governmental Fund Balance Sheet and the Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

### **Infrastructure Assets**

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

The infrastructure assets are accounted for as of June 30, 2004. Also, the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

### **Net Assets**

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. The Municipality's unrestricted net assets deficit (excess of liabilities over assets) totaled \$1.56 millions at the end of 2004, and the net assets as of June 30, 2004 amounted to \$38.9 millions.

**Municipality of Hatillo**  
**Condensed Statement of Net Assets**  
**June 30, 2004**

|   | <b>Governmental</b>  | <b>Business-type<br/>Activities</b> |
|---|----------------------|-------------------------------------|
| Current assets                                  | \$ 6,841,773         | \$ 340,619                          |
| Capital assets                                  | 41,066,855           | 4,935,531                           |
| Other assets                                    | <u>5,765,161</u>     | <u>800,000</u>                      |
| Total assets                                    | <u>53,673,789</u>    | <u>6,076,150</u>                    |
| <br>  |                      |                                     |
| Current liabilities                             | 3,987,731            | 196,149                             |
| Non-current liabilities                         | <u>10,477,587</u>    | <u>5,117,047</u>                    |
| Total liabilities                               | <u>14,465,318</u>    | <u>5,313,196</u>                    |
| <br>  |                      |                                     |
| Invested in capital assets, net of related debt | 36,705,056           | 633,931                             |
| Restricted                                      | 3,785,123            | -                                   |
| Unrestricted                                    | <u>( 1,557,190)</u>  | <u>129,023</u>                      |
| Total net assets                                | <u>\$ 38,932,989</u> | <u>\$ 762,954</u>                   |

**Changes in Net Assets**

The Municipality's net assets increased by \$223,457. Approximately 55.08 percent of the Municipality's total revenue came from taxes, while 39.92 percent resulted from grants and contributions, including federal aid. Charges for Services provided 3.99 percent of the total revenues and interests and donations 1.01 percent. The Municipality's expenses cover a range of services. The largest expenses were for health and welfare services, general government, public works, and urban development

**Municipality of Hatillo**  
**Condensed Statement of Activities**  
**June 30, 2004**

|  | <b>Governmental</b>  | <b>Business-type<br/>Activities</b> |
|--|----------------------|-------------------------------------|
| <b>Program revenues:</b>                                     |                      |                                     |
| Charges for services   | \$ 300,825           | \$ 481,672                          |
| Operating grants and contributions                           | 699,939              | -                                   |
| Capital grants and contributions                             | 833,600              | -                                   |
| <b>General revenues:</b>                                     |                      |                                     |
| Property taxes   | 7,684,785            | -                                   |
| Municipal license tax  | 3,120,169            | -                                   |
| Grants and contributions not restricted to specific programs | 6,296,195            | -                                   |
| Interest and investment earnings                             | 135,242              | -                                   |
| Donations  | 63,000               | -                                   |
| Transfer   | <u>( 2,216,092)</u>  | <u>2,216,092</u>                    |
| <b>Total revenues</b>  | <u>16,917,663</u>    | <u>2,697,764</u>                    |
| <b>Expenses:</b>   |                      |                                     |
| General  | 5,193,470            | 319,144                             |
| Public safety  | 437,932              | -                                   |
| Public works   | 4,241,114            | -                                   |
| Culture and recreation                                       | 1,028,668            | -                                   |
| Health and welfare   | 2,283,507            | -                                   |
| Education  | 28,704               | -                                   |
| Interest on long-term debt                                   | 502,642              | 382,031                             |
| Depreciation   | -                    | 17,981                              |
| Loss on disposal of assets                                   | <u>8,088</u>         | <u>200</u>                          |
| <b>Total expenses</b>  | <u>13,724,037</u>    | <u>719,356</u>                      |
| <b>Change in net assets</b>                                  | <b>3,193,538</b>     | <b>1,978,408</b>                    |
| <b>Net assets, beginning of year</b>                         | <u>38,709,532</u>    | <u>334,349</u>                      |
| <b>Prior period adjustment</b>                               | <b>( 2,694,599)</b>  | <b>( 1,549,803)</b>                 |
| <b>Net assets, beginning as restated</b>                     | <u>35,739,45</u>     | <u>( 1,215,454)</u>                 |
| <b>Net assets, end of year</b>                               | <u>\$ 38,932,989</u> | <u>\$ 762,954</u>                   |

## **MANAGEMENT'S DISCUSSION AND ANALYSIS CONTINUES**

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

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

#### **Governmental Funds**

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

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$7.9 million, an increase of \$607,605 in comparison with the prior year. There are reservations of fund balance amounting to \$5.5 million. This is the fund balance that is not available for new spending because it has already been committed; 1) to pay debt service (\$1.3 million), 2) to pay for capital projects (\$1.8 million), 3) for special revenues fund (\$1.7 million), 4) for encumbrances \$223,067, and for other purposes \$519,010.

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2004, the general fund has an unrestricted balance of 2.4 million.

### **GENERAL FUND BUDGETARY HIGHLIGHTS**

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

### **CAPITAL ASSETS AND DEBT ADMINISTRATION**

#### **Capital Assets**

The Municipality's investment in capital assets as of June 30, 2004, amounts to \$52.5 millions, net of accumulated depreciation of \$11.4 millions, leaving a net book value of \$41.1 million. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, lighting systems, and similar items.

The total increase in the Municipality's investment in capital assets for the current fiscal year was about 1.9% in terms of net book value. Depreciation charges for the year totaled \$636,347. This amount included \$618,366 for general fund and \$17,981 for enterprise fund.

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

## **MANAGEMENT'S DISCUSSION AND ANALYSIS CONTINUES**

### **Debt Administration**

The Puerto Rico Legislature has established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each Municipality may be pledged. See "Limitations on Ability of Municipalities to Issue General Obligation Debt - The Municipal Bonds" for a general description of such limitations. The Municipality outstanding general obligation debt as of June 30, 2004, is \$11.9 millions.

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

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

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

The Municipality relies primarily on property and municipal taxes as well as Federal Grants to carry out the government activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal Grant Revenues may vary if new grants are available but the revenue also is very predictable.

Those factors were considered when preparing the Municipality's budget for the 2003-2004 fiscal year.

### **FINANCIAL CONTACT**

The Municipality's financial statements are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer.

**INDEPENDENT AUDITOR'S REPORT**

# GONZÁLEZ TORRES & Co.

*Certified Public Accountants and Consultants*

Member of:  
Puerto Rico Society of Certified Public Accountants  
American Institute of Certified Public Accountants  
Association of Certified Fraud Examiners



## INDEPENDENT AUDITORS REPORT

Honorable Mayor and Municipal Council  
Municipality of Hatillo, Puerto Rico  
Hatillo, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, business - type activities, each major fund, and the aggregate remaining fund information of the Municipality of Hatillo, Puerto Rico, as of and for the year ended June 30, 2004, which collectively comprise the Municipality's financial statements as listed in the table of contents. Our responsibility is to express an opinion of these 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 respective financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit and the report of other auditors provide 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, business type activities, each major fund, and the aggregate remaining fund information of the Municipality's of Hatillo as of June 30, 2004, and the respective changes in financial position and cash flow, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1, the Municipality has implemented a new financial reporting model, as required by the provisions of Governmental Accounting Standards Board ("GASB") Statement No. 34, Basic Financial Statements-and Management's Discussion and Analysis for States and Local Governments.

In accordance with Government Auditing Standards, we have also issued our report dated December 3, 2004, on our consideration of the Municipality of Hatillo internal control over financial reporting and on 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.

The Management's Discussion and Analysis and budgetary comparison information on pages 1 through 7 and 49 through 51, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

**INDEPENDENT AUDITORS REPORT**  
(Continues)

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Hatillo, basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is also not a required part of the basic financial statements of Municipality of Hatillo. The schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

December 3, 2004  
San Juan, Puerto Rico

The stamp number 2017697  
was affixed to the original of this report.



*Gonzalez Torres & Co. P.R.*  
GONZALEZ TORRES & CO., PSC  
License number 96  
Expires December 1, 2005

**BASIC FINANCIAL STATEMENTS**

**MUNICIPALITY OF HATILLO**  
**STATEMENT OF NET ASSETS**  
**JUNE 30, 2004**

|  | <b>Primary Government</b>          |   |   |
|--|------------------------------------|---|---|
|  | <b>Governmental<br/>Activities</b> | <b>Business<br/>Type<br/>Activities</b> | <b>Total<br/>Primary<br/>Government</b> |
| <b>ASSETS</b>  |                                    |   |   |
| Cash including \$5,050,000 in certificates of deposits | \$ 4,888,351                       | \$ 340,619                              | \$ 5,228,970                            |
| Receivables, net                                       |                                    |   |   |
| Municipal license taxes                                | 121,117                            | -                                       | 121,117                                 |
| Rents and construction permits                         | 82,773                             | -                                       | 82,773                                  |
| Other  | 2,588                              | -                                       | 2,588                                   |
| Due from:  |                                    |   |   |
| Commonwealth Government                                | 1,400,218                          | -                                       | 1,400,218                               |
| Federal Government                                     | 346,726                            | -                                       | 346,726                                 |
| Restricted assets:                                     |                                    |   |   |
| Cash   | 2,114,133                          | -                                       | 2,114,133                               |
| Cash with fiscal agents                                | 3,651,028                          | 800,000                                 | 4,451,028                               |
| Capital assets:  |                                    |   |   |
| Land and construction in progress                      | 23,286,115                         | 4,021,403                               | 27,307,518                              |
| Other capital assets, net                              | 17,780,740                         | 914,128                                 | 18,694,868                              |
| Total capital assets, net                              | <u>41,066,855</u>                  | <u>4,935,531</u>                        | <u>46,002,386</u>                       |
| <b>Total assets</b>                                    | <b><u>\$ 53,673,789</u></b>        | <b><u>\$ 6,076,150</u></b>              | <b><u>\$ 59,749,939</u></b>             |
| <b>LIABILITIES</b>                                     |                                    |   |   |
| Accounts payable and accrued liabilities               | 1,062,109                          | 14,822                                  | 1,076,931                               |
| Interest Payable                                       | 288,117                            | 126,487                                 | 414,604                                 |
| Due to:  |                                    |   |   |
| Commonwealth Government                                | 182,044                            | -                                       | 182,044                                 |
| Federal Government                                     | 9,884                              | -                                       | 9,884                                   |
| Interfund  | (54,840)                           | 54,840                                  | -                                       |
| Deferred revenues:                                     |                                    |   |   |
| Municipal license taxes                                | 2,492,968                          | -                                       | 2,492,968                               |
| Federal grants   | 7,449                              | -                                       | 7,449                                   |
| Long term liabilities :                                |                                    |   |   |
| Due within one year                                    | 1,264,177                          | 133,047                                 | 1,397,224                               |
| Due in more than one year                              | 9,488,892                          | 4,984,000                               | 14,472,892                              |
| Total liabilities                                      | <u>14,740,800</u>                  | <u>5,313,196</u>                        | <u>20,053,996</u>                       |
| <b>NET ASSETS</b>                                      |                                    |   |   |
| Invested in capital assets, net of related debt        | 36,705,056                         | 633,931                                 | 37,338,987                              |
| Restricted for:  |                                    |   |   |
| Capital projects                                       | 288,603                            | -                                       | 288,603                                 |
| Debt service   | 1,792,870                          | -                                       | 1,792,870                               |
| Other specified purposes                               | 1,703,650                          | -                                       | 1,703,650                               |
| Unrestricted (deficit)                                 | (1,557,190)                        | 129,023                                 | (1,428,167)                             |
| Total net assets                                       | <u>\$ 38,932,989</u>               | <u>\$ 762,954</u>                       | <u>\$ 39,695,943</u>                    |

The accompanying notes are an integral part of this statement.

**MUNICIPALITY OF HATILLO**  
**STATEMENT OF ACTIVITIES**  
**FISCAL YEAR ENDED JUNE 30, 2004**

| Functions                                  | Expenses             | Program Revenues                     |  |                                  | Net (expenses) revenue and changes in net assets |                          |                        |
|--|----------------------|--------------------------------------|--|----------------------------------|--|--------------------------|------------------------|
|  |                      | Fees, Fines and Charges for Services | Operating Grants and Contributions                       | Capital Grants and Contributions | Governmental Activities                          | Business Type Activities | Total                  |
| <b>Governmental Activities:</b>            |                      |                                      |  |                                  |  |                          |                        |
| General government                         | \$ 5,193,470         | \$ 300,825                           | \$ -   | \$ -                             | \$ (4,892,645)                                   | \$ -                     | \$ (4,892,645)         |
| Public works and sanitation                | 4,241,114            | -                                    | -  | 141,845                          | (4,099,169)                                      | -                        | (4,099,169)            |
| Public safety                              | 437,932              | -                                    | -  | -                                | (437,932)  | -                        | (437,932)              |
| Health                                     | 657,911              | -                                    | -  | -                                | (657,911)  | -                        | (657,911)              |
| Recreation                                 | 1,028,668            | -                                    | -  | -                                | (1,028,668)                                      | -                        | (1,028,668)            |
| Housing, welfare and community development | 1,625,596            | -                                    | 699,939  | 691,655                          | (234,002)  | -                        | (234,002)              |
| Education                                  | 28,704               | -                                    | -  | -                                | (28,704)   | -                        | (28,704)               |
| Interest on long term debt                 | 502,642              | -                                    | -  | -                                | (502,642)  | -                        | (502,642)              |
| <b>Total</b>                               | <b>\$ 13,716,037</b> | <b>\$ 300,825</b>                    | <b>\$ 699,939</b>  | <b>\$ 833,600</b>                | <b>\$ (11,881,673)</b>                           | <b>\$ -</b>              | <b>\$ (11,881,673)</b> |
| <b>Business Type Activities:</b>           |                      |                                      |  |                                  |  |                          |                        |
| Recreation                                 | 719,356              | 481,672                              | -  | -                                | -  | (237,684)                | (237,684)              |
| Total business type activities             | 719,356              | 481,672                              | -  | -                                | -  | (237,684)                | (237,684)              |
| <b>Totals</b>                              | <b>\$ 14,435,393</b> | <b>\$ 782,497</b>                    | <b>\$ 699,939</b>  | <b>\$ 833,600</b>                | <b>\$ (11,881,673)</b>                           | <b>\$ (237,684)</b>      | <b>\$ (12,119,357)</b> |
|  |                      |                                      |  |                                  |  |                          |                        |
|  |                      |                                      | <b>General revenues</b>                                  |                                  |  |                          |                        |
|  |                      |                                      | Property taxes   |                                  | 7,534,761  | -                        | 7,534,761              |
|  |                      |                                      | Municipal license taxes                                  |                                  | 3,120,169  | -                        | 3,120,169              |
|  |                      |                                      | Grants and contributions not restricted to specific prog |                                  | 5,773,209  | -                        | 5,773,209              |
|  |                      |                                      | Interest   |                                  | 135,242  | -                        | 135,242                |
|  |                      |                                      | Operating Transfers                                      |                                  | (2,216,092)                                      | 2,216,092                | -                      |
|  |                      |                                      | Capital Assets Donations                                 |                                  | 63,000   | -                        | 63,000                 |
|  |                      |                                      | Loss on Disposal of Assets                               |                                  | (8,088)  | -                        | (8,088)                |
|  |                      |                                      | Special Item   |                                  | 673,010  | -                        | 673,010                |
|  |                      |                                      | <b>Total</b>   |                                  | <b>15,075,211</b>                                | <b>2,216,092</b>         | <b>17,291,303</b>      |
|  |                      |                                      | <b>Change in net assets</b>                              |                                  | <b>3,193,538</b>                                 | <b>1,978,408</b>         | <b>5,171,946</b>       |
|  |                      |                                      | <b>Net assets-beginning, as restated</b>                 |                                  | <b>35,739,451</b>                                | <b>(1,215,454)</b>       | <b>34,523,997</b>      |
|  |                      |                                      | <b>Net assets-ending</b>                                 |                                  | <b>\$ 38,932,989</b>                             | <b>762,954</b>           | <b>39,695,943</b>      |

The accompanying notes are an integral part of this statement.

MUNICIPALITY OF HATILLO

BALANCE SHEET  
GOVERNMENTAL FUNDS  
JUNE 30, 2004

|   | General             | State<br>Legislative<br>Resolutions | Debt<br>Service<br>Fund | Other<br>Governmental<br>Funds | Total<br>Governmental<br>Funds |
|---|---------------------|-------------------------------------|-------------------------|--------------------------------|--------------------------------|
| <b>ASSETS</b>   |                     |                                     |                         |                                |                                |
| Cash, including \$4,900,000 in certificates of deposits | \$ 4,625,357        | \$ -                                | \$ -                    | \$ 262,994                     | \$ 4,888,351                   |
| Receivables, net:                                       |                     |                                     |                         |                                |                                |
| Municipal license taxes                                 | 121,117             | -                                   | -                       | -                              | 121,117                        |
| Rents and others  | 137,653             | -                                   | -                       | 2,648                          | 140,201                        |
| Due from:   |                     |                                     |                         |                                |                                |
| Commonwealth Government                                 | 680,402             | 665,394                             | -                       | 54,422                         | 1,400,218                      |
| Federal Government                                      | -                   | -                                   | -                       | 348,726                        | 348,726                        |
| Other funds   | 756,779             | -                                   | -                       | -                              | 756,779                        |
| Restricted assets:                                      |                     |                                     |                         |                                |                                |
| Cash  | -                   | 1,468,205                           | -                       | 645,828                        | 2,114,133                      |
| Cash with fiscal agents                                 | -                   | -                                   | 2,080,987               | 1,570,041                      | 3,651,028                      |
| <b>Total assets</b>                                     | <b>\$ 6,321,208</b> | <b>\$ 2,133,599</b>                 | <b>\$ 2,080,987</b>     | <b>\$ 2,882,759</b>            | <b>\$ 13,418,553</b>           |
| <b>LIABILITIES</b>                                      |                     |                                     |                         |                                |                                |
| Accounts payable and accrued liabilities                | \$ 532,407          | \$ 269,351                          | -                       | \$ 260,350                     | \$ 1,062,108                   |
| Matured bonds and interest payable                      | -                   | -                                   | 763,117                 | -                              | 763,117                        |
| Due to:   |                     |                                     |                         |                                |                                |
| Commonwealth Government                                 | 182,044             | -                                   | -                       | -                              | 182,044                        |
| Federal Government                                      | -                   | -                                   | -                       | 9,884                          | 9,884                          |
| Other funds   | -                   | 402,333                             | -                       | 354,446                        | 756,779                        |
| Deferred revenues:                                      |                     |                                     |                         |                                |                                |
| Municipal license taxes                                 | 2,492,968           | -                                   | -                       | -                              | 2,492,968                      |
| Intergovernmental-Commonwealth Government               | 226,936             | -                                   | -                       | -                              | 226,936                        |
| Federal grants  | -                   | -                                   | -                       | 7,449                          | 7,449                          |
| <b>Total liabilities</b>                                | <b>3,434,355</b>    | <b>671,684</b>                      | <b>763,117</b>          | <b>632,129</b>                 | <b>5,501,285</b>               |
| <b>FUND BALANCES</b>                                    |                     |                                     |                         |                                |                                |
| Reserved for:   |                     |                                     |                         |                                |                                |
| Encumbrances  | 307,712             | -                                   | -                       | -                              | 307,712                        |
| Debt service  | -                   | -                                   | 1,317,870               | -                              | 1,317,870                      |
| Capital projects  | -                   | -                                   | -                       | 1,797,599                      | 1,797,599                      |
| Other specified purposes                                | 223,067             | 1,461,915                           | -                       | 453,031                        | 2,138,013                      |
| Undesignated  | 2,356,074           | -                                   | -                       | -                              | 2,356,074                      |
| <b>Total fund balances</b>                              | <b>2,886,853</b>    | <b>1,461,915</b>                    | <b>1,317,870</b>        | <b>2,250,630</b>               | <b>7,917,268</b>               |
| <b>Total liabilities and fund balances</b>              | <b>\$ 6,321,208</b> | <b>\$ 2,133,599</b>                 | <b>\$ 2,080,987</b>     | <b>\$ 2,882,759</b>            | <b>\$ 13,418,553</b>           |

The accompanying notes are an integral part of this statement.

**MUNICIPALITY OF HATILLO**  
**RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCE**  
**TO NET ASSETS OF GOVERNMENTAL ACTIVITIES**  
**JUNE 30, 2004**

**Total governmental fund balances:** **\$ 7,917,268**

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

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds: 41,066,855

Other assets are not available to pay for current-period expenditures and therefore are deferred in the funds:

|                                    |                |         |
|------------------------------------|----------------|---------|
| Property Tax Liquidation from CRIM | \$ 83,379      |         |
| Christmas bonus                    | <u>143,557</u> | 226,936 |

Long term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds:

|   |                  |              |
|---|------------------|--------------|
| General obligation bonds and notes          | \$ (6,344,420)   |              |
| Compensated absences                        | (1,268,123)      |              |
| Debt to The Health Reform                   | (918,047)        |              |
| Doubtful accounts debt payable to CRIM      | (356,923)        |              |
| Christmas bonus                             | (287,113)        |              |
| LIMS Reimbursement to CRIM                  | (327,962)        |              |
| Landfill Closure and Postclosure Care Costs | <u>(775,482)</u> | (10,278,070) |

**Net assets of governmental activities:** **\$ 38,932,989**

The accompanying notes are an integral part of this statement.

MUNICIPALITY OF HATILLO

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES-  
GOVERNMENTAL FUNDS  
FISCAL YEAR ENDED JUNE 30, 2004

|   | General             | State<br>Legislative<br>Resolutions | Debt<br>Service<br>Fund | Other<br>Governmental<br>Funds | Total<br>Governmental<br>Funds |
|---|---------------------|-------------------------------------|-------------------------|--------------------------------|--------------------------------|
| <b>Revenues</b>                                       |                     |                                     |                         |                                |                                |
| Property taxes  | \$ 5,887,122        | \$ -                                | \$ 1,564,260            | \$ -                           | \$ 7,451,382                   |
| Municipal license taxes                               | 3,120,169           | -                                   | -                       | -                              | 3,120,169                      |
| Intergovernmental :                                   |                     |                                     |                         |                                |                                |
| Commonwealth government                               | 3,630,812           | 1,206,584                           | -                       | 573,742                        | 5,411,138                      |
| Federal government                                    | -                   | -                                   | -                       | 1,533,538                      | 1,533,538                      |
| Fees, fines and charges for services                  | 300,825             | -                                   | -                       | -                              | 300,825                        |
| Interest  | 120,541             | -                                   | 14,290                  | 411                            | 135,242                        |
| Other   | 146,663             | -                                   | -                       | 71,863                         | 218,526                        |
| Total revenues  | <u>13,206,132</u>   | <u>1,206,584</u>                    | <u>1,578,550</u>        | <u>2,179,554</u>               | <u>18,170,820</u>              |
| <b>Expenditures</b>                                   |                     |                                     |                         |                                |                                |
| General government                                    | 4,468,344           | -                                   | -                       | 445,136                        | 4,913,480                      |
| Public works and sanitation                           | 3,816,434           | -                                   | -                       | 3,905                          | 3,820,339                      |
| Public safety   | 359,670             | -                                   | -                       | -                              | 359,670                        |
| Culture and recreation                                | 824,905             | -                                   | -                       | 5,892                          | 830,797                        |
| Health  | 657,911             | -                                   | -                       | -                              | 657,911                        |
| Housing, welfare and community development            | 487,646             | 371,513                             | -                       | 672,237                        | 1,531,396                      |
| Others  | 32,293              | -                                   | -                       | 36                             | 32,329                         |
| Capital outlays                                       | 1,633,403           | 581,989                             | -                       | 3,334,701                      | 5,550,093                      |
| Debt service:   |                     |                                     |                         |                                |                                |
| Principal   | 398,813             | -                                   | 605,000                 | -                              | 1,003,813                      |
| Interest  | -                   | -                                   | 728,186                 | -                              | 728,186                        |
| Total expenditures                                    | <u>12,679,419</u>   | <u>953,502</u>                      | <u>1,333,186</u>        | <u>4,461,907</u>               | <u>19,428,014</u>              |
| Excess (deficiency) of revenues over expenditures:    | 526,713             | 253,082                             | 245,364                 | (2,282,353)                    | (1,257,194)                    |
| <b>Other financing sources (uses)</b>                 |                     |                                     |                         |                                |                                |
| Transfers in from other funds                         | 519,140             | -                                   | -                       | 262,994                        | 782,134                        |
| Transfers out from other funds                        | (262,994)           | -                                   | (519,140)               | -                              | (782,134)                      |
| Special Items   | 673,010             | -                                   | -                       | -                              | 673,010                        |
| Total other financing sources (uses)                  | <u>929,156</u>      | <u>-</u>                            | <u>(519,140)</u>        | <u>262,994</u>                 | <u>673,010</u>                 |
| <b>Net change in fund balance</b>                     | 1,455,869           | 253,082                             | (273,776)               | (2,019,359)                    | (584,184)                      |
| <b>Fund balance at beginning of year, as restated</b> | <u>1,430,984</u>    | <u>1,208,833</u>                    | <u>1,591,646</u>        | <u>4,269,989</u>               | <u>8,501,452</u>               |
| <b>Fund balance at end of year</b>                    | <u>\$ 2,886,853</u> | <u>\$ 1,461,915</u>                 | <u>\$ 1,317,870</u>     | <u>\$ 2,250,630</u>            | <u>\$ 7,917,268</u>            |

The accompanying notes are an integral part of this statement.

MUNICIPALITY OF HATILLO

RECONCILIATION OF STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN  
FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES  
FISCAL YEAR ENDED JUNE 30, 2004

Net change in fund balances-total governmental funds: \$ (584,184)

Amounts reported for governmental activities in the Statement of activities are different because:

Governmental funds reports capital assets 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:

|                                 |                  |           |
|---------------------------------|------------------|-----------|
| Expenditures for capital assets | \$ 3,674,032.00  |           |
| Less: current year depreciation | <u>(818,366)</u> | 3,055,666 |

Governmental funds only report the proceeds received in the disposal of assets. In the Statement of Activities, a gain or loss is reported for each disposal. Thus, the change in net assets differs from the change in fund balance by the cost of the disposed asset: (8,088)

Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:

|                                    |                |         |
|------------------------------------|----------------|---------|
| Property Tax Liquidation from CRIM | \$ 83,379      |         |
| Christmas Bonus Reimbursement      | <u>143,557</u> | 226,936 |

Revenues reported in funds which are not reported as revenues in the Statement of Activities:

|                          |                  |        |
|--------------------------|------------------|--------|
| Capital Assets Donations | <u>\$ 63,000</u> | 63,000 |
|--------------------------|------------------|--------|

Repayment of long term debt is an expenditure in the governmental funds, but reduces long-term liabilities in the Statement of Net Assets:

|                                    |                |         |
|------------------------------------|----------------|---------|
| General obligation bonds and notes | \$ 517,600     |         |
| Other long term liabilities        | <u>413,628</u> | 931,228 |

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:

|                      |                  |           |
|----------------------|------------------|-----------|
| Compensated absences | \$ (203,907)     |           |
| Christmas Bonus      | <u>(287,113)</u> | (491,020) |

Change in net assets of governmental activities: \$ 3,193,638

The accompanying notes are an integral part of this statement.

**MUNICIPALITY OF HATILLO  
PROPRIETARY FUND  
STATEMENT OF NET ASSETS  
JUNE 30, 2004**

|   | <b>Enterprise<br/>Fund</b> |
|---|----------------------------|
| <b>ASSETS</b>   |                            |
| <b>Current Assets:</b>                                |                            |
| Cash including \$ 150,000 in certificates of deposits | \$ 340,619                 |
| <b>Restricted assets:</b>                             |                            |
| Cash with fiscal agents                               | 800,000                    |
| <b>Total Current Assets</b>                           | <b>1,140,619</b>           |
| <b>Noncurrent Assets:</b>                             |                            |
| <b>Capital assets:</b>                                |                            |
| Land and construction in progress                     | 4,021,403                  |
| Other capital assets, net                             | 914,128                    |
| <b>Total capital assets, net</b>                      | <b>4,935,531</b>           |
| <b>Total Noncurrent Assets</b>                        | <b>4,935,531</b>           |
| <b>Total assets</b>                                   | <b>\$ 6,076,150</b>        |
| <b>LIABILITIES</b>                                    |                            |
| <b>Current Liabilities:</b>                           |                            |
| Accounts payable and accrued liabilities              | \$ 14,822                  |
| Interfund   | 54,840                     |
| <b>Total Current Liabilities</b>                      | <b>69,662</b>              |
| <b>Noncurrent Liabilities:</b>                        |                            |
| Long term liabilities :                               |                            |
| Due within one year                                   | -                          |
| Due in more than one year                             | 5,243,534                  |
| <b>Total Noncurrent Liabilities</b>                   | <b>5,243,534</b>           |
| <b>Total Liabilities</b>                              | <b>5,313,196</b>           |
| <b>NET ASSETS</b>                                     |                            |
| Invested in capital assets, net of related debt       | 633,930                    |
| Unrestricted (deficit)                                | 129,024                    |
| <b>Total net assets</b>                               | <b>\$ 762,954</b>          |

The accompanying notes are an integral part of this statement.

**MUNICIPALITY OF HATILLO  
PROPRIETARY FUND  
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS  
FOR THE YEAR THEN ENDED JUNE 30, 2004**

|  | <b>Enterprise<br/>Fund</b> |
|--|----------------------------|
| <b>Operating Revenues</b>                        |                            |
| Charges for Services                             | \$ 481,672                 |
| <b>Operating Expenses:</b>                       |                            |
| Maintenance, payroll and supplies                | 319,144                    |
| Interest   | 382,031                    |
| Depreciation                                     | 17,981                     |
| Other  | 200                        |
| Total operating expenses                         | 719,356                    |
| Operating Loss                                   | \$ (237,684)               |
| <br><b>Nonoperating Revenues and (Expenses):</b> |                            |
| Transfers from Governmental Activities           | 2,216,092                  |
| Total Nonoperating Revenues and Expenses         | 2,216,092                  |
| Change in Net Assets                             | 1,978,408                  |
| Net Assets-beginning, as restated                | (1,215,454)                |
| Net Assets-ending                                | \$ 762,954                 |

The accompanying notes are an integral part of this statement.

**MUNICIPALITY OF HATILLO  
STATEMENT OF CASH FLOWS - PROPRIETARY FUND  
YEAR ENDED JUNE 30, 2004**

|  | Enterprise   |
|--|--------------|
|  | Fund         |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |              |
| Receipts from customers  | \$ 484,890   |
| Cash paid to Suppliers   | (189,178)    |
| Cash paid to Employees   | (131,341)    |
| Interest Paid  | (255,543)    |
| Other receipts   | 122          |
| Net cash provided (used) by operating activities   | (71,250)     |
| <b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>                                |              |
| Principal paid on capital debt   | (108,400)    |
| Debt Issued  | 800,000      |
| Transfers from Governmental Activities   | 2,218,092    |
| Net Cash Provided by Financing Activities  | 2,909,692    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |              |
| Purchase of Equipment  | (108,479)    |
| Payments on Construction in Progress   | (1,747,145)  |
| Cash used by Investing Activities  | (1,855,624)  |
| Net Increase in Cash and Cash Equivalents  | 982,818      |
| Balance-beginning of the year  | 157,801      |
| Balance-end of the year  | \$ 1,140,619 |
| <b>Reconciliation of operating income to net cash provided by operating activities</b>         |              |
| Operating Income   | \$ (237,884) |
| Adjustments to reconcile operating income to net cash provided (used) by operating activities: |              |
| Depreciation expense   | 17,981       |
| Other Losses   | 200          |
| Change in assets and liabilities:  |              |
| Receivables, net   | 3,140        |
| Accounts and other payables  | 145,113      |
| Net cash provided by operating activities  | \$ (71,250)  |

The notes are an integral part of these accompanying basic financial statements.

**NOTES TO FINANCIAL STATEMENTS**

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2004**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The **Municipality of Hatillo** was founded in 1823. The Municipality is governed by the executive and the legislative branch elected for a four year term during the general elections in Puerto Rico. The Mayor is the executive officer and the legislative branch consists of fourteen (14) members of the Municipal Legislature. The Municipality engages in a comprehensive range of services to the community such as: general government administration, public works, health, environmental control, education, public security, welfare, housing, community development and culture and recreation activities.

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

**1. *Financial reporting entity***

The financial reporting entity included in this report consists of the financial statements of the **Municipality of Hatillo** (primary government). To fairly present the financial position and the results of operations of the financial reporting entity, management must determine whether its reporting entity consists of only the legal entity known as the primary government or one or more organizations called component units. The inclusion of a potential component unit in the primary government's reporting entity depends on whether the primary government is financially accountable for the potential component unit or on whether the nature and significance of the relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The basic criteria for deciding financial accountability are any one of the following:

- a. Fiscal dependency of the potential component unit on the primary government, or
- b. The primary government appoints a voting majority of the potential component unit's governing body and,
  - 1) The primary government can impose its will on the potential component unit and/or,
  - 2) A financial benefit/ burden exist between the primary government and the potential component unit.

There are two methods of presentation of the component unit in the financial statement:

- a. Blending the financial data of the component units, balances and transactions in a similar manner to the presentation of the Municipality's balances.
- b. Discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continues)**

In fiscal year 2003-2004 the Municipality adopted Statement No. 39 "*Determining Whether Certain Organizations Are Component Units - an amendment of GASB 34 Statement No. 14*". This Statement amends GASB Statement No. 14 to provide additional guidance to determine whether certain organizations for which the primary government is not financially accountable should be reported as components units based on the nature and significance of their relationship with the primary government. A legally separate, tax-exempt organization should be discretely presented as a component unit of a reporting entity if *all* of the following criteria are met:

- a. The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
- b. The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.
- c. The economic resources received or held by an *individual organization* that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to the primary government.

In addition, other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government.

The Statement continues the requirement in Statement No. 14 to apply professional judgment in determining whether the relationship between a primary government and other organizations for which the primary government is not accountable and that do not meet these criteria is such, that exclusion of the organization would render the financial statements of the reporting entity misleading or incomplete.

Based on the above criteria there are no potential component units which should be included as part of the financial statements.

**2. *Basis of presentation, measurement focus and basis of accounting***

The financial report of the Municipality consists of a Management Discussion and Analysis (MD&A), basic financial statements, notes to the financial statements and required supplementary information other than the MD&A. Following is a summary presentation of each, including the measurement focus and basis of accounting. Measurement focus is a term used to describe *which* transactions are recorded within the various financial statements. Basis of accounting refers to *when* transactions are recorded regardless of the measurement focus:

**Management Discussion and Analysis**

This consists of a narrative introduction and analytical overview of the Municipality's financial activities. This analysis is similar to the analysis that the private sector provides in their annual reports.

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continues)**

**Basic financial statements**

Basic financial statements include both government-wide and fund financial statements. Both levels of statements categorize primary activities as governmental type, which are primarily supported by taxes and intergovernmental revenues.

**Government-wide statements**

The government-wide statements consist of a Statement of Net Assets and a Statement of Activities. These statements are prepared using the economic resources measurement focus, which concentrates on an entity or fund's net assets. All transactions and events that affect the total economic resources (net assets) during the period are reported. The statements are reported on the full accrual basis of accounting. Revenues are recognized in the period earned and expenses recognized in the period in which the associated liability is incurred. Fiduciary activities, if any, whose resources are not available to finance government programs, are excluded from the government-wide statements. The effect of inter-fund activities is eliminated.

The Statement of Net Assets incorporates all capital (long lived) assets and receivables as well as long term debt and obligations. The Statement of Activities reports revenues and expenses in a format that focus on the net cost of each function of the Municipality. Both the gross and net cost of the function, which is otherwise being supported by the general government revenues, is compared to the revenues generated directly by the function. This Statement reduces gross expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. Program revenues must be directly associated with the function.

The types of transactions included as program revenues are: charges for services, fees, licenses and permits; operating grants which include operating-specific and discretionary (either operating or capital) grants; and capital grants which are capital-specific grants. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes. Property taxes are recognized as revenues in the year for which they are levied. Revenues on both operating and capital grants are recognized when all eligibility requirements (which include time requirements) imposed by the provider have been met. For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. As a policy, indirect expenses in the Statement of Activities are not allocated. The Municipality first uses restricted assets for expenses incurred for which both restricted and unrestricted assets are available.

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2004**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continues)**

The Municipality reports deferred revenues in the government-wide statements. Deferred revenues arise when resources are received before the Municipality has a legal claim to them or before applicable eligibility requirements are met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed and the revenue is recognized.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. As allowed by GASB Statement No. 20, the Municipality has elected not to follow only those Financial Accounting Standard Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARB), issued prior to December 1, 1989.

**Business Type Activities**

**Enterprise Fund**

The enterprise fund statements consist of a Statement of Net Assets, Statement of Activities and Statement of Cash Flows. This fund accounts for exchange like transactions, like in the private enterprises and its operations are intended to be self supporting through charges to users. These statements are prepared using the economic resources measurement focus, which concentrates on an entity or fund's net assets. All transactions end events that affect the total economic resources (net assets) during the period are reported. The statements are reported on the full accrual basis of accounting. Revenues are recognized in the period earned and expenses recognized in the period in which the associated liability is incurred.

**Fund Statements**

The financial transactions of the Municipality are recorded in individual funds, each of which are considered an independent fiscal entity. Each fund is accounted for by providing a separate set of self balancing accounts that comprise its assets, liabilities, reserves, fund equity, revenues and expenditures. Funds are segregated according to their intended purpose which helps management in demonstrating compliance with legal, financial and contractual provisions. Governmental Funds are those through which most governmental functions of the Municipality are financed. The governmental fund statements include a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances with one column for the general fund, one for each major fund and one column combining all non-major governmental funds. Major funds are determined based on a minimum criterion (percentage of the assets, liabilities, revenues or expenditures) or based on the Municipality's official's criteria, if the fund is particularly important to financial statement users.

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continues)**

The Municipality reports the following major governmental funds:

**General Fund:** The General Fund is the general operations fund of the Municipality. It is used to account for all financial resources except those required to be accounted in another fund.

**State Legislative Grants:** This fund is used to account for revenues sources from appropriations of the Commonwealth of Puerto Rico legislative assembly for the development of viable urban communities and social development.

**Debt Service Fund:** Debt Service Fund is used to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest.

Governmental funds are accounted for using the current financial resources measurement focus. With this measurement focus, only current assets and current liabilities are included on the balance sheet in the funds statements. Long-term assets and long-term liabilities are included in the government-wide statements. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

The fund statements are maintained and reported on the modified accrual basis of accounting. Under this method 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 Municipality 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 the related liability is incurred.

Property taxes are recognized as revenues in the year for which they are levied. Revenues on intergovernmental grants are recognized when all eligibility requirements (which include time requirements) imposed by the provider have been met and revenue becomes available. For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. Licenses and permits, charges for services, rent and miscellaneous revenues are recorded as revenues when received because they are not measurable and available.

The Municipality reports deferred revenues in the governmental funds statements which arise when potential revenue does not meet both measurable and available criteria for recognition in the current period (in the government-wide statements revenue is recognized as soon as it is earned regardless of its availability). Deferred revenues also arise when resources are received before the Municipality has a legal claim to them or before applicable eligibility requirements are met. (In case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the revenue recognition criteria is met, or when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed from the combined balance sheet and the revenue is recognized.

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2004**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continues)**

Expenditures are generally recognized when the related liability is incurred. Certain exceptions to this fundamental concept include the following: 1) payments of principal and interest on general long term debt, which are recorded as expenditures when due, except for principal and interest due on July 1 (in this case amounts are recorded as liabilities and expenditures on June 30 since amounts have been accumulated or transferred to the debt service fund before July 1 payments are made), 2) vested compensated absences, claims and judgments and special termination benefits which are recorded as expenditures only to the extent that they are expected to be liquidated with expendable financial resources (in the government-wide statements the expense and related accrual liability for long term portions of debt must be included).

Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statements, reconciliation is necessary to explain the adjustments needed to transform the fund financial statements into the government-wide statements. This reconciliation is part of the financial statements.

**Notes to Financial Statements**

The notes to financial statements provide information that is essential to a user's understanding of the basic financial statements.

**Required Supplementary Information:**

Required supplementary information consists of the Budgetary Comparison Schedule – General Fund as required by GASB.

**3. *Cash, cash equivalents, restricted and restricted cash with fiscal agents***

Cash and cash equivalents consists of cash on hand, demand deposits and short term investments with original maturities of three months or less from the date of acquisition. The Municipality follows the practice of pooling cash of all funds except for certain Commonwealth's grants, restricted funds generally held by outside custodians and federal grants. Available pooled cash balance beyond immediate needs is invested in certificates of deposits.

Restricted cash consists of the un-disbursed balance of those donor imposed, federal and state's special revenues funds for specific purposes. These balances are restricted until their nature and amount satisfy their applicable and contractual provisions.

Restricted cash with fiscal agent in the debt service fund consists of the un-disbursed balance of property tax collections retained by the Commonwealth of Puerto Rico which are restricted for the repayment of the Municipality's general and special obligation bonds and notes as established by law. Restricted cash with fiscal agent of other governmental funds represent the un-disbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the GDB or a federal government agency.

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continues)**

**4. *Receivables and due from governmental entities***

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions.

Amounts due from federal government represent amounts owed to the Municipality for the reimbursement of expenditures incurred pursuant to federally funded programs. Amounts reported in the debt service fund represent property tax revenue of current fiscal year collected by the CRIM on the first month (July) of subsequent fiscal year.

**5. *Inter-fund receivables and payables***

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

**6. *Inventories***

The Municipality purchases gasoline, oil and other expendable supplies held for consumption. The cost of those purchases is recorded as expenditure when incurred in the appropriate fund but the year-end inventory is not recorded in the Statement of Net Assets, as management believes is not significant.

**7. *Capital assets***

Capital assets, which include property, plant, equipment, and infrastructure (e.g., roads, bridges, sidewalks, and similar items), are reported in the governmental activities column in the Statement of Net Assets. Capital assets are capitalized at historical cost or estimated historical cost if historical cost is not available. Donated assets are recorded as capital assets at their estimated fair market value at the date of donation. The municipality maintains a threshold level of \$500 or more for capitalizing vehicles, machinery and equipment. Infrastructure assets are capitalized based on a percentage of the estimated useful life. 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.

All capital assets, other than land, are depreciated using the straight-line method over the following useful lives:

| <u>Description</u>                  | <u>Years</u> |
|-------------------------------------|--------------|
| Land improvements                   | 20           |
| Buildings and building improvements | 20-50        |
| Infrastructure                      | 15-40        |
| Vehicles, machinery and equipment   | 5-15         |

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2004**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continues)**

**8. Long-term obligations**

Long-term debt and other long-term obligations, which are reported as liabilities in the governmental activities column in the Statement of Net Assets, consists of general and special obligation bonds, liabilities for compensated absences, claims and judgments, and long-term liabilities to other governmental entities.

**9. Deferred charges**

Bond issuance costs are reported as deferred charges and amortized as required by current standards. Governmental fund types recognize bond issuance costs as expenditures during the current period. Those issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures in the appropriate fund.

**10. Compensated absences**

The Municipality's employees accumulate vacation, sick leave and compensatory time based on continuous service. The compensated absences are accumulated on the basis of 2½ days per month of vacation and 1½ days per month of sick pay and compensatory time up to a maximum of 60 days of vacations and 90 days of sick leave. Upon separation from employment the accumulated vacations are liquidated up to the maximum number of days. Accumulated sick pay is liquidated to employees with 10 years or more service up to the maximum number of days. The amount of vacations leave is accrued if earned based on services already performed by employees and if it is probable that will be paid in a future period. The amount of sick leave is accrued based on all vesting amounts for which payment is probable and on accumulated benefits as of the fiscal year-end.

The accrual of compensated absences includes estimated payments that are related to payroll. The entire compensated absence liability is reported on the government-wide financial statements. For governmental fund financial statements, the current portion of unpaid compensated absences is the amount that is normally expected to be paid using expendable available financial resources. The non-current portion of the liability is not reported.

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2004**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continues)**

**11. Fund balances and Net Assets**

**a. Fund balances:**

In the fund financial statements, governmental funds report reserved and unreserved fund balances. Reservations of fund balance represent portions of the fund balance that are legally segregated for a specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

- |                                  |   |
|----------------------------------|---|
| <b>Encumbrances:</b>             | Represent future expenditures under purchase orders and other commitments, which generally will become liabilities in future periods as the goods or services are received.   |
| <b>Debt Service:</b>             | Represents net assets available to finance future debt service payments.  |
| <b>Capital Projects:</b>         | Represent amounts to be used for future expenditures for capital projects under contracts and other commitments. These commitments generally will become liabilities in future periods as the projects are completed. |
| <b>Other specified purposes:</b> | Represent amounts to be used for future expenditures of Federal and Commonwealth's grants to be used to finance activities other than construction or capital improvement commitments                                 |
| <b>Advances:</b>                 | Represent the non current portion of inter-fund loans.  |

Unreserved fund balances are segregated between designated and undesignated. Designations of unreserved fund balances represent tentative plans or commitments of governmental resources. The undesignated fund balance is the difference between the total unreserved fund balance and the total amount of designations.

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -- (Continued)**

b. Net assets:

In the government-wide statements net assets are segregated into three categories:

**Invested in capital assets, net of related debt:** Consists of capital asset balances net of accumulated depreciation and outstanding balances of any bonds, notes and other borrowings that are attributable to the acquisition, construction, or improvement of those assets. This category should not include cash that is restricted to capital asset acquisition or construction (unspent bond proceeds) and any unamortized debt issue costs.

**Restricted net assets:** Represents net assets that are subject to restrictions beyond the Municipality's control. These include restrictions that are externally imposed (by creditors, grantors, contributors, or laws and regulations of other governments) or restrictions imposed by the law through constitutional provisions or enabling legislation (including enabling legislation passed by the government itself).

**Unrestricted net assets:** Represent net assets that do not meet the definition of net assets invested in capital assets, net of related debt or restricted. Unrestricted assets are often designated to indicate that management does not consider them to be available for general operations. These types of constraints are internal and management can remove or modify them. Designations are not reported on the face of the statement of net assets.

**12. Inter-fund transactions**

The Municipality reports certain transactions as operating transfers, which are legally required transfers that are reported when incurred as "Operating transfers-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.

**13. Risk financing**

The Puerto Rico Treasury Department (PRDT) acts as an agent, obtaining and determining the coverage for the municipalities of Puerto Rico. The coverage for the Municipality consists of professional, public responsibility, property and theft, auto and fidelity bond coverage.

Insurance policies costs are allocated by PRDT among all the municipalities of Puerto Rico. Payment of the Municipality's insurance premiums is monthly deducted from advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM). Workers compensation insurance is also deducted from the monthly advances by the CRIM. Settled cases have not exceeded insurance coverage for any of the past three years.

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2004**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continues)**

**14. Use of estimates**

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

**15. Future adoption of accounting pronouncements**

The GASB has issued the following statements, which the Municipality has not yet adopted:

| Statement  | To be Adopted in Fiscal<br>year ended, |
|--|--|
| 40      Deposit and Investment Risk Disclosure - an amendment of GASB Statement No. 3                    | June 30, 2005                          |
| 42      Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries | June 30, 2006                          |
| 43      Financial Reporting for Post employment Benefits Plans Other Than Pension Plans                  | June 30, 2008                          |
| 44      Economic Condition Reporting: The Statistical Section – an amendment of NCGA Statement No. 1     | June 30, 2006                          |
| 45      Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions | June 30, 2009                          |

The impact of these statements on the Municipality's basic financial statement has not yet been determined.

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2004**

**NOTE B – DEPOSITS**

The Municipality maintains its cash deposits in commercial banks located in Puerto Rico. Under Commonwealth of Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal deposit insurance. All securities pledged as collateral by the Municipality are held by the Secretary of Treasury of Puerto Rico in the Municipality's name. The table presented below discloses the level of custody risk assumed by the Municipality based upon how its deposits were insured or secured with collateral at June 30, 2004:

- Category 1:** Insured or collateralized with securities held by the Secretary of Treasury agent's in the Municipality's name.
- Category 2:** Collateralized with securities held by the pledging financial institution's trust department or its agents in the Municipality's name.
- Category 3:** Uncollateralized, including any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the Municipality's name.

The bank balances and carrying amount of deposits with financial institutions as of June 30, 2004 were as follows:

|                                | Category           |             |                     | Bank<br>balance      | Carrying<br>Amount   |
|--------------------------------|--------------------|-------------|---------------------|----------------------|----------------------|
|                                | 1                  | 2           | 3                   |                      |                      |
| Deposits in commercial banks   | \$4,704,812        | \$ -        | \$ -                | \$ 4,704,812         | \$ 4,344,175         |
| Deposits in governmental banks | -                  | -           | 7,449,956           | 7,449,956            | 7,449,956            |
|                                | <u>\$4,704,812</u> | <u>\$ -</u> | <u>\$ 7,449,956</u> | <u>\$ 12,154,768</u> | <u>\$ 11,794,131</u> |

Reconciliation to government-wide statement of net assets:

|   | Unrestricted        | Restricted          | Total                |
|---|---------------------|---------------------|----------------------|
| Carrying amount of deposits in commercial banks   | \$ 2,228,970        | \$ 2,115,205        | \$ 4,344,175         |
| Carrying amount of deposits in governmental banks | <u>3,000,000</u>    | <u>4,449,956</u>    | <u>7,449,956</u>     |
|   | <u>\$ 5,228,970</u> | <u>\$ 6,565,161</u> | <u>\$ 11,794,131</u> |

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

**NOTE C - DUE FROM (TO) GOVERNMENTAL ENTITIES**

1. Amounts due from governmental entities as of June 30, 2004 follows:

|  | Commonwealth<br>Entities | Federal<br>Government |
|--|--------------------------|-----------------------|
| Treasury Department- State Legislative Resolutions                 | \$ 665,394               | \$ -                  |
| Municipal Revenue Collection Center (CRIM) Property tax amnesty    | 536,845                  | -                     |
| State Department of Labor – Law 52                                 | 54,422                   | -                     |
| Office of Commissioner of Municipal Affairs – CDBG                 | -                        | 265,273               |
| US Department of Housing and Urban Development – Section 8         | -                        | 21,799                |
| Puerto Rico Department of Treasury – Christmas bonus reimbursement | 143,557                  | -                     |
| Department of Family – Elderly Program                             | -                        | 40,584                |
| Federal Transit Administration                                     | -                        | 1,988                 |
| Department of Family- Child Care                                   | -                        | 17,082                |
|  | \$ 1,400,218             | \$ 346,726            |

The amount due from Puerto Rico Department of Treasury – Christmas bonus \$143,557 and \$83,379 from the CRIM annual property tax liquidation, are recorded as deferred revenue in the governmental funds statements (general fund) since is not available as required by current standards.

2. Amounts due to governmental entities as of June 30, 2004 follows:

|  | Commonwealth<br>Entities | Federal<br>Government |
|--|--------------------------|-----------------------|
| Puerto Rico Aqueduct and Sewer Authority (PRASA)           | \$ 10,285                | \$ -                  |
| US Department of Housing and Urban Development – Section 8 | -                        | 9,884                 |
| Puerto Rico Telephone Company                              | 59,844                   | -                     |
| Puerto Rico Retirement System                              | 63,240                   | -                     |
| E.L.A Employees Association                                | 3,624                    | -                     |
| State Insurance Fund Corporation                           | 43,756                   | -                     |
| General Services Administration                            | 1,295                    | -                     |
|  | \$ 182,044               | \$ 9,884              |

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

**NOTE D - INTERFUND TRANSACTIONS**

**1. Due from/to other funds:**

Amounts due from/to other funds represent temporary advances to other funds by the general fund payroll and payroll taxes expenditures, as follows:

| Receivable<br>Fund | Payable Fund                        | Amount            |
|--------------------|-------------------------------------|-------------------|
| General Fund       | Other governmental funds -FTA       | \$ 2,400          |
| General Fund       | Other governmental funds-Child Care | 87,173            |
| General Fund       | Other governmental funds-Law 52     | 82,392            |
| General Fund       | Major Fund- State Resolutions       | 402,333           |
| General Fund       | Other governmental funds-BGF Loans  | 103,272           |
| General Fund       | Other governmental funds -CDBG      | 79,209            |
|                    | <b>Total:</b>                       | <b>\$ 756,779</b> |

**2. Operating transfers:**

Transfers between individual funds were made for operational purposes. Transfers includes interest earned on restricted cash with fiscal agents in the debt service fund, the capital improvement loan fund and operating and capital improvement loans in other governmental funds which is transferred to the general fund; and principal and interest payments of general long term debt transferred from the general fund to the debt service fund.

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

**NOTE E - CAPITAL ASSETS**

Capital assets and depreciation activity as of and for the year ended June 30, 2004 is as follows:

|   | Balance,<br>as restated<br>(Note L)<br>July 1,<br>2003 | Increases           | Decreases           | Balance<br>June 30, 2004 |
|---|--|---------------------|---------------------|--------------------------|
| <b><u>Governmental Activities:</u></b>      |  |                     |                     |                          |
| Capital assets, not being depreciated:      |  |                     |                     |                          |
| Land  | \$ 22,705,544  | \$ -                | \$ -                | \$ 22,705,544            |
| Construction in progress                    | <u>3,136,581</u>                                       | <u>1,002,910</u>    | <u>3,558,920</u>    | <u>580,571</u>           |
| Total capital assets not being depreciated: | <u>25,842,125</u>                                      | <u>1,002,910</u>    | <u>3,558,920</u>    | <u>23,286,115</u>        |
| Capital assets, being depreciated:          |  |                     |                     |                          |
| Buildings and building improvements         | 12,198,781   | 4,549,075           | -                   | 16,747,856               |
| Infrastructure                              | 6,941,744  | 602,159             | -                   | 7,543,903                |
| Vehicles, machinery and equipment           | <u>3,788,852</u>                                       | <u>1,141,808</u>    | <u>56,869</u>       | <u>4,873,791</u>         |
| Total capital assets being depreciated      | 22,929,377   | 6,293,042           | 56,869              | 29,165,550               |
| Less accumulated depreciation for:          |  |                     |                     |                          |
| Buildings and building improvements         | 3,323,802  | 257,754             | -                   | 3,581,556                |
| Infrastructure                              | 5,190,748  | 30,604              | -                   | 5,221,352                |
| Vehicles, machinery and equipment           | <u>2,300,675</u>                                       | <u>330,008</u>      | <u>48,781</u>       | <u>2,581,902</u>         |
| Total accumulated depreciation              | 10,815,225   | 618,366             | 48,781              | 11,384,810               |
| Total capital assets being depreciated, net | <u>12,114,152</u>                                      | <u>5,674,676</u>    | <u>8,088</u>        | <u>17,780,740</u>        |
| Governmental activities capital assets, net | <u>\$ 37,956,277</u>                                   | <u>\$ 6,677,586</u> | <u>\$ 3,567,008</u> | <u>\$ 41,066,855</u>     |

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2004**

**NOTE E - CAPITAL ASSETS – (Continues)**

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

Governmental activities:

|                                   |               |
|-----------------------------------|---------------|
| General government                | \$ 94,925     |
| Public works and sanitation       | 222,643       |
| Public safety                     | 58,585        |
| Culture and recreation            | 173,321       |
| Welfare and community development | 40,189        |
| Education                         | <u>28,703</u> |

|  |                          |
|--|--------------------------|
| <b>Total depreciation expense, governmental activities</b> | <b><u>\$ 618,366</u></b> |
|--|--------------------------|

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

**NOTE E - CAPITAL ASSETS – (Continues)**

Capital assets and depreciation for business type activities as of and for the year ended June 30, 2004 is as follows:

|  | Balance,<br>as restated<br>(Note L)<br>July 1,<br>2003 | Increases           | Decreases     | Balance<br>June 30,<br>2004 |
|--|--|---------------------|---------------|-----------------------------|
| <b><u>Business Type Activities:</u></b>            |  |                     |               |                             |
| Capital assets, not being depreciated:             |  |                     |               |                             |
| Land   | \$ 1,215,200   | \$ -                | \$ -          | \$ 1,215,200                |
| Construction in progress                           | 1,059,058  | 1,747,145           | -             | 2,806,203                   |
| <b>Total capital assets not being depreciated:</b> | <b>2,274,258</b>                                       | <b>1,747,145</b>    |               | <b>4,021,403</b>            |
| Capital assets, being depreciated:                 |  |                     |               |                             |
| Buildings and building improvements                | 932,095  | -                   | -             | 932,095                     |
| Vehicles, machinery and equipment                  | 35,084   | 108,479             | 2,000         | 141,563                     |
| <b>Total capital assets being depreciated</b>      | <b>967,179</b>   | <b>108,479</b>      | <b>2,000</b>  | <b>1,073,658</b>            |
| Less accumulated depreciation for:                 |  |                     |               |                             |
| Buildings and building improvements                | 126,506  | 13,981              | -             | 140,487                     |
| Vehicles, machinery and equipment                  | 16,844   | 3,999               | 1,800         | 19,043                      |
| <b>Total accumulated depreciation</b>              | <b>143,350</b>   | <b>17,980</b>       | <b>1,800</b>  | <b>159,530</b>              |
| <b>Total capital assets being depreciated, net</b> | <b>823,829</b>   | <b>90,499</b>       | <b>200</b>    | <b>914,128</b>              |
| <b>Governmental activities capital assets, net</b> | <b>\$ 3,098,087</b>                                    | <b>\$ 1,837,644</b> | <b>\$ 200</b> | <b>\$ 4,935,531</b>         |

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2004**

**NOTE F - LONG TERM DEBT**

**1. Summary of long-term debt activity**

The following summarizes activity in long-term debt for the Fiscal year ended June 30, 2004:

|  | Balance at<br>July 1, 2003<br>(As restated<br>Note L) | Increases          | Decreases          | Balance at<br>June 30,<br>2004 | Due within<br>one year |
|--|---|--------------------|--------------------|--------------------------------|------------------------|
| General, Special<br>Obligations<br>Bonds and<br>Notes  | \$11,745,020  | \$ 800,000         | \$ 624,000         | \$11,921,020                   | \$ 515,000             |
| Compensated<br>absences                                | 1,064,217   | 219,353            |                    | 1,283,570                      | 559,254                |
| Health Reform  | 1,316,860   |                    | 398,813            | 918,047                        | -                      |
| Municipal<br>Landfill<br>obligation<br>(note G)        | 775,482   |                    |                    | 775,482                        | -                      |
| LIMS<br>Reimburseme<br>nt- CRIM                        | 361,777   |                    | 33,815             | 327,962                        | 35,857                 |
| Payable to<br>CRIM-prior<br>years doubtful<br>accounts | 356,922   |                    |                    | 356,922                        | -                      |
| Christmas bonus  | -   | 287,113            |                    | 287,113                        | 287,113                |
|  | <u>\$15,620,278</u>                                   | <u>\$1,306,466</u> | <u>\$1,056,628</u> | <u>\$15,870,116</u>            | <u>\$1,397,224</u>     |

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2004**

**NOTE F - LONG TERM DEBT - (Continues)**

**2. *General and special obligation bonds and notes***

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2004 amount to \$11,921,020. All these bonds are serviced by the Governmental Development Bank of Puerto Rico (GDB) maturing at various dates. As required by law, the Commonwealth Government is obligated to levy and collect property taxes for payment of principal and interest on bonds and notes. A debt service fund has been established for the bonds and notes at GDB with the proceeds of those property taxes, whereby sufficient funds must be set aside in order to cover the projected debt service requirement, before any new bonds are issued. The Municipality is required to maintain a legal debt margin of 10% of the total assessment of property located within the Municipality plus the balance of the property taxes in the debt service fund. Principal and interest payments of long term debt issued for operational purposes are made through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM).

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

**NOTE F - LONG TERM DEBT – (Continues)**

A detail of the general and special obligation bonds and notes as of June 30, 2004 follows:

|   | <u>Outstanding<br/>Amount</u> |
|---|-------------------------------|
| 1995 general obligation bonds of \$550,000 due in annual installments of \$14,000 to \$38,020 through January 1, 2020; bearing interest at 4.50%                              | \$ 451,020                    |
| 1998 general obligation bonds of \$2,810,000 due in annual installments of \$40,000 to \$250,000 through July 1, 2023; bearing interest from 4.865% to 6.56%                  | 2,585,000                     |
| 1998 general obligation bonds of \$624,000 due in annual installments of \$17,000 to \$44,000 through January 1, 2022; with interest at 4.50%                                 | 550,000                       |
| 2000 public improvement bonds of \$700,000 due in annual installments of \$50,000 to \$100,000 through July 1, 2009; bearing interest at rates ranging from 2.70% to 7.81%    | 485,000                       |
| 2002 general obligation bonds of \$2,265,000 due in annual installments of \$30,000 to \$200,000 through July 1, 2025; with interest from 2.70% to 6.13%                      | 2,165,000                     |
| 2003 general obligation bonds of \$1,035,000 due in annual installments of \$180,000 to \$235,000 through July 1, 2007; bearing interest at rates ranging from 5.00% to 6.50% | 855,000                       |
| 2004 special obligation note of \$800,000 due in annual installments of \$145,000 to \$175,000 through July 1, 2009; with interest at 4.05%                                   | 800,000                       |
| 1997 general obligation bonds of \$3,875,000 due in annual installments of \$65,000 to \$345,000 through July 1, 2020; bearing interest at rates ranging from 4.865% to 6.69% | 3,405,000                     |
| 1996 general obligation bonds of \$715,000 due in annual installments of \$10,000 to \$65,000 through July 1, 2020; bearing interest at rates ranging from 4.865% to 6.75%    | <u>625,000</u>                |
| Outstanding Amount  | <u>\$ 11,921,020</u>          |

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2004**

**NOTE F - LONG TERM DEBT – (Continues)**

The annual requirement to amortize general and special obligation bonds and notes as of June 30, 2004 follows:

| <u>June 30</u> | <u>Principal</u>            | <u>Interest</u>            |
|----------------|-----------------------------|----------------------------|
| 2005           | \$ 515,000                  | \$ 610,306                 |
| 2006           | 692,000                     | 612,931                    |
| 2007           | 744,000                     | 593,470                    |
| 2008           | 796,000                     | 554,472                    |
| 2009           | 593,000                     | 520,315                    |
| 2010-2014      | 2,395,000                   | 2,187,268                  |
| 2015-2019      | 3,062,000                   | 1,437,466                  |
| 2020-2024      | 2,744,020                   | 463,996                    |
| 2025-2028      | 380,000                     | 21,840                     |
| <b>Totals</b>  | <b><u>\$ 11,921,020</u></b> | <b><u>\$ 7,002,064</u></b> |

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

**NOTE F - LONG TERM DEBT – (Continues)**

**3. Other long-term liabilities**

|  | <u>Amount</u>       |
|--|---------------------|
| Compensated absences - includes accrued vacations, sick leave benefits and other benefits with similar characteristics such as compensatory time, represents the Municipality's commitment to fund such costs from future operations. Amount is paid with unrestricted funds   | <u>\$ 1,283,570</u> |
| Health Reform- represent the balance payable to Health Insurance Administration, ASES, for accrued portion corresponding to fiscal years 1994-1995 to 1996-1997 payment of the State Health Insurance. The balance will be paid from state electronic lottery revenues.  | <u>\$ 918,047</u>   |
| Payable to the CRIM-LIMS balance - the Municipality has entered into an agreement with the Municipal Revenue Collection Center (CRIM) to refinance the prior year's LIMS reimbursement. The refinancing was done through a special loan to repaid \$408,924 at 5.95% to 10 years, payable with property taxes revenues from CRIM.  | <u>\$ 327,962</u>   |
| Payable to the CRIM-prior year's doubtful accounts - the Municipality has entered into an agreement with the Municipal Revenue Collection Center (CRIM) to refinance the prior year's property tax doubtful accounts, on a long-term basis under the provision of Law No. 146 of October 11, 2001. The refinancing was done through a special loan to be repaid from .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico's general fund. | <u>\$ 356,922</u>   |
| Christmas Bonus - represent the accrued portion corresponding to fiscal year 2003-2004 of the Christmas bonus to be paid in December 2004  | <u>\$ 287,113</u>   |

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

**NOTE G - LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS OBLIGATIONS**

The Municipality discontinued the operation and ceased to accept solid waste in one of its landfill. State and Federal laws and regulations requires the Municipality to perform certain closure procedures and establish monitoring and maintenance procedures at the landfill site for thirty years after closure. The closure and post closure care procedures are being assumed by the Municipality. As guidance for calculation of total closure costs, the Municipality utilized an estimate provided by the Puerto Rico Solid Waste Disposal Authority. The Municipality is required to provide post closure care after the closure is completed. Total post closure care costs has been determined and accounted as required by accounting principles generally accepted in the United States as of June 30, 2004. The Municipality has reserved \$775,482 as of June 30, 2004 to finance post-closure care costs of this solid waste landfill.

**NOTE H - PROPERTY TAXES**

The Municipal Revenue Collection Center (CRIM) (a state governmental agency) is responsible for the assessment, collection and distribution of real and personal property taxes in accordance with the Municipal Property Tax Law (Law 83 of August, 1995). The tax levied on property is determined by the Municipal Government based on limits established by the Commonwealth Legislature. The tax on personal property is self-assessed by the taxpayer. The assessment is made on a return, which must be filed, with the CRIM by May 15 of each year. Real property is assessed by the CRIM. The tax is general assessed on January 1 on all taxable property located within the Municipality. For personal property the tax is due with the return filed on or before May 15. Taxes on real property may be paid on two equal installments, July 1<sup>st</sup> and January 1<sup>st</sup>.

The CRIM advances funds to the Municipality based on an estimate of special governmental subsidies and the property taxes to be levied and which are collected in subsequent periods. This distribution includes advances of property tax and amounts of municipal equalization fund from the Commonwealth government. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. The CRIM prepares a preliminary settlement not later than three months after fiscal year-end, and a final settlement not later than six months after fiscal year-end. If actual collections exceed the advances a receivable from CRIM is recorded. However, if advances exceed actual collections, a payable to CRIM is recorded. The Municipality has a net receivable to the CRIM of \$114,821 resulting from the final settlement for fiscal year 2003-2004.

**NOTE I - MUNICIPAL LICENSE TAXES**

Municipal license taxes are assessed annually by the Municipality to all organizations or entities subject to the tax doing business in the Municipality's location except for entities totally or partially exempt pursuant to certain Commonwealth's statutes. This tax is based generally on volume of business or gross sales as shown in a tax return that should be submitted on or before April 15. During the Fiscal year ended June 30, 2004 the tax rates were as follows:

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

**NOTE I - MUNICIPAL LICENSE TAXES – (Continues)**

Financial business - 1.50% of gross revenues  
 Other organizations – from .30% to .50% of gross revenues

The tax is due in two equal installments on July 1 and January 1 of each fiscal year. Tax revenue is recognized at that moment by the Municipality. A discount of 5% is allowed when full payment is made on or before April 15.

Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year in the amount of \$ 2,492,968 is recorded as deferred revenues.

**NOTE J - INTERGOVERNMENTAL REVENUES**

Intergovernmental revenues in the General Fund are comprised of the following:

|   | Amount       |
|---|--------------|
| Amount of municipal subsidies send by CRIM  | \$ 2,051,125 |
| Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)       | 971,260      |
| Reimbursement from Commonwealth Government of Christmas Bonus expenditure               | 209,614      |
| Reimbursement from State Electronic Lottery to paid State Health Insurance debt to ASES | 398,813      |
|   | \$ 3,630,812 |

**NOTE K – SPECIAL ITEMS**

During fiscal year the municipality received the following non-current intergovernmental revenues that were classified as Special Items. Special Items are transactions or other events within the control of the management that are either unusual in nature or infrequent in occurrence:

|  | Amount     |
|--|------------|
| Gain on legal settlement over the Puerto Rico Electric Power Authority (PREPA) | 522,986    |
| Property Tax Amnesty - Law 74 -CRIM  | 150,024    |
|  | \$ 673,010 |

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

**NOTE L- FUND BALANCE AND NET ASSETS RESTATEMENTS**

**1. Fund balances**

Certain special funds with self-imposed restrictions in the amount of \$4,107,827 and previously reported as special revenue and capital project funds were reclassified to the Other Government Funds and State Legislative Resolutions. In addition, the beginning fund balance of the general fund has been restated to correct an overstatement of accounts receivables in the amount of \$946,152. The beginning fund balance of the debt service was understated by an overstatement on accounts payables by \$576,328. The beginning fund balance of the state resolutions funds were overstated for \$380,064 on legislative funds and the other remaining funds were understated by \$1,944,676. The following schedule reconciles the fund balance on July 1, 2003 as previously reported to the beginning fund balance, as restated:

| Fund                          | Prior period adjustments                             |                        |                      | Balance at beginning of year, as Restated |
|-------------------------------|--|------------------------|----------------------|---|
|                               | Balance at beginning of year, as previously reported | Fund reclassifications | Correction of errors |   |
| General Fund                  | \$ 2,183,519   | \$ 193,617             | \$ (946,152)         | \$ 1,430,984                              |
| Special Revenues              | 688,118  | (688,118)              | -                    | -   |
| Capital Projects              | 3,419,709  | (3,419,709)            | -                    | -   |
| Debt Service                  | 1,015,318  | -                      | 576,328              | 1,591,646                                 |
| State Legislative Resolutions | -  | 1,588,897              | (380,064)            | 1,208,833                                 |
| Other governmental funds      | -  | 2,325,313              | 1,944,676            | \$ 4,269,989                              |
| <b>Total</b>                  | <b>\$ 7,306,664</b>                                  | <b>\$ -</b>            | <b>\$ 1,194,788</b>  | <b>\$ 8,501,452</b>                       |

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

**NOTE L - FUND BALANCE AND NET ASSETS RESTATEMENTS – (Continues)**

**2. Net assets**

Net assets at beginning of the year have been adjusted to correct certain overstatements and understatements of assets and liabilities:

|   | Governmental<br>Amount | Business Type<br>Amount |
|---|------------------------|-------------------------|
| Net assets at beginning of year as previously reported: | \$ 38,709,532          | \$ 334,349              |
| Restatements:   |                        |                         |
| Overstatement of accounts receivables                   | ( 946,152)             | -                       |
| Overstatement of accounts payables                      | 576,328                | -                       |
| Understatement of Cash                                  | 1,564,612              | -                       |
| Overstatement of Cash                                   | -                      | ( 600,043)              |
| Restatement on Capital Assets                           | ( 6,331,064)           | 35,084                  |
| Restatement of Accumulated Depreciation                 | 2,339,102              | ( 16,844)               |
| Restatement on Debt Balances                            | ( 172,907)             | ( 968,000)              |
| <br>Net assets at beginning of year, as restated:       | <br>\$ 35,739,451      | <br>\$ ( 1,215,454)     |

**NOTE M - RETIREMENT PLAN**

**1. Plan description**

Regular employees of the Municipality contribute to a cost sharing multiple employer defined benefit retirement plan, administered by the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). ERS covers all regular full time public employees working for the central government, public corporations and the municipalities of Puerto Rico. The system provides retirement pensions, death and disability benefits.

Retirement benefits depend upon age at retirement and number of years of credited service. Disability retirement benefits are available to members of occupational and no occupational disabilities. Vested benefits after ten years of plan participation. The system was created under Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. Retirement benefits are determined by the application of stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a plan member is eligible, is limited to a minimum of \$200 per month and a maximum of 75% of the average compensation. ERS issues a publicly financial report that includes financial statements and required supplementary information of the Plan, which may be obtained from the ERS.

Law No. 305 of September 24, 1999 amended the Act No. 447 of 1951 and was enacted with the purpose of establishing a new pension program (System 2000). The new pension program became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999 may elect either to stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000 will only be allowed to become members of the new program.

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

**NOTE M - RETIREMENT PLAN – (Continues)**

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. There will be a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the State government and will be subject to the total accumulated balance of the savings account. The annuity will be based on a formula, which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. If savings accounts balance is \$10,000 or less at time of retirement, the balance will be distributed by the System to the participant as a lump sum. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not been granted under the new program. The employer contributions (9.275% of the employee's salary) will be used to fund the current plan. Under System 2000 the retirement age is reduced from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

**2. Funding policy**

The Act 447, as amended, is the authority under which obligations to contribute to the Plan by the Plan members, employers and other contributing entities are established or may be amended. Plan members are required to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600 except for the Mayor or employee under a supplementation plan, which contributes 8.275% of gross salary. The Municipality is required to contribute 9.275% of gross salary.

The Municipality's actual contribution for the current and the previous two fiscal years, which is equal to the required contribution, follows:

| <u>Fiscal year ended:</u> | <u>Law No. 447</u> | <u>System 2000</u> |
|---------------------------|--------------------|--------------------|
| 2004                      | \$ 300,596         | \$ 4,534           |

**MUNICIPALITY OF HATILLO**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2004**

**NOTE O - CONTINGENCIES**

**1. *Federal and State grants***

Projects financed by Federal and State Grants are subject to audits by grantors and other governmental agencies in order to determine its expenditures to comply with the conditions of such grants. It is the Municipality's opinion that no additional material unrecorded liabilities will arise from audits previously performed or to perform.

**2. *Litigations***

The Municipality is, at present, a defendant in a number of legal matters that arise in the ordinary course of the Municipality's activities. There are cases whereby the Municipality has been named as a defendant or codefendant in various lawsuits amounting approximately \$1.2 millions. They are primarily related to accidents and personal injuries. Certain cases whereby the legal counsel has not determined an outcome and other cases that will not be covered by insurance. The Municipality believes it has meritorious defenses against these legal actions and is contesting vigorously. However, it is the opinion of the Municipality and the legal counsels that based on their experience, such actions and the potential liabilities will not impair the Municipality financial position.

**NOTE P - SUBSEQUENT EVENTS**

On August 2004, the Municipality completed the construction of "Luis Muñoz Marín" vacation resort for business type activity purposes.

**REQUIRED SUPPLEMENTARY INFORMATION**

MUNICIPALITY OF HATILLO

BUDGETARY COMPARISON SCHEDULE - GENERAL FUND  
FISCAL YEAR ENDED JUNE 30, 2004

|   | Budgeted amounts  |                   | Actual Amounts<br>(Budgetary<br>Basis)<br>(See Note A) | Variance with<br>Final Budget<br>Positive (Negative) |
|---|-------------------|-------------------|--|--|
|   | Original          | Final             |  |  |
| <b>Revenues</b>   |                   |                   |  |  |
| Property taxes  | \$ 4,266,433      | \$ 5,583,681      | \$ 5,583,681   | \$ -   |
| Municipal license taxes   | 3,020,000         | 3,136,051         | 3,203,557  | 67,506   |
| Intergovernmental   | 3,313,935         | 3,759,323         | 3,759,312  | (11)   |
| Fees, fines and charges for services  | 223,000           | 276,097           | 307,403  | 31,306   |
| Interest  | 260,000           | 130,606           | 120,542  | (10,064)   |
| Other   | 125,100           | 160,774           | 162,640  | 1,866  |
| <b>Total revenues</b>   | <b>11,208,468</b> | <b>13,046,532</b> | <b>13,137,135</b>                                      | <b>90,603</b>  |
| <b>Expenditures</b>   |                   |                   |  |  |
| General government  | 3,953,608         | 4,707,523         | 4,618,753  | 88,770   |
| Public works and sanitation   | 4,820,512         | 6,122,611         | 6,093,528  | 29,083   |
| Public safety   | 468,776           | 414,482           | 405,506  | 8,976  |
| Culture and recreation  | 697,504           | 877,029           | 873,077  | 3,952  |
| Health  | 657,911           | 657,911           | 657,911  | -  |
| Welfare and community development   | 610,157           | 507,880           | 494,588  | 13,292   |
| <b>Total expenditures</b>   | <b>11,208,468</b> | <b>13,287,436</b> | <b>13,143,363</b>                                      | <b>144,073</b>                                       |
| <b>Excess (deficiency) of revenues over expenditures</b>  | <b>-</b>          | <b>(240,904)</b>  | <b>(6,228)</b>   | <b>234,676</b>                                       |
| <b>Other financing sources (uses)</b>   |                   |                   |  |  |
| Transfers in  | -                 | 503,898           | 503,898  | -  |
| Transfers out   | -                 | (262,994)         | (262,994)  | -  |
| <b>Total other financing sources (uses)</b>   | <b>-</b>          | <b>240,904</b>    | <b>240,904</b>   | <b>-</b>   |
| <b>Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses</b> | <b>\$ -</b>       | <b>\$ -</b>       | <b>\$ 234,676</b>                                      | <b>\$ 234,676</b>                                    |

The accompanying notes to required supplemental information are an integral part of this schedule.

**MUNICIPALITY OF HATILLO**

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -  
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND**

**June 30, 2004**

**NOTE A – BUDGET PROCESS AND BUDGETARY BASIS OF ACCOUNTING**

The Municipal budget is prepared for General Fund following the requirements of the Municipal Law of 1981 as amended. Although all operating expenses and expenditures are allocated to departmental operating budgets, certain items are not considered to be subject to direct control at the department level. These includes: terminal leave payments, payroll taxes, pension costs, court costs and settlements, telephone and electricity expenses and liability, workers compensation and property insurance premiums. Budget amendments, which require a change in total appropriations of any department, are approved by the Municipal Legislature. Certain budget transfers within the limitations and restriction of the Municipal Law can be approved by the Executive Branch or by the Legislature Branch. The budget is prepared on a budgetary (statutory) basis of accounting which is different from GAAP. Revenues include amounts classified by GAAP as other financing sources and expenditures include encumbrances and amounts classified by GAAP as other financing uses. On a GAAP basis, encumbrances outstanding at year end are reported in the governmental funds statements as a reservation of fund balance since they do not constitute expenditures or liabilities while on a budgetary basis encumbrances are recorded as expenditures of current year. Encumbrance appropriations lapse one year after the end of the fiscal year. Unencumbered appropriations are lapsed at year end.

The presentation of the budgetary data excludes other appropriations such as capital projects, debt service and special revenue funds because projects are funded on a multi-year nature, generally requiring several years to complete or effective budgetary control is alternatively achieved through general obligation bond indentures and legal and contractual grant agreement provisions.

**NOTE B - BUDGET TO GAAP RECONCILIATION**

The budgetary comparison schedule - general fund present comparisons of the original and final legally adopted budget with actual data on a budgetary basis. Since accounting principles applied for the purposes of developing data on a budgetary basis differ significantly from those used to present accounting principles generally accepted in the United States, the following budget to GAAP reconciliation is presented:

**MUNICIPALITY OF HATILLO**  
**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -**  
**BUDGETARY COMPARISON SCHEDULE - GENERAL FUND**

June 30, 2004

**NOTE B - BUDGET TO GAAP RECONCILIATION - Continued**

|   |                            |
|---|----------------------------|
| <b>Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):</b> | <b>\$ 234,676</b>          |
| Budget to GAAP differences:   |                            |
| Non budgeted funds recorded as revenues for financial reporting purposes:   | 956,243                    |
| Non budgeted funds recorded as expenditures for financial reporting:  | (398,813)                  |
| Revenues recorded for financial reporting purposes but not in budgetary basis:                                      | 203,830                    |
| Revenues recorded in budgetary basis purposes but not in financial reporting:                                       | (402,824)                  |
| Expenditures recorded in budgetary basis but not for financial reporting purposes:                                  | 1,389,481                  |
| Expenditures recorded for financial reporting purposes but not in budgetary basis:                                  | (1,064,649)                |
| Current year encumbrances recorded as expenditures for budgetary reporting purposes:                                | <u>537,925</u>             |
| <b>Net change in fund balance (GAAP basis):</b>   | <b><u>\$ 1,455,869</u></b> |

REPORTS REQUIRED UNDER THE OMB CIRCULAR A-133

# GONZÁLEZ TORRES & Co.

*Certified Public Accountants and Consultants*

Member of:  
Puerto Rico Society of Certified Public Accountants  
American Institute of Certified Public Accountants  
Association of Certified Fraud Examiners

## **REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Mayor and Municipal Assembly  
**Municipality of Hatillo**  
Hatillo, Puerto Rico

We have audited the accompanying financial statements of governmental activities, each major fund and aggregated fund information of **Municipality of Hatillo**, as for the year ended June 30, 2004, and have issued our report thereon dated December 3, 2004, 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 of America.

### **Compliance**

As part of obtaining reasonable assurance about whether **Municipality of Hatillo's** financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The result of our tests disclosed instances of noncompliance that are required to be reported under Government Auditing Standards which are described in the accompanying Schedule of Findings and Questioned Cost, identified as items 2004-III-1 thru 2004-III-4.

### **Internal Control over Financial Reporting**

In planning and performing our audit, we considered the **Municipality of Hatillo's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting.

However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the **Municipality of Hatillo's** ability to record, process, summarize, and report financial data consistent with the assertions of Management in the statement of the basic financial statements.

**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**  
(Continues)

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the statement of the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of reportable condition is a material weakness. We also noted other matters involving the internal control over financial reporting, which we have reported to the management the **Municipality of Hatillo** in a separate letter dated December 3, 2004.

This report is intended for the information of the audit committee, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

San Juan, Puerto Rico  
December 3, 2004

The stamp number 2028979  
was affixed to original of this report



*González Torres & Co. PSE*  
GONZÁLEZ TORRES & CO., PSC  
LIC. 96  
Expires on December 1, 2005



## REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE WITH OMB CIRCULAR A-133

To the Mayor and Municipal Assembly  
**Municipality of Hatillo**  
Hatillo, Puerto Rico

### Compliance

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

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

In our opinion, **Municipality of Hatillo**, complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2004. However, the results of our auditing procedures disclosed instances of non compliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs -Section III as items 2004-III-1 thru 2004-III-4.

### Internal Control Over Compliance

Management of **Municipality of Hatillo** is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs.

In planning and performing our audit, we considered **Municipality of Hatillo's** internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM  
AND ON INTERNAL CONTROL OVER COMPLIANCE WITH OMB CIRCULAR A-133  
(Continues)**

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weakness.

**Schedule of Expenditures of Federal Awards**

We have audited the accompanying financial statements of governmental activities, each major fund and aggregated fund information of **Municipality of Hatillo**, as for the year ended June 30, 2004, and have issued our report thereon dated December 3, 2004.

Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the **Municipality of Hatillo's** basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements of **Municipality of Hatillo**. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended for the information of the audit committee, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

San Juan, Puerto Rico  
December 3, 2004

The stamp number 2028980  
was affixed to the original of this report.



*González Torres*  
GONZALEZ TORRES & CO., PSC  
LIC. 96  
Expires on December 1, 2005

MUNICIPALITY OF HATILLO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FISCAL YEAR ENDED JUNE 30, 2004

| Federal Grantor/Pass-Through<br>Grantor/Program Title   | Federal<br>CFDA<br>Number<br>(note B) | Pass-Through<br>Grantor's<br>Number<br>(note C) | Expenditures<br>(note A) |
|---|---------------------------------------|---|--------------------------|
| <b><u>U.S. Department of Housing and Urban Development</u></b>  |                                       |   |                          |
| Program:  |                                       |   |                          |
| Passed through the Office of Commissioner of Municipal Affairs:<br>Community Development Block Grant - State's Program  | 14.218                                | SC-29   | \$ 762,010               |
| Program:  |                                       |   |                          |
| Direct Program:<br>Section 8 Housing Choice Vouchers  | 14.871                                | N/A   | <u>334,481</u>           |
|   |                                       |   | 1,096,491                |
| <b><u>U.S. Department of Health and Human Services</u></b>  |                                       |   |                          |
| Program:  |                                       |   |                          |
| Passed through the P.R. Department of Family - Families and<br>Children Administration:<br>Child Care and Development Block Grant   | 93.575                                | N/AV  | 201,425                  |
| Program:  |                                       |   |                          |
| Passed through the P.R. Governor Office ( Office of Elderly Affairs):<br>Special Programs for the Aging_ Title III Part B_ Grants for<br>Supportive Services and Senior Centers | 93.044                                | N/AV  | <u>39,528</u>            |
|   |                                       |   | 240,953                  |
| <b><u>U.S. Department of Agriculture</u></b>  |                                       |   |                          |
| program:  |                                       |   |                          |
| Passed through the P.R. Department of Education:<br>Child and Adult Care Food Program   | 10.558                                | N/AV  | 25,479                   |
| <b><u>U.S. Department of Transportation:</u></b>  |                                       |   |                          |
| Programs:   |                                       |   |                          |
| Direct Program:<br>Federal Transit—Formula Grants   | 20.507                                | N/AV  | 141,948                  |
| Total federal awards expenditures:  |                                       |   | <u>\$ 1,504,871</u>      |

The accompanying notes are an integral part of this schedule.

**MUNICIPALITY OF HATILLO**  
**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**June 30, 2004**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality and is presented on the modified accrual basis of accounting. Expenditures are recognized when the related liability is incurred. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Government and Nonprofit Organizations.

**NOTE B - FEDERAL CFDA NUMBER**

The Catalog of Federal Domestic Assistance (CFDA) Number is a program identification number. The first two digits identify the federal department or agency that administers the program and the last three numbers are assigned by numerical sequence.

**NOTE C - PASS -THROUGH GRANTOR'S NUMBER**

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

**NOTE D - RECONCILIATION OF EXPENDITURES PRESENTED IN THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS TO THE EXPENDITURES PRESENTED IN THE BASIC FINANCIAL STATEMENTS**

| Description                          | Other Governmental<br>Funds |
|--------------------------------------|-----------------------------|
| 14.228                               | \$ 762,010                  |
| 14.871                               | 334,481                     |
| 10.558                               | 25,479                      |
| 93.575                               | 201,425                     |
| 93.044                               | 39,528                      |
| 20.507                               | 141,948                     |
| Total federal awards expenditures    | 1,504,871                   |
| Total nonfederal awards expenditures | 2,957,036                   |
| Total expenditures, fund statements  | \$ 4,461,907                |

**MUNICIPALITY OF HATILLO**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**For the year ended JUNE 30, 2004**

**SECTION I-SUMMARY OF AUDITOR'S RESULTS**

**Part I Financial Statements:**

1. Type of audit report:
  - Unqualified opinion
  - Qualified opinion
  - Adverse opinion
  - Disclaimer of opinion
2. Reportable conditions reported
  - Yes
  - No
3. Reportable condition reported as a major weakness:
  - Yes
  - No
4. Material noncompliance disclosed:
  - Yes
  - No

**Part II Federal Awards**

Type of report: on compliance for major programs:

- Unqualified opinion**
- Qualified opinion
- Adverse opinion
- Disclaimer of opinion

Reportable condition reported as a major weakness:

- Yes
- No

**MUNICIPALITY OF HATILLO**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

**For the year ended JUNE 30, 2004**  
(Continues)

**SECTION I-SUMMARY OF AUDITOR'S RESULTS (Continued)**

**Part II Federal Awards (Continued):**

Material noncompliance disclosed:

Yes  No

Audit findings required to be reported under Section 510 (a) of Circular A-133:

Yes  No

Major Programs:

| <u>CFDA<br/>Number (s)</u> | <u>Federal Program Grantor and Program Name</u>                    |
|----------------------------|--|
| 14.218                     | <i>US Department of Housing and Urban Development.</i>             |
| 14.871                     | Community Development Block Grants<br>Section 8 (Housing Vouchers) |

Dollar threshold used to distinguish Type A and Type B programs:

\$300,000 or 3% of total federal awards expended

Low-risk auditee

Yes  No

Waive risk criteria under 520 (i) of Circular A-133

Yes  No

**MUNICIPALITY OF HATILLO**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

For the year ended JUNE 30, 2004

**SECTION III- FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS**

**Program: CDBG**

**Finding Number**  
**2004-III-1**

**Procurement, Suspension and Debarment**

**Criteria and Condition:**

As per OMB Circular A-133, compliance I, states and governmental sub recipients of States, shall use the same State policies and procedures used for procurements from non-Federal funds. They also shall ensure that every purchase order or other contract includes any clauses required by Federal statutes an executive orders and their implementing regulations. Non-Federal entities are prohibited from contracting with or making sub awards under covered transactions to parties that are suspended whose principals are suspended or debarred.

During our audit we could not observe any suspension and debarment clauses or certifications regarding to the active construction contracts during fiscal year.

**Cause:**

The municipality does not request to supplier suspension certifications at the time to do the contract in order to comply with the compliance on suspension and debarment compliance.

**Effect:**

Program is not complying with required suspension and debarment compliance procedures.

**Questioned Costs:**

None.

**Recommendation:**

We recommend to include suspension and debarment contract clauses or to require suspension and debarment certifications to suppliers.

**Management Response:**

Management is going to apply procedures to comply federal regulations.

**MUNICIPALITY OF HATILLO**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

For the year ended JUNE 30, 2004  
(Continues)

**SECTION III- FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS**

**Program: CDBG**

**Finding Number**  
**2004-III-2**

**Davis Bacon -Act**

**Criteria and Condition:**

The OMB Circular A-133, (compliance D), non-federal entities shall include in their construction contracts subject to the Davis-Bacon Act a requirement that the contractor or subcontractor comply with the requirements of the Davis-Bacon Act and the DOL regulations (29 CFR parts 5, "Labor Standards Provisions Applicable to Contracts Governing Federally Financed and Assisted Construction"). This includes a requirement for the contractor or subcontractor to submit to the non-Federal entity weekly, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance (certified payrolls) (29 CFR sections 5.5 and 5.6). This reporting is often done using Optional Form WH-347, which includes the required statement of compliance (OMB No. 1215-0149). The requirements for Davis- Bacon are also contained in the A-102 Common Rule (§\_\_\_\_.36 (i) (5)

During our examination we could not observe, in two construction contracts, documents of projects payrolls being monitored by the municipality.

**Cause:**

The municipality did not monitor the payrolls to comply with Davis Bacon Act on the above mentioned projects.

**Effect:**

The municipality is not in compliance with Davis Bacon Act.

**Questioned Costs:**

None.

**Recommendation:**

To verify and document contractor or subcontractor's required weekly submission, for construction contracts over \$2,000. And document in those payrolls submitted, that wages rates were compared to the prevailing wages rates list.

**Management Response:**

Management stated that they complied with Davis Bacon Act.

**MUNICIPALITY OF HATILLO**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**For the year ended JUNE 30, 2004**  
**(Continues)**

**SECTION III- FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS**

**Program: CDBG**

**Finding Number**  
**2004-III-3**

**Cash Management**

**Criteria and Condition:**

As per OMB C-A 133, compliance C, when entities are funded on a reimbursement basis, program costs must be paid for by entity funds before reimbursement is requested from the Federal Government. When funds are advanced, recipients must follow procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement. When advance payment procedures are used, recipients must establish similar procedures for sub recipients.

During our examination, we were unable to observe from our sample, the time elapsing between fund deposits and payments dates.

**Cause:**

Client does not provide evidence for cash management compliance.

**Effect:**

The municipality is not complying with program regulations.

**Questioned Costs:**

None.

**Recommendation:**

To have a detail of payments that support the cash advances requests amounts, which are going to be disbursed for the payments at the time the money is deposit on bank account.

**Management Response:**

Management will establish and coordinate in the municipality's finance department internal controls in order to comply with cash management regulations.

**MUNICIPALITY OF HATILLO**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

For the year ended JUNE 30, 2004  
(Continues)

**SECTION III- FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS**

**Program: CDBG**

**Finding Number**  
**2004-III-4**

**Equipment**

**Criteria and Condition:**

Title to equipment acquired by a non-Federal entity with Federal awards vests with the non-Federal entity. Equipment means tangible nonexpendable property, including exempt property, charged directly to the award having a useful life of more than one year and an acquisition cost of \$5,000 or more per unit. However, consistent with a non-Federal entity's policy, lower limits may be established. A State shall use, manage, and dispose of equipment acquired under a Federal grant in accordance with State laws and procedures. Sub recipients of States who are local governments or Indian tribes shall use State laws and procedures for equipment acquired under a sub grant from a State. Local governments and Indian tribes shall follow the A-102 Common Rule for equipment acquired under Federal awards received directly from a Federal awarding agency.

**Cause:**

The municipality did not provide CDBG inventory at 06/3/04.

**Effect:**

Management is not complying with program regulation.

**Questioned Costs:**

None.

**Recommendation:**

To have a CDBG's property and equipment inventory to comply with federal regulations.

**Management Response:**

Management responded that the property inventory records funded with CDBG's funds are included within the rest of the municipality's property records. Responsible personnel were instructed to update a CDBG's property inventory.

**MUNICIPALITY OF HATILLO**  
**SCHEDULE OF PRIOR YEARS AUDIT FINDINGS AND QUESTIONED COSTS**  
**For the year ended JUNE 30, 2004**

**Program: CDBG**

**Finding Number**  
**2003-1**

**Procurement**

**Condition:**

We noted in our tests of the Municipality internal control over disbursement process, that supporting documents corresponding to CDBG, the authorization signatures of Official Payer, Supervisor, and Finance Director were missing.

**Status:**

Finding has not been cleared by grantor's agency.

**Questioned Costs:**

None.

**Program: CDBG**

**Finding Number**  
**2003-2**

**Procurement**

**Condition:**

During our tests we noted that one purchase order was missing.

**Status:**

Finding has not been cleared by grantor's agency.

**Questioned Costs:**

None.

**MUNICIPALITY OF HATILLO**  
**SCHEDULE OF PRIOR YEARS AUDIT FINDINGS AND QUESTIONED COSTS**

**For the year ended JUNE 30, 2004**  
**(Continues)**

**Program: CDBG, FTA**

**Finding Number**  
**2003-3**

**Cash Management**

**Condition:**

In our examination, we found that programs held excess of cash amounts.

**Status:**

Finding has not been cleared by grantor and federal agency.

**Questioned Costs:**

None.

**Program: Child Care**

**Finding Number**  
**2003-4**

**Payroll**

**Condition:**

During our payroll tests of control, we did not find evidence of I-9 form on employee's files.

**Status:**

Finding has not been cleared.

**Questioned Costs:**

None.

**MUNICIPALITY OF HATILLO**  
**SCHEDULE OF PRIOR YEARS AUDIT FINDINGS AND QUESTIONED COSTS**  
**For the year ended JUNE 30, 2004**  
**(Continues)**

**Program: Child Care  
COPS  
SECTION 8  
FEMA**

**Finding Number  
2002-1**

**Procurement**

**Condition:**

Reportable condition over disbursement process.

**Status:**

Finding has not been cleared.

**Questioned Costs:**

None.

**Program: SECTION 8  
CDBG**

**Finding Number  
2002-2**

**Reporting**

**Condition:**

Reportable condition over reporting requirements over Section 8 and CDBG.

**Status:**

Finding has not been cleared.

**Questioned Costs:**

None.

**MUNICIPALITY OF HATILLO**  
**SCHEDULE OF PRIOR YEARS AUDIT FINDINGS AND QUESTIONED COSTS**  
**For the year ended JUNE 30, 2004**  
**(Continues)**

**Program: CDBG  
CHILD CARE  
SECTION 8**

**Finding Number  
2002-3**

**Cash Management**

**Condition:**

Reportable conditions over cash management.

**Status:**

Finding has not been cleared.

**Questioned Costs:**

None.