

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE HATILLO

AUDITORIA 2006-2007

30 DE JUNIO DE 2007

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MUNICIPALITY OF HATILLO, PUERTO RICO
BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007

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

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MUNICIPALITY OF HATILLO

June 30, 2007

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MUNICIPALITY OF HATILLO

June 30, 2007

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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 AUDITOR'S REPORT

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

We have audited the financial statements of the governmental activities, major funds, business-type activities, and remaining fund information of the Municipality of Hatillo ("Municipality"), as of and for the year ended June 30, 2007, which collectively comprise the Municipality's financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express 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 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, major funds, business type activities, and remaining fund information of the Municipality of Hatillo as of June 30, 2007, 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 March 18, 2008, 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 agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

INDEPENDENT AUDITOR'S REPORT
(Continued)

The Management's Discussion and Analysis and budgetary comparison information on pages 1 through 8 and 45 through 47, 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 required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted 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 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.

March 18, 2008
San Juan, Puerto Rico

The stamp number 2261352
was affixed to the original of this report.

González Torres Co. PSC
GONZÁLEZ TORRES & CO., PSC
License number 96
Expires December 1, 2008



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, 2007. 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 **\$1,680,344**.
- In the fund financial statements, the governmental activities revenue increased **\$3,831,043** (or 20%) while governmental activities expenditures increased **\$3,660,500** (or 19%).
- On a budgetary basis, actual expenditures exceeded actual revenues by **\$903,338**.
- The business-type activity closed with net assets of **\$1,118,531**.

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. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Municipality is improving or deteriorating.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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.

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, 2007. Also, the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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 deficit (excess of liabilities over assets) totaled \$1,278,225 million at the end of 2007, and the net assets as of June 30, 2007 amounted to \$39,927,544 million.

MUNICIPALITY OF HATILLO

CONDENSED STATEMENT OF NET ASSETS
June 30, 2007

	Governmental	Business-type Activities
Current assets	\$ 5,771,778	\$ 328,895
Capital assets	43,066,199	5,358,991
Other assets	<u>5,850,785</u>	<u>-</u>
Total assets	54,688,762	5,687,886
Current liabilities	5,302,323	453,755
Non-current liabilities	<u>9,458,895</u>	<u>4,115,600</u>
Total liabilities	14,761,218	4,569,355
Invested in capital assets, net of related debt	36,518,779	1,436,391
Restricted	4,686,990	-
Unrestricted	<u>(1,278,225)</u>	<u>(317,860)</u>
Total net assets	<u>\$ 39,927,544</u>	<u>\$ 1,118,531</u>

Changes in Net Assets

The Municipality's net assets increased by **\$1,680,344**. Approximately 55 percent of the Municipality's total revenue came from taxes, while 41 percent resulted from grants and contributions, including federal aid. Charges for Services provided 2 percent of the total revenues and interests and donations 2 percent. The Municipality's expenses cover a range of services. The largest expenses were for public works and sanitation, general government and health and welfare services.

MUNICIPALITY OF HATILLO

CONDENSED STATEMENT OF ACTIVITIES
June 30, 2007

	Governmental	Business-type Activities
Program revenues:		
Charges for services	\$ 44,603	\$ 961,266
Operating grants and contributions	714,683	-
Capital grants and contributions	1,795,818	-
General revenues:		
Property taxes	8,801,867	-
Municipal license tax	4,147,246	-
Grants and contributions not restricted to specific programs	7,173,290	-
Interest and investment earnings	570,228	-
Miscellaneous	-	-
Other	204,267	-
Transfers in	150,000	551,498
Transfers out	<u>(551,498)</u>	<u>(150,000)</u>
Total revenues	23,050,504	1,362,764
Expenses:		
General	7,092,020	-
Public safety	646,479	-
Public works	7,431,004	-
Culture and recreation	1,724,093	939,246
Health and welfare	3,174,705	-
Interest on long-term debt	508,462	243,915
Depreciation	793,397	108,001
Loss on disposal of assets	-	-
Other	<u>-</u>	<u>-</u>
Total expenses	21,370,160	1,291,162
Change in net assets	1,680,344	71,602
Net assets, beginning of year	<u>38,247,200</u>	<u>1,046,929</u>
Net assets, end of year	<u>\$ 39,927,544</u>	<u>\$ 1,118,531</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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 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 **\$6,409,115**, an increase of **\$179,025** in comparison with the prior year. There are reservations of fund balance amounting to **\$4.7 million**. This is the fund balance that it is not available for new spending because it has already been committed; 1) to pay debt service (**\$813,000**), 2) to pay for capital projects (**\$2.6 million**), 3) for special revenues fund (**\$815,000**), 4) for encumbrances **\$828,000**, and for other purposes **\$280,000**.

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2007, the general fund has an unrestricted balance of **\$1.09 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, 2007, amounts to **\$56 million**, net of accumulated depreciation of **\$13 million**, leaving a net book value of **\$43 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% in terms of net book value. Depreciation charges for the year totaled **\$901,399**. This amount included **\$793,397** for general fund and **\$108,002** for enterprise fund.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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.

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. The Municipality outstanding general obligation (bonds and notes) debt as of June 30, 2007, is \$10.9 million.

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 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 2006-2007 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 AUDITORS' REPORT

EXAMPLE & CO. REPORT

BASIC FINANCIAL STATEMENTS

MUNICIPALITY OF HATILLO

STATEMENT OF NET ASSETS
June 30, 2007

	Primary Government		
	Governmental Activities	Business Type Activities	Total Primary Government
ASSETS			
Cash, including \$3,650,000 in CD	\$ 4,142,613	\$ 257,864	\$ 4,400,477
Receivables, net			
Municipal license taxes, \$1,306,108 less allowance of \$444,077	862,031	-	862,031
Rents and construction permits	125,708	-	125,708
Other	87,039	(87,039)	-
Due from:			
Commonwealth Government	502,987	-	502,987
Federal Government	51,400	-	51,400
Interfunds	-	-	-
Restricted assets:			
Cash	2,959,783	-	2,959,783
Cash with fiscal agents	2,690,670	158,070	2,848,640
Deferred expense	200,432	-	200,432
Capital assets:			
Land and construction in progress	25,209,490	1,216,200	26,424,690
Other capital assets, net	17,866,709	4,143,791	22,000,500
Total capital assets, net	<u>43,066,199</u>	<u>5,358,991</u>	<u>48,425,190</u>
Total assets	<u>\$ 54,688,762</u>	<u>\$ 5,687,886</u>	<u>60,376,648</u>
LIABILITIES			
Accounts payable and accrued liabilities	1,113,430	29,860	1,143,290
Interest Payable	273,510	116,895	390,405
Due to:			
Commonwealth Government	88,925	-	88,925
Deferred revenues:			
Municipal license taxes	3,192,458	-	3,192,458
Federal grants	-	-	-
Long term liabilities :			
Due within one year	634,000	307,000	941,000
Due in more than one year	9,458,895	4,115,600	13,574,495
Total liabilities	<u>14,761,218</u>	<u>4,568,355</u>	<u>19,330,573</u>
NET ASSETS			
Invested in capital assets, net of related debt	36,518,779	1,436,391	37,955,170
Restricted for:			
Capital projects	2,576,528	-	2,576,528
Debt service	813,059	-	813,059
Other specified purposes	1,297,403	-	1,297,403
Unrestricted (deficit)	<u>(1,278,225)</u>	<u>(317,860)</u>	<u>(1,596,085)</u>
Total net assets	<u>39,927,544</u>	<u>1,118,531</u>	<u>41,046,075</u>

The accompanying notes are an integral part of this statement.

MUNICIPALITY OF HATILLO

**STATEMENT OF ACTIVITIES
Fiscal year ended June 30, 2007**

Functions	Expenses	Program Revenues			Net (expenses) revenues and changes in net assets		Total
		Fees, Fines and Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business Type Activities	
Governmental Activities:							
General government	\$ 6,972,996	\$ 44,603	\$ -	\$ -	\$ 6,928,392	\$ -	\$ 6,928,392
Public works and sanitation	7,418,274	-	-	-	7,418,274	-	7,418,274
Public safety	687,872	-	-	-	687,872	-	687,872
Recreation	1,851,323	-	-	-	1,851,323	-	1,851,323
Housing, welfare and community development	3,212,847	-	714,683	1,795,818	702,346	-	702,346
Interest on long term debt	608,462	-	-	-	608,462	243,916	752,377
Other	718,387	-	-	-	718,387	-	718,387
Total	\$ 21,370,160	\$ 44,603	\$ 714,683	\$ 1,795,818	\$ 18,815,056	\$ 243,916	\$ 19,058,971
Business Type Activities:							
Recreation	1,047,247	961,266	-	-	-	85,981	85,981
Total business type activities	1,047,247	961,266	-	-	-	85,981	85,981
Totals	\$ 22,417,407	\$ 1,005,869	\$ 714,683	\$ 1,795,818	\$ 18,815,056	\$ 329,896	\$ 19,144,952
General revenues							
Property taxes					8,801,867	-	8,801,867
Municipal license taxes					4,147,246	-	4,147,246
Grants and contributions not restricted to specific programs					7,173,290	-	7,173,290
Interest					570,228	-	570,228
Operating Transfers					(401,498)	401,498	-
Loss on Disposal of Assets					-	-	-
Other					204,267	-	204,267
Total					20,495,400	401,498	20,896,898
			Change in net assets		1,680,344	71,602	1,751,946
			Net assets-beginning		38,247,200	1,046,929	39,294,129
			Net assets-ending		\$ 39,927,544	\$ 1,118,531	\$ 41,046,075

The accompanying notes are an integral part of this statement.

MUNICIPALITY OF HATILLO

BALANCE SHEET – GOVERNMENTAL FUNDS

June 30, 2007

	General	State Legislative Resolutions	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
ASSETS					
Cash, including \$3,650,000 in certificates of deposits	\$ 4,138,741	\$ -	\$ -	\$ 3,873	\$ 4,142,614
Receivables, net:					
Municipal license taxes	862,031	-	-	-	862,031
Rents and others	125,708	-	-	-	125,708
Due from:					
Commonwealth Government	502,791	-	-	198	502,987
Federal Government	-	-	-	51,400	51,400
Other funds	739,168	-	-	105,431	844,599
Deferred expense	-	-	-	200,432	200,432
Restricted assets:					
Cash	-	407,987	-	2,551,798	2,959,783
Cash with fiscal agents	-	-	1,821,569	869,000	2,890,569
Total assets	\$ 6,388,439	\$ 407,987	\$ 1,821,569	\$ 3,782,128	\$ 12,380,123
LIABILITIES					
Accounts payable and accrued liabilities	\$ 693,377	\$ -	\$ -	\$ 40,304	\$ 733,981
Matured bonds and interest payable	-	-	1,008,510	-	1,008,510
Due to:					
Commonwealth Government	88,925	-	-	-	88,925
Other funds	-	43,195	-	714,365	757,560
Deferred revenues:					
Municipal license taxes	3,192,458	-	-	-	3,192,458
Intergovernmental-Commonwealth Government	189,874	-	-	-	189,874
Federal grants	-	-	-	-	-
Total liabilities	4,184,634	43,195	1,008,510	754,669	6,971,008
FUND BALANCES					
Reserved for:					
Encumbrances	827,697	-	-	-	827,697
Debt service	-	-	813,059	-	813,059
Capital projects	-	-	-	2,578,528	2,578,528
Other specified purposes	279,818	364,792	-	450,931	1,095,541
Undesignated	1,096,290	-	-	-	1,096,290
Total fund balances	2,203,805	364,792	813,059	3,027,459	6,409,115
Total liabilities and fund balances	\$ 6,388,439	\$ 407,987	\$ 1,821,569	\$ 3,782,128	\$ 12,380,123

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, 2007

Total governmental fund balances:		\$6,409,115
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:		43,066,199
Other assets are not available to pay for current-period expenditures and therefore are deferred in the funds:		189,873
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	\$ (5,812,420)	
Compensated absences	(1,669,380)	
Debt to The Health Reform	(552,486)	
Doubtfull accounts debt payable to CRIM	(309,336)	
Christmas bonus	(379,748)	
LIMS Reimbursement to CRIM	(213,765)	
Landfill Closure and Postclosure Care Costs	<u>(800,508)</u>	<u>(9,737,643)</u>
Net assets of governmental activities:		<u>\$ 39,927,544</u>

The accompanying notes are an integral part of this statement.

MUNICIPALITY OF HATILLO

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES—GOVERNMENT FUNDS

Fiscal year ended June 30, 2007

	General	Joint Resolutions	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues					
Property taxes	\$ 6,771,793	\$ -	\$ 2,030,074	\$ -	\$ 8,801,867
Municipal license taxes	4,147,247	-	-	-	4,147,247
Intergovernmental:					
Commonwealth government	4,300,941	245,590	-	2,586,975	7,133,506
Federal government	79,608	-	-	2,430,892	2,510,500
Fees, fines and charges for services	44,603	-	-	-	44,603
Interest	406,456	26,155	95,073	42,544	570,228
Other	185,876	-	-	18,390	204,266
Total revenues	15,936,524	271,745	2,125,147	5,078,801	23,412,217
Expenditures					
General government	7,271,554	-	-	-	7,271,554
Public works and sanitation	6,829,481	-	-	302,850	7,132,331
Public safety	587,676	-	-	9,862	597,538
Culture and recreation	1,651,478	-	-	-	1,651,478
Health	-	-	-	-	-
Housing, welfare and community development	572,912	32,608	-	2,514,625	3,120,145
Others	-	-	-	50	50
Capital outlays	201,830	684,027	-	1,021,078	1,906,935
Debt service:					
Principal	-	-	779,000	-	779,000
Interest	-	-	588,294	-	588,294
Total expenditures	17,114,931	716,635	1,367,294	3,848,465	23,047,325
Excess (deficiency) of revenues over expenditures	(1,178,407)	(444,890)	757,853	1,230,336	364,892
Other financing sources (uses)					
Transfers in from other funds	1,568,545	-	-	150,000	1,718,545
Transfers out from other funds	(178,389)	-	(1,416,497)	(152,047)	(1,746,933)
Proceeds from loans	-	-	-	-	-
Total other financing sources (uses)	1,390,156	-	(1,416,497)	(2,047)	(28,388)
Net change in fund balance	211,749	(444,890)	(658,644)	1,228,289	336,504
Fund balance at beginning of year	1,992,056	809,882	1,471,703	1,799,170	6,072,611
Fund balance at end of year	\$ 2,203,805	\$ 364,792	\$ 813,059	\$ 3,027,459	\$ 6,409,115

*W. J. ...
12/04/08*

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, 2007

Net change in fund balances-total governmental funds:	\$	336,504
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	\$ 1,906,936	
Less: current year depreciation	<u>(793,367)</u>	1,113,539
Governmental funds only report the proceeds received from loans as revenues in the Statement of Activities. Thus the change in net assets differs from the change in fund balance by the total of the proceeds:		
Revenues reported as revenues in the funds and previously reported on the statement of activities		
Christmas Bonus Reimbursement		(150,090)
Revenues reported as deferred revenues in the Governmental funds, but as revenues on the Statement of Activities		
		189,874
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	\$ 779,000	
Other long term liabilities	<u>63,057</u>	842,057
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	\$ (571,872)	
Christmas Bonus	<u>(79,568)</u>	(651,540)
Change in net assets of governmental activities:	\$	<u>1,680,344</u>

The accompanying notes are an integral part of this statement.

MUNICIPALITY OF HATILLO

PROPRIETARY FUND—STATEMENT OF NET ASSETS

June 30, 2007

ASSETS	<u>Enterprise Fund</u>
Current Assets:	
Cash	\$ 257,864
Restricted assets:	
Cash with fiscal agents	158,070
Total Current Assets	<u>415,934</u>
Noncurrent Assets:	
Capital assets:	
Land and construction in progress	1,215,200
Other capital assets, net	4,143,791
Total capital assets, net	<u>5,358,991</u>
Total Noncurrent Assets	<u>5,358,991</u>
Other Assets	<u>-</u>
Total assets	<u>\$ 5,774,925</u>
LIABILITIES	
Current Liabilities:	
Accounts payable and accrued liabilities	\$ 233,794
Total Current Liabilities	<u>233,794</u>
Noncurrent Liabilities:	
Long term liabilities :	
Due within one year	307,000
Due in more than one year	4,115,600
Total Noncurrent Liabilities	<u>4,422,600</u>
Total Liabilities	<u>4,656,394</u>
NET ASSETS	
Invested in capital assets, net of related debt	1,436,391
Unrestricted (deficit)	(317,860)
Total net assets	<u>\$ 1,118,531</u>

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 ended June 30, 2007

	<u>Enterprise Fund</u>
Operating Revenues	
Charges for Services	\$ 961,266
Operating Expenses:	
Maintenance, payroll and supplies	939,246
Interest	243,915
Depreciation	<u>108,001</u>
Total operating expenses	<u>1,291,162</u>
Operating Loss	(329,896)
Nonoperating Revenues and (Expenses):	
Tranfers from Governmental Activities, net	401,498
Loss on disposal of asset	-
Total Nonoperating Revenues and Expenses	<u>401,498</u>
Change in Net Assets	71,602
Net Assets-beginning	<u>1,046,929</u>
Net Assets-ending	<u>\$ 1,118,531</u>

The accompanying notes are an integral part of this statement.

MUNICIPALITY OF HATILLO

PROPRIETARY FUND—STATEMENT OF CASH FLOWS Year ended June 30, 2007

CASH FLOWS FROM OPERATING ACTIVITIES	
Receipts from customers	\$ 961,266
Cash paid to Suppliers and Employees	(963,759)
Interest Paid	(260,698)
Other receipts	-
Net cash provided (used) by operating activities	<u>(263,191)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Principal paid on capital debt	(290,800)
Transfers from Governmental Activities, net	<u>401,498</u>
Net Cash Provided by Financing Activities	<u>110,698</u>
CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of Equipment	(7,415)
Loss on disposal	-
Cash used by Investing Activities	<u>(7,415)</u>
Net decrease in Cash and Cash Equivalents	(159,908)
Balance-beginning of the year	<u>575,842</u>
Balance-end of the year	<u>\$ 415,934</u>
Reconciliation of operating income(loss) to net cash provided by operating activities	
Operating loss	\$ (329,896)
Adjustments to reconcile operating income to net cash provided (used) by operating activities:	
Depreciation expense	108,001
Other Losses	-
Change in assets and liabilities:	
Receivables, net	-
Accounts and other payables	(41,296)
Net cash used by operating activities	<u>\$ (263,191)</u>

The accompanying notes are an integral part of this statement.

NOTES TO FINANCIAL STATEMENTS

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS June 30, 2007

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.

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS June 30, 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

In fiscal year 2006-2007 the Municipality adopted Statement No. 39 "*Determining Whether Certain Organizations Are Component Units - an amendment of GASB 34 Statement No. 14*". This Statement amends GASE 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.

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS June 30, 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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.

Governmental Activities

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.

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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.

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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.

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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.

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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.

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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:

Encumbrances: Represent future expenditures under purchase orders and other commitments, which generally will become liabilities in future periods as the goods or services are received.

Debt Service: Represents net assets available to finance future debt service payments.

Capital Projects: 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.

Other specified purposes: 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

Advances: 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, 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

A) 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.

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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 year ended,
43	Financial Reporting for Post employment Benefits Plans Other Than Pension Plans	June 30, 2008
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, 2007

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, 2007:

- 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, 2007 were as follows:

	1	Category 2	3	Bank Balance	Carrying Amount
Deposits in commercial banks	\$ 7,336,238	\$ -	\$ -	\$ 7,336,236	\$ 7,102,396
Deposits in governmental banks	-	2,690,570	-	2,690,570	2,690,570
	<u>\$ 7,336,238</u>	<u>\$ 2,690,570</u>	<u>\$ -</u>	<u>\$ 10,026,808</u>	<u>\$ 9,792,966</u>

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS
June 30, 2007

NOTE B – DEPOSITS (CONTINUED)

Reconciliation to government-wide statement of net assets:

	Unrestricted	Restricted	Total
Carrying amount of deposits in commercial banks	4,142,613	2,959,783	7,102,396
Carrying amount of deposits in governmental banks	-	2,690,570	2,690,570
	<u>\$4,142,613</u>	<u>\$5,650,353</u>	<u>\$9,792,966</u>

NOTE C - DUE FROM (TO) GOVERNMENTAL ENTITIES

1. Amounts due from governmental entities as of June 30, 2007 follows:

	<u>Commonwealth Entities</u>	<u>Federal Government</u>
Amount due from	<u>\$ 502,987</u>	<u>\$ 51,400</u>

The amount due from Puerto Rico Department of Treasury – Christmas bonus \$189,874 is recorded as deferred revenue in the governmental funds statements (general fund) since is not available as required by current standards.

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS
June 30, 2007

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

2. Amounts due to governmental entities as of June 30, 2007 follows:

	Commonwealth Entities
Puerto Rico Retirement System	\$ 80,375
E.L.A. Employees Association	<u>8,550</u>
	\$ 88,925
	=====

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:

Fund	Payable Fund	Amount
General Fund	Other governmental funds – Public Order	\$ 103,219
General Fund	Other governmental funds-Child Care	63,792
General Fund	Major Fund- State Resolutions	7,365
General Fund	Other governmental funds-BGF Loans	103,272
General Fund	Other governmental funds –CDBG	165,604
General Fund	Other governmental funds – Title III	10,745
General Fund	Other governmental funds – Law 52	198,132
Other Government Funds – Law 82	Other governmental funds – Law 52	50,000
Other Government Funds – Resolution 1166	Other governmental funds – State Resolutions & Law 2	<u>55,431</u>
Total		\$ 757,560
		=====

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, 2007

NOTE E - CAPITAL ASSETS

Capital assets and depreciation activity as of and for the year ended June 30, 2007 is as follows:

	Balance July 1, 2006	Increases	Decreases	Balance June 30, 2007
<u>Governmental Activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 23,326,044	\$ -	\$ -	\$ 23,326,044
Construction in progress	<u>444,611</u>	<u>1,438,835</u>		<u>1,883,446</u>
Total capital assets not being depreciated:	<u>23,770,655</u>	<u>1,438,835</u>	<u>-</u>	<u>25,209,490</u>
Capital assets, being depreciated:				
Buildings and building improvements	17,117,906	-	-	17,117,906
Infrastructure	7,754,424	-	-	7,754,424
Vehicles, machinery and equipment	<u>5,763,265</u>	<u>468,101</u>	<u>-</u>	<u>6,231,366</u>
Total capital assets being depreciated	30,635,595	468,101	-	31,103,696
Less accumulated depreciation for:				
Buildings and building improvements	4,166,961	293,258	-	4,460,219
Infrastructure	5,288,834	35,436	-	5,324,270
Vehicles, machinery and equipment	<u>2,997,795</u>	<u>464,703</u>	<u>-</u>	<u>3,462,498</u>
Total accumulated depreciation	12,453,590	793,397	-	13,246,987
Total capital assets being depreciated, net	<u>18,182,005</u>	<u>(325,296)</u>	<u>-</u>	<u>17,856,709</u>
Governmental activities capital assets, net	<u>\$ 41,952,660</u>	<u>\$ 1,113,539</u>	<u>\$ -</u>	<u>\$ 43,066,199</u>

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS
June 30, 2007

NOTE E - CAPITAL ASSETS (CONTINUED)

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

Governmental activities:

General government	\$ 185,081
Public works and sanitation	282,371
Public safety	67,236
Culture and recreation	196,762
Welfare and community development	28,676
Education	<u>33,271</u>
Total depreciation expense, governmental activities	<u>\$ 793,397</u>

Capital assets and depreciation for business type activities as of and for the year ended June 30, 2007 is as follows:

	Balance, July 1, 2006	Increases	Decreases	Balance June 30, 2007
<u>Business Type Activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 1,215,200	\$ -	\$ -	\$ 1,215,200
Total capital assets not being depreciated:	1,215,200	-	-	1,215,200
Capital assets, being depreciated:				
Buildings and building improvements	4,291,404	-	-	4,291,404
Vehicles, machinery and equipment	<u>312,847</u>	<u>7,415</u>	-	<u>320,262</u>
Total capital assets being depreciated	4,604,251	7,415	-	4,611,666
Less accumulated depreciation	359,874	108,001	-	467,875
Total capital assets being depreciated, net	<u>4,244,377</u>	<u>(100,586)</u>	-	<u>4,143,791</u>
Governmental activities capital assets, net	<u>\$ 5,459,577</u>	<u>\$ (100,586)</u>	<u>\$ -</u>	<u>\$ 5,358,991</u>

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS
June 30, 2007

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, 2007:

	Balance at July 1, 2006	Increases	Decreases	Balance at June 30, 2007	Due within one year
General, Special Obligations Bonds and Notes	\$ 11,854,020	\$ -	\$ 884,000	\$ 10,970,020	\$ 941,000
Compensated absences	1,097,408	571,972	-	1,669,380	793,256
Health Reform	918,047	-	365,561	552,486	-
Municipal Landfill obligation (Note G)	775,482	25,026	-	800,508	-
LIMS Reimbursement - CRIM	218,272	-	4,507	213,765	21,063
Payable to CRIM- prior years doubtful accounts	320,629	-	11,293	309,336	-
Christmas bonus	<u>300,180</u>	<u>601,169</u>	<u>521,601</u>	<u>379,748</u>	<u>379,748</u>
	<u>\$ 15,484,038</u>	<u>\$ 1,198,167</u>	<u>\$ 1,786,962</u>	<u>\$ 14,895,243</u>	<u>\$ 2,135,067</u>

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE F - LONG TERM DEBT (CONTINUED)

2. *General and special obligation bonds and notes*

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2007 amount to \$10,970,020. 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, 2007

NOTE F - LONG TERM DEBT (CONTINUED)

A detail of the general and special obligation bonds and notes as of June 30, 2007 follows:

	Outstanding Amount
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%	\$ 388,020
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%	2,405,000
1998 general obligation bonds of \$624,000 due in annual installments of \$12,000 to \$44,000 through January 1, 2022; with interest at 4.50%	487,000
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%	275,000
2002 general obligation bonds of \$2,265,000 due in annual installments of \$70,000 to \$200,000 through July 1, 2025; with interest from 2.70% to 6.13%	2,040,000
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%	235,000
2004 special obligation note of \$800,000 due in annual installments of \$145,000 to \$235,000 through July 1, 2009; with interest at 4.05%	500,000
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%	3,075,000
1996 general obligation bonds of \$715,000 due in annual installments of \$65,000 to \$345,000 through July 1, 2020; bearing interest at rates ranging from 4.865% to 6.75%	585,000
2005 general obligation bonds of \$1,140,000 due in annual installments of \$140,000 to \$190,000 through July 1, 2012; bearing interest at rates ranging from 4.23% to 4.73%	<u>1,000,000</u>
Outstanding Amount	<u><u>\$10,970,020</u></u>

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS
June 30, 2007

NOTE F - LONG TERM DEBT (CONTINUED)

The annual requirement to amortize general and special obligation bonds and notes as of June 30, 2007 follows:

June 30,	Principal	Interest
2007	\$ 941,000	\$586,912
2008	748,000	548,981
2009	801,000	512,956
2010	563,000	479,603
2011	600,000	449,401
2012 - 2016	2,832,000	1,764,187
2017 - 2021	3,305,020	836,224
2022 - 2026	<u>1,180,000</u>	<u>114,991</u>
Totals	<u>\$10,970,020</u>	<u>\$5,293,256</u>

MUNICIPALITY OF HATILLO

**NOTES TO FINANCIAL STATEMENTS
June 30, 2007**

NOTE F - LONG TERM DEBT (CONTINUED)

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	\$1,669,380
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.	552,486
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.	213,765
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.	309,336
Christmas Bonus - represent the accrued portion corresponding to fiscal year 2005-2007 of the Christmas bonus to be paid in December 2007	<u>379,748</u>
Total other Long-term liabilities	<u>\$3,124,715</u> =====

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE G - LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS OBLIGATIONS

The Municipality discontinued the operation and ceased to accept solid waste of its landfill. State and Federal laws and regulations require 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, 2007. The Municipality has reserved \$800,508 as of June 30, 2007 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 1st and January 1st.

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.

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS June 30, 2007

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, 2007 the tax rates were as follows:

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 \$3,192,458 is recorded as deferred revenues.

NOTE J - 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.

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE J - RETIREMENT PLAN (CONTINUED)

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.

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>
2007	385,951	5,729

MUNICIPALITY OF HATILLO

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE K - 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 \$ 2.6 million. 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.

REQUIRED SUPPLEMENTARY INFORMATION

MUNICIPALITY OF HATILLO

BUDGETARY COMPARISON SCHEDULE – GENERAL FUND

Fiscal year ended June 30, 2007

	<u>Budgeted amounts</u>		<u>Basis</u> <u>(See Note A)</u>	<u>Final Budget</u> <u>Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Property taxes	5,702,021	6,289,896	6,458,876	\$ 188,981
Municipal license taxes	4,060,000	4,214,084	4,347,749	133,666
Intergovernmental	3,726,849	3,743,870	3,744,671	801
License and Permits	175,000	127,074	28,220	(98,854)
Interest	220,000	394,580	500,685	106,105
Other	165,100	1,344,281	179,662	(1,164,619)
Rent	145,000	114,881	116,390	1,509
Transfer from other funds	8,000	887,268	697,268	(190,000)
Transfer in	-	-	-	-
Total revenues	14,191,970	17,115,932	16,073,521	(1,042,411)
Expenditures				
General government	5,896,236	7,180,281	6,882,538	297,743
Public works and sanitation	6,002,337	7,061,460	6,878,726	372,736
Public safety	615,284	596,050	584,852	11,198
Culture and recreation	1,046,903	1,726,642	1,673,643	152,999
Health	-	-	-	-
Welfare and community development	631,211	561,499	538,763	22,736
Education	-	-	-	-
Other	-	-	718,337	718,337
Total expenditures	14,191,970	17,115,932	16,976,868	1,575,748
Excess (deficiency) of revenues over expenditures	-	-	(903,337)	533,337
Other financing sources (uses)				
Transfers in	-	-	-	-
Transfers out	-	-	-	-
Total other financing sources (uses)	-	-	-	-
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	\$ -	\$ -	\$ (903,337)	\$ 533,337

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

MUNICIPALITY OF HATILLO

NOTES REQUIRED SUPPLEMENTARY INFORMATION

June 30, 2007

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
BUDGET COMPARISON SCHEDULE – GENERAL FUND**

June 30, 2007

NOTE B - BUDGET TO GAAP RECONCILIATION - Continued

**Excess of revenues and other financing sources over expenditures and other financing
uses (budgetary basis):**

Budget to GAAP differences:	(\$903,337)
Non budgeted funds recorded as revenues for financial reporting purposes:	1,568,544
Non budgeted funds recorded as expenditures for financial reporting:	(178,389)
Revenues recorded for financial reporting purposes but not in budgetary basis:	4,317,866
Revenues recorded in budgetary basis purposes but not in financial reporting:	(4,667,568)
Expenditures recorded in budgetary basis but not for financial reporting purposes:	1,004,817
Expenditures recorded for financial reporting purposes but not in budgetary basis:	<u>(720,662)</u>

Net change in fund balance (GAAP basis): **\$ 421,272**

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

To the Mayor and Municipal Legislature
Municipality of Hatillo
Hatillo, Puerto Rico

We have audited the accompanying financial statements of governmental activities, the business-type activities, each major fund, and aggregated fund information of Municipality of Hatillo, as for the year ended June 30, 2007, which collectively comprise Municipality of Hatillo's basic financial statements and have issued our report thereon dated December 14, 2007. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Municipality of Hatillo's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Municipality of Hatillo's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Municipality of Hatillo's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of Municipality of Hatillo's financial statements that is more than inconsequential will not be prevented or detected by Municipality of Hatillo's internal control.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be weaknesses, as defined above.

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

(Continued)

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 agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

We noted certain other matters that we reported to management of Municipality of Hatillo in a separate letter dated on March 12, 2008.

This report is intended solely for the information and use of management, audit committee, 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
March 12, 2008

The stamp number 2297139
was affixed to original of this report.

Gonzalez Torres & Co. PSC

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American Institute of Certified Public Accountants

Association of Certified Fraud Examiners

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

To the Mayor and Municipal Legislature
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, 2007. The Municipality of Hatillo's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of 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; the standards applicable to financial audits contained in the Government Auditing Standards, issued by the Comptroller of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that 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, 2007.

Internal Control Over Compliance

The 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, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Municipality of Hatillo's internal control over compliance.

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

Our consideration of the internal control over compliance would not necessarily disclose all matters in the A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Municipality of Hatillo's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by Municipality of Hatillo's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by Municipality of Hatillo's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be weaknesses, as defined above.

Municipality of Hatillo's response to the findings identified in our audit are described in the accompanying schedule of findings and questions costs. We did not audit Municipality of Hatillo's response and, we express no opinion on it.

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
March 12, 2008

The stamp number 2297140
was affixed to the original of this report.

González Torres Jca. PSC

GONZALEZ TORRES & CO., PSC

Lic. 96

Expires on December 1, 2008



MUNICIPALITY OF HATILLO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FISCAL YEAR ENDED JUNE 30, 2007

<u>Federal Grantor/Pass Trough Grantor/Program Title</u>	<u>Federal CFDA Number (note B)</u>	<u>Pass- Through Grantor's Number (note C)</u>	<u>Expenditures (note A)</u>
<u>U.S. Department of Housing and Urban Development</u>			
Program:			
Passed through the Office of Commissioner of Municipal Affairs: Community Development Block Grant – State's Program	14.218	SC-29	\$1,169,249
Program:			
Direct Program Section 8 Housing Choice Vouchers	14.871	N/A	377,964
<u>U.S. Department of Health and Human Services</u>			
Program:			
Passed Through the P.R. Department of Family – Families and Children Administration: Child Care and Development Block Grant	93.575	N/AV	286,852
Program:			
Passed through the P.R. Governors Office (Office of Elderly Affairs) Special programs for the Aging-Title III-Part B Grants for Supportive Services and Senior Centers	93.044	N/AV	72,888
<u>U.S. Department of Agriculture</u>			
Program:			
Passed through the P.R. Department of Education: Child and Adult Care Food Program	10.558	N/AV	16,485
<u>U.S. Department of Transportation</u>			
Program:			
Direct Program: Federal Transit - Formula Grants	20.507	N/AV	18,016
Total Federal Awards Expenditures			<u>\$1,941,454</u>

The accompanying notes are an integral part of this schedule.

MUNICIPALITY OF HATILLO
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
June 30, 2007

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 Funds
14.218	\$ 1,169,249
14.871	377,964
10.558	16,485
93.575	286,852
93.044	72,888
20.507	18,016
Total federal awards expenditures	1,941,454
Total nonfederal awards expenditures	1,907,011
Total expenditures, fund statements	\$ 3,848,465

MUNICIPALITY OF HATILLO
SCHEDULE OF CURRENT YEAR FINDINGS AND QUESTIONED COSTS
For the year ended June 30, 2007

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. Control deficiencies reported:
 - Yes
 - No
3. Material weakness reported:
 - Yes
 - No
4. Material noncompliance disclosed:
 - Yes
 - No

Part II Federal Awards:

1. Type of report: on compliance for major programs:
 - Unqualified opinion
 - Qualified opinion
 - Adverse opinion
 - Disclaimer of opinion
2. Control deficiencies reported:
 - Yes
 - No

MUNICIPALITY OF HATILLO
SCHEDULE OF CURRENT YEAR FINDINGS AND QUESTIONED COSTS
For the year ended June 30, 2007
(Continued)

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

Part II Federal Awards (Continued):

3. Material noncompliance disclosed:

Yes No

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

Yes No

5. Major Programs:

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

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

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

6. Low-risk auditee

Yes No

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

Yes No

MUNICIPALITY OF HATILLO
SCHEDULE OF CURRENT YEAR FINDINGS, PRIOR YEAR FINDINGS AND QUESTIONED COSTS
For the year ended June 30, 2007

SECTION II- FINANCIAL STATEMENTS FINDINGS

Current year:

None.

Prior years:

FINANCIAL STATEMENTS FINDINGS - 2004

Finding Number 2004-II-1

Cash Reconciliation

Criteria and Condition:

Good internal controls must be following on the reconciliations among accounts balances and transactions classes in order to satisfy completeness over financial reporting.

During our audit we observed that the current account cash adjusted bank balance did not match with "Modelo 4A" at June 30, 2004 by approximately \$199,000.

Current Year Status:

Condition has been partially corrected.

Finding Number 2004-II-2

Revenues

Criteria and Condition:

Good internal controls must be following in the accounting cycle support documentation in order to safeguard the municipality's assets.

During our cash receipts test, we did not observe the required paperwork to support construction taxes cash collections revenues amounts.

Current Year Status:

Condition was corrected.

MUNICIPALITY OF HATILLO
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS
For the year ended June 30, 2007

SECTION III- FEDERAL AWARDS FINDINGS

Current year:

None.

Prior years:

FEDERAL AWARDS FINDINGS – 2006

Finding Number 2006-III-01
PROGRAM: CDBG

Cash management

Criteria and Condition:

As required by 31 CFR 205 the sub recipients must establish procedures to minimize the time elapsing between the transfer of funds from the recipients and the disbursements. The average paid out of funds already disbursed was sixteen days, for eleven disbursements (checks issued) out of our sample.

Current Year Status:

Condition has been partially corrected.

Finding Number 2006-III-02
PROGRAM: SECTION 8

Special tests and provisions

Criteria and Condition:

As per OMB Circular A-133, under Special Tests and Provisions, the PHA must consider unit attributes such as the location, quality, size, unit type, and age of the unit, and any amenities, housing services, maintenance and utilities provided by the owner. As part of this requirement the Municipality must required the buy-sale deed of the property chosen for the lease. The deed certifies the size, type, localization and ownership of the property. We found several cases in which the buy-sale deed was not included. The Municipality did not verify properly the attributes of the properties used for the six cases of our sample of participants of the program.

Current Year Status:

Condition has been corrected.

MUNICIPALITY OF HATILLO
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS
For the year ended June 30, 2007

SECTION IV- PRIOR YEAR FINDINGS AND QUESTIONED COSTS (CONTINUED)

FEDERAL AWARDS FINDINGS – 2005

Finding Number 2005-III-01
Program: CDBG

Allowable Costs

Criteria and Condition:

As required by OMB Circular A-102 Common Rule, costs must be documented. The Municipality requested \$16,206 as administrative expense without the corresponding evidence. Just only \$3,350 for fringe benefits was paid without supporting document and the remaining balance of \$12,850 could not be supported as expenditures. Also, requested \$3,200 on December 13, 2004, unpaid as of February 8, 2006.

Current Year Status:

Condition has been corrected.

Finding Number 2005-III-02
Program: CDBG

Cash Management

Criteria and Condition:

As required by 31 CFR 205 the sub recipients must establish procedures to minimize the time elapsing between the transfer of funds from the recipients and the disbursements. The average paid out of funds already disbursed was 35, days, for 18 disbursements (checks issued) out of 25 selected as sample.

Current Year Status:

Condition has been partially corrected.

MUNICIPALITY OF HATILLO
SCHEDULE OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS
For the year ended June 30, 2007

SECTION IV- PRIOR YEAR FINDINGS AND QUESTIONED COSTS (CONTINUED)

Finding Number 2005-III-03
Program: SECTION 8

Special tests and provisions

Criteria and Condition:

As per OMB Circular A -133, under Special Tests and Provisions, the PHA must consider unit attributes such as the location, quality, size, unit type, and age of the unit, and any amenities, housing services, maintenance and utilities provided by the owner. As part of this requirement the Municipality must required the buy-sale deed of the property chosen for the lease. The deed certifies the size, type, localization and ownership of the property. We found several cases in which the buy-sale deed was not included.

Current Year Status:

Condition has been corrected.

FEDERAL AWARDS FINDINGS – 2004

Finding Number 2004-III-1
Program: CDBG

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, for some of the suppliers.

Current Year Status:

Condition has been corrected.

MUNICIPALITY OF HATILLO
SCHEDULE OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS
For the year ended June 30, 2007

Finding Number 2004-III-3
Program: CDBG

Cash Management

Criteria and Condition:

As per OMB Circular 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.

Current Year Status:

Conditions still prevails.

Finding Number 2004-III-4
Program: CDBG

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.

Current Year Status:

Condition has been partially corrected.

MUNICIPALITY OF HATILLO
SCHEDULE OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS
For the year ended June 30, 2007

FEDERAL AWARDS FINDINGS – 2003

Finding Number 2003-1
Program: CDBG

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.

Current Year Status:

Condition has been corrected.

Finding Number 2003-2
Program: CDBG

Procurement

Condition:

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

Status:

Condition has been corrected.

Finding Number 2003-3
Program: CDBG, FTA

Cash Management

Condition:

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

Status:

Condition has been corrected.

MUNICIPALITY OF HATILLO
SCHEDULE OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS
For the year ended June 30, 2007

Finding Number 2003-4
Program: Child Care

Payroll

Condition:

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

Status:

Condition has been corrected.