

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES
ÁREA DE ASESORAMIENTO, REGLAMENTACIÓN E INTERVENCIÓN FISCAL
ÁREA DE ARCHIVO DIGITAL

MUNICIPIO DE HATILLO
AUDITORÍA 2008-2009
30 DE JUNIO DE 2009

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO**

**BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED
JUNE 30, 2009**

ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

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BASIC FINANCIAL STATEMENTS
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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Hatillo, as of and for the year ended June 30, 2009, which collectively comprise the Municipality's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Hatillo as of June 30, 2009, and the respective changes in financial position, thereof and the respective budgetary comparison for the general and debt service funds for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 12, 2009 on our consideration of the Municipality's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations,

contracts, 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.

The Management's Discussion and Analysis on pages 3 through 10 is not a required part of the basic financial statements, but is supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the 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'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. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

San Juan, Puerto Rico
November 12, 2009

Ortiz, Rivera, Rivera & Co.

The stamp 2459306 was affixed
to the original of this report.



**Commonwealth of Puerto Rico
Municipality of Hatillo**

Management's Discussion and Analysis

Year Ended June 30, 2009

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Municipality of Hatillo (the "Municipality") discussion and analysis has been designed with the followings 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;
- e) Identify individual fund issues or concerns.

Since the Management's Discussion and Analysis (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.

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.

FINANCIAL HIGHLIGHTS

- The Municipality net assets decreased by \$1,106,094.
- In the fund financial statements, general fund revenues increased by \$1,181,547 (or 6%).
- The General Fund (the primary operating fund) reflected, on a current financial resource basis, a decrease of \$353,181.
- On a budgetary basis, actual expenditures exceed actual revenues by \$609,785.
- Capital expenditures amounted to \$1,800,422.

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.

**Commonwealth of Puerto Rico
Municipality of Hatillo**

Management's Discussion and Analysis

Year Ended June 30, 2009

The Statement of Net Assets presents information on all of the Municipality's assets and liabilities, with the difference between 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.

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. However, unlike the Government Wide Financial Statements, Government Fund Financial Statements focus on near term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information 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

**Commonwealth of Puerto Rico
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Management's Discussion and Analysis

Year Ended June 30, 2009

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 Municipality has elected to depreciate infrastructure assets instead of using the modified approach.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. The Municipality's net assets totaled \$39.4 million at the end of 2009, compared to \$41.5 million at the end of the previous year.

The largest portion of the Municipality's net assets consists of the investment made throughout the years in capital assets such as land, buildings, equipment and infrastructure. The Municipality uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although, the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from the Debt Service Fund, since the capital assets themselves cannot be used to liquidate these liabilities. The amounts restricted for debt service represents another portion of the net assets, and these are resources subject to external restrictions for the purposes explained above.

The unrestricted deficit is the consequence of previous budgets which did not provide funding for incurred long-term obligations such as compensated absences and claims and judgments among others. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation. Consequently, the Municipality cannot draw from its existing assets to provide services to its citizens and depends on its taxing ability to continue its operations. The restricted portion consists of monies reserved for debt service and future capital expenditures.

**Commonwealth of Puerto Rico
Municipality of Hatillo**

Management's Discussion and Analysis

Year Ended June 30, 2009

**Municipality of Hatillo
Condensed Statement of Net Assets
June 30, 2009 and 2008**

	<u>2009</u>	<u>2008</u>
Current assets	\$ 15,282,467	\$ 15,338,861
Capital assets	49,017,993	48,042,096
Total assets	<u>64,300,460</u>	<u>63,380,957</u>
Current liabilities	7,228,718	6,505,635
Noncurrent liabilities	17,681,259	15,330,012
Total liabilities	<u>24,909,977</u>	<u>21,835,647</u>
Invested in capital assets, net of related debt	49,017,993	34,223,075
Restricted	5,847,391	5,022,998
Unrestricted	(15,474,901)	2,299,237
Total net assets	<u>\$ 39,390,483</u>	<u>\$ 41,545,310</u>

Changes in Net Assets

The Municipality's net assets decreased by \$1.1 million approximately, forty two (42%) percent of the Municipality's total revenue came from Taxes generated by the general fund. Federal Grants was ten (10%) percent, while the State Contributions made twenty one (21%) percent of the total revenues. The Municipality's expenses cover a range of services. The largest expenses were for general government, public works and health and welfare.

**Commonwealth of Puerto Rico
Municipality of Hatillo**

Management's Discussion and Analysis

Year Ended June 30, 2009

**Municipality of Hatillo
Condensed Statement of Activities
June 30, 2009 and 2008**

	<u>2009</u>	<u>2008</u>
Program revenues:		
Charges for services	\$ 6,588,097	\$ 4,640,488
Licenses and Permits		
Operating grants and contributions	967,190	724,120
Capital grants and contributions	2,913,662	937,898
General revenues:		
Property taxes	6,923,174	7,655,960
Municipal license tax	4,251,760	4,079,913
Grants and contributions not restricted to specific programs	4,714,387	5,596,166
Interest, fines and penalties	247,139	513,470
Miscellaneous	<u>204,090</u>	<u>535,622</u>
 Total revenues	 <u>26,809,499</u>	 <u>24,683,637</u>
Expenses:		
General government	10,514,500	7,327,086
Public safety	1,038,538	894,900
Public work	8,236,994	9,193,817
Culture and recreation	2,947,229	3,011,481
Health and welfare	3,439,290	1,601,101
Economic development	251,021	-
Interest on long-term debt	1,488,021	572,742
Other	<u>-</u>	<u>34,191</u>
 Total expenses	 <u>27,915,593</u>	 <u>22,635,318</u>

**Commonwealth of Puerto Rico
Municipality of Hatillo**

Management's Discussion and Analysis

Year Ended June 30, 2009

Change in net assets	(1,106,094)	2,048,319
Net assets, beginning of year	<u>40,496,577</u>	<u>39,496,991</u>
Net assets, end of year	<u>\$ 39,390,483</u>	<u>\$ 41,545,310</u>

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 spendable resources. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$10,154,452 an increase of \$3,992,955 in comparison with the prior year. There are reservations of fund balance amounting to \$7,684,152.

The general fund is included within the governmental funds; it is the chief operating fund of the Municipality. As of June 30, 2009, the general fund has a superavit of \$242,172. The superavit decreased by \$353,181 during current fiscal year.

Notes to the Financial Statements

The basic financial statements also include notes to explain information in the financial statements and provide more detailed data.

Required Supplementary Information

The statements are followed by the required supplementary information that contains the budgetary comparison schedule for the General and Debt Service Funds.

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Municipality of Hatillo**

Management's Discussion and Analysis

Year Ended June 30, 2009

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2009, amounts to \$64.3 million, net of accumulated depreciation of \$15.3 million, leaving a net book value of \$49 million. This investment in capital assets includes land, buildings, improvements, equipment, intangibles, 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, drainage systems, lighting systems, and similar items.

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. As of June 30, 2009 the Municipality has \$7.1 million of unexpended proceeds from bond issuances that are committed to future construction activities.

The Municipality acquired a total of \$1,800,422 of capital assets during the fiscal year 2008-2009 as follows:

- Construction in Progress - \$386,332
- Building and building improvements - \$136,698
- Acquisition of Equipment and Vehicles - \$77,645
- Infrastructure - \$1,199,747

Other projects related to repair and maintenance of roads (not capitalized) was development during the year 2009.

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 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

**Commonwealth of Puerto Rico
Municipality of Hatillo**

Management's Discussion and Analysis

Year Ended June 30, 2009

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's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal grants to carry out the governmental 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.

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 Mr. Jesus Alicea Torres, Chief Financial Officer on the Finance Offices in the Central Town, Hatillo, Puerto Rico.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
STATEMENT OF NET ASSETS
JUNE 30, 2009**

<u>Assets</u>	<u>Governmental Activities</u>
Cash in bank (Notes 2 and 5)	\$ 5,277,968
Cash with fiscal agent (Notes 2 and 5)	7,736,300
Accounts receivable:	
Municipal license taxes	495,000
Sales and use taxes	641,233
Interest	466
Due from other agencies (Note 9)	1,131,500
Capital assets, net (Note 11)	49,017,993
	<hr/>
Total assets	\$ 64,300,460
	<hr/>
<u>Liabilities and Net Assets</u>	
Liabilities	
Accounts payable and accrued liabilities	\$ 785,394
Due to other agencies (Note 12)	481,162
Matured bonds and interest payable	1,227,659
Deferred revenues (Note 13):	
Municipal license tax	3,055,092
Noncurrent liabilities (Note 15):	
Due within one year	919,072
Due in more than one year	17,681,259
Accrued interest	760,339
Total liabilities	24,909,977
	<hr/>
Net Assets	
Investment in capital assets, net of related debt	49,017,993
Restricted for:	
Debt service	1,294,552
Capital projects	4,552,839
Unrestricted	(15,474,901)
Total net assets	39,390,483
	<hr/>
Total liabilities and net assets	\$ 64,300,460
	<hr/>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

<u>Functions/Programs</u>	<u>Program Revenues</u>			<u>Net (Expense) Revenue and Changes in Net Assets Primary Government Governmental Activities</u>	
	<u>Expenses</u>	<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>		<u>Capital Grants and Contributions</u>
Primary Government:					
General government	\$ 10,514,500	\$ 1,399,518	\$ -	\$ (9,114,982)	
Public safety	1,038,538			(1,038,538)	
Culture and recreation	2,947,229			(2,947,229)	
Health and welfare	3,439,290		967,190	(2,472,100)	
Public work	8,236,994			(5,323,332)	
Economic development	251,021			(251,021)	
Interest on long-term debt	1,488,021			(1,488,021)	
Total primary government	<u>\$ 27,915,593</u>	<u>\$ 1,399,518</u>	<u>\$ 967,190</u>	<u>\$ 2,913,662</u>	<u>(22,635,223)</u>
General revenues:					
Property taxes (Note 6)				6,923,174	
Municipal license tax (Note 7)				4,251,760	
Sales and use tax (Note 8)				5,188,579	
Grants and contributions not restricted to specific programs				4,714,387	
Interest, fines and penalties				247,139	
Miscellaneous				204,090	
Total general revenues				<u>21,529,129</u>	
Change in net assets				(1,106,094)	
Net assets at beginning of year as restated (Note 22)				40,496,577	
Net assets at end of year				<u>\$ 39,390,483</u>	

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2009

<u>Assets</u>	<u>General</u>	<u>Debt Service</u>	<u>Joint Resolution</u>	<u>Loan \$ 3,370,000</u>	<u>Loan \$ 1,510,000</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Cash and cash equivalents (Notes 2 and 5)	\$ 1,980,808	\$ -	\$ 1,631,209	\$ -	\$ -	\$ 1,665,951	\$ 5,277,968
Cash with fiscal agent (Notes 2 and 5)	2,954	2,272,979		3,094,517	1,458,322	907,528	7,736,300
Accounts receivable:							
Municipal licenses taxes	495,000						495,000
Sales and use taxes	641,233						641,233
Interest	466						466
Due from other agencies (Note 8)	343,508	249,232				538,760	1,131,500
Due from other funds (Note 9)	584,955						584,955
Total assets	\$ 4,048,924	\$ 2,522,211	\$ 1,631,209	\$ 3,094,517	\$ 1,458,322	\$ 3,112,239	\$ 15,867,422

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2009

<u>Liabilities and Fund Balance</u>	<u>General</u>	<u>Debt Service</u>	<u>Joint Resolution</u>	<u>Loan \$ 3,370,000</u>	<u>Loan \$ 1,510,000</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Liabilities							
Accounts payable and accrued liabilities	\$ 145,802	\$ -	\$ -	\$ -	\$ -	\$ 93,604	\$ 239,406
Due to other funds (Note 10)						584,955	584,955
Due to other agencies (Note 12)	329,464						329,464
General obligations: (Note 15)							
Bonds		920,000					920,000
Interest		307,659					307,659
Deferred revenues: (Note 13)							
Municipal license tax	3,055,092						3,055,092
Intergovernmental	276,394						276,394
Total liabilities	<u>3,806,752</u>	<u>1,227,659</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>678,559</u>	<u>5,712,970</u>
Fund Balances							
Reserved for:							
Encumbrances	205,552						205,552
Debt service		1,294,552					1,294,552
Capital projects			1,631,209	3,094,517	1,458,322		6,184,048
Unreserved fund balance	36,620					2,433,680	2,470,300
Total fund balance	<u>242,172</u>	<u>1,294,552</u>	<u>1,631,209</u>	<u>3,094,517</u>	<u>1,458,322</u>	<u>2,433,680</u>	<u>10,154,452</u>
Total liabilities and fund balance	<u>\$ 4,048,924</u>	<u>\$ 2,522,211</u>	<u>\$ 1,631,209</u>	<u>\$ 3,094,517</u>	<u>\$ 1,458,322</u>	<u>\$ 3,112,239</u>	<u>\$ 15,867,422</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO STATEMENT OF NET ASSETS
JUNE 30, 2009**

Total fund balances - governmental funds \$ 10,154,452

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

- Capital assets, net used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet 49,017,993

- Other assets are not available to pay for current-period expenditures and therefore are deferred in the governmental funds balance sheet 276,393

- Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds **(Note 4)** (20,058,355)

Net assets of governmental activities \$ 39,390,483

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

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

	General	Debt Service	Joint Resolution	Loan \$3,370,000	Loan \$ 1,510,000	Other Governmental Funds	Total Governmental Funds
REVENUES							
Property taxes (Note 6)	\$ 5,696,116	\$ 1,227,058	\$ -	\$ -	\$ -	\$ -	\$ 6,923,174
Municipal license taxes (Note 7)	4,251,760						4,251,760
Sales and use taxes (Note 8)	4,381,961	806,618					5,188,579
Licenses, permits, and other local taxes	99,443						99,443
Charges for services	1,300,075						1,300,075
Intergovernmental revenues (Note 14):							
Federal grants and contributions						2,720,509	2,720,509
State contributions	4,356,033		1,000,000			358,354	5,714,387
Interest, fines, and penalties	222,086	7,132	13,034			4,887	247,139
Other revenues	189,756					14,334	204,090
Total revenues	<u>20,497,230</u>	<u>2,040,808</u>	<u>1,013,034</u>	<u>-</u>	<u>-</u>	<u>3,098,084</u>	<u>26,649,156</u>
EXPENDITURES							
Current:							
General government	8,289,369			5,666	6,678	236,343	8,538,056
Public safety	844,388						844,388
Health and welfare	706,966					2,734,208	3,441,174
Culture and recreation	2,833,775						2,833,775
Public works	7,919,910						7,919,910
Economic development			592,797	269,817	45,000	1,135,267	2,042,881
Debt service:							
Principal		1,188,335					1,188,335
Interest and other		727,682					727,682
Total expenditures	<u>20,594,408</u>	<u>1,916,017</u>	<u>592,797</u>	<u>275,483</u>	<u>51,678</u>	<u>4,105,818</u>	<u>27,536,201</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(97,178)</u>	<u>124,791</u>	<u>420,237</u>	<u>(275,483)</u>	<u>(51,678)</u>	<u>(1,007,734)</u>	<u>(887,045)</u>
OTHER FINANCING SOURCES (USES)							
Loan proceeds				3,370,000	1,510,000		4,880,000
Transfers in	12,418	268,421					280,839
Transfers out	<u>(268,421)</u>	<u>(7,132)</u>				<u>(5,286)</u>	<u>(280,839)</u>
Total other financing sources	<u>(256,003)</u>	<u>261,289</u>	<u>-</u>	<u>3,370,000</u>	<u>1,510,000</u>	<u>(5,286)</u>	<u>4,880,000</u>
Excess (deficiency) of revenues over expenditures and other financing sources	<u>(353,181)</u>	<u>386,080</u>	<u>420,237</u>	<u>3,094,517</u>	<u>1,458,322</u>	<u>(1,013,020)</u>	<u>3,992,955</u>
FUND BALANCE AT BEGINNING OF YEAR AS RESTATED (Note 22)	<u>595,353</u>	<u>908,472</u>	<u>1,210,972</u>	<u>-</u>	<u>-</u>	<u>3,446,700</u>	<u>6,161,497</u>
FUND BALANCE AT END OF YEAR	<u>\$ 242,172</u>	<u>\$ 1,294,552</u>	<u>\$ 1,631,209</u>	<u>\$ 3,094,517</u>	<u>\$ 1,458,322</u>	<u>\$ 2,433,680</u>	<u>\$ 10,154,452</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

Net change in fund balances - total governmental funds \$ 3,992,955

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

- Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. 1,800,422
- Depreciation expense on capital assets is reported in the statement of activities, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditure in governmental funds. (824,525)
- Governmental funds report issuance of long-term as other other financial sources because provides current financial resources. (4,880,000)
- Governmental funds report principal payments on long-term obligations as expenditures, whereas the principal payments reduces the long-term obligations in the statement of activities. 1,188,335
- Change in accrued interest expense which does not require the use of current financial resources. (760,339)
- Some expenses reported in the statement of activities do not require the use of current financial resources; therefore, are not reported as expenditures in governmental funds. (1,622,942)

Changes in net assets of governmental activities \$ (1,106,094)

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
STATEMENT OF REVENUES AND EXPENDITURES, BUDGET AND ACTUAL - GENERAL AND DEBT SERVICE FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

	General Fund				Debt Service Fund			Variance with Final Budget- Positive (Negative)
	Budgeted Amounts		Actual	Variance with Final Budget- Positive (Negative)	Budgeted Amounts		Actual	
	Original	Final			Original	Final		
REVENUES								
Property taxes	\$ 5,629,002	\$ 5,883,983	\$ 5,883,983	\$ -	\$ 1,628,567	\$ 1,628,567	\$ 1,227,058	\$ (401,509)
Municipal license taxes	4,425,000	4,425,000	3,756,760	(668,240)				
Sales taxes	3,100,000	4,050,000	4,135,022	85,022			806,618	806,618
Licenses and permits	140,000	140,000	99,443	(40,557)				
Charges for services	163,000	163,000	245,541	82,541				
Intergovernmental revenues:								
State contributions	4,381,881	4,491,368	4,356,033	(135,335)				
Interest, fines, and penalties	350,000	350,000	234,038	(115,962)			7,132	7,132
Other revenues	155,100	356,400	391,056	34,656				
Total revenues	<u>18,343,983</u>	<u>19,859,751</u>	<u>19,101,876</u>	<u>(757,875)</u>	<u>1,628,567</u>	<u>1,628,567</u>	<u>2,040,808</u>	<u>412,241</u>
EXPENDITURES								
Current:								
General government	7,203,522	8,272,086	8,199,430	72,656				
Public safety	946,550	862,146	854,245	7,901				
Public works	7,757,183	8,320,708	8,272,191	48,517				
Recreation	1,588,425	2,201,652	2,189,729	11,923				
Health and welfare	848,303	720,738	713,645	7,093				
Debt service:								
Principal					1,102,799	1,102,799	1,188,335	(85,536)
Interest					525,768	525,768	727,682	(201,914)
Total expenditures	<u>18,343,983</u>	<u>20,377,330</u>	<u>20,229,240</u>	<u>148,090</u>	<u>1,628,567</u>	<u>1,628,567</u>	<u>1,916,017</u>	<u>(287,450)</u>
OTHER FINANCING SOURCES								
Reprogramming funds	-	517,579	517,579	-				
Excess of (expenditures) revenues over revenues (expenditures)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (609,785)</u>	<u>\$ (609,785)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 124,791</u>	<u>\$ 124,791</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

1. ORGANIZATION

The Municipality of Hatillo, Puerto Rico (Municipality) was founded in 1823. The Municipality is a political legal entity with full legislative and administrative faculties in every affair of the municipal character, with perpetual succession existence and legal personality, separate and independent from the central government of the Commonwealth of Puerto Rico. The Municipality provides a full range of services including health, public works, environmental control, education, public safety, public housing and community development, culture and recreation as well as many other general and administrative services.

The Municipal Government comprises the executive and legislative branches. The executive power is exercised by the Mayor and the legislative by the Municipal Assembly, which has 14 members. The members of these branches are elected every four years in the Puerto Rico general elections.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the Municipality have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The financial information of the Municipality is presented in this report as follows:

- Management's Discussion and Analysis - Introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.
- Government - Wide Financial Statements - The reporting model includes financial statements prepared using full accrual of accounting for all of the government's activities. This approach includes not just current assets and liabilities, but also capital assets and long-term liabilities (such as buildings and infrastructure, including bridges and roads, and general obligation debt).

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

- Statement of Net Assets - The statement of net assets is designed to display the financial position of the Municipality, including capital assets and infrastructure. The net assets of the Municipality will be broken down into three categories; invested in capital assets, net of related debt; restricted; and unrestricted.
- Statement of Program Activities - The government - wide statement of activities report expenses and revenues in a format that focuses on the cost of each of the government's functions. The expense of individual functions is compared to the revenues generated directly by the function.
- Budgetary comparison schedules - Demonstrating compliance with the adopted budget is an important component of a government's accountability to the public. Under the reporting model, the Municipality will continue to provide budgetary comparison information in their financial statements. An important change, however, is a requirement to add the government's original budget to the current comparison of final budget and actual results.

The following is a summary of the more significant policies.

a. Reporting Entity

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, "The Financial Reporting Entity," as amended by GASB Statement No. 39, "Determining whether Certain Organizations are Components Units" – an amendment of GASB Statement No. 14". The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

GASB Statement No. 39 provided additional guidance to determine whether certain organization for which the primary government is not financially accountable should be reported as components units. A legally separate, tax exempt organization should be discretely presented as a component unit 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, and; (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. GAAP details two methods of presentation: blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component units' financial data in columns separate from the Municipality's balances and transactions. Based on the aforementioned criteria, the Municipality has no component units.

b. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all the activities of the Municipality. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities are supported mainly by taxes and intergovernmental revenues.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

The fund financial statements segregate transactions related to certain functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. These statements present each major fund as a separate column on the fund financial statements; all non-major funds are aggregated and presented in a single column.

c. Measurement Focus, Basis of Accounting and Financial Statement Presentation

The government-wide financial statements are reported using the *economic resources measurement focus and the accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the *current financial resources measurement focus and the modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within the current period or soon enough thereafter. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the government.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

The Municipality reports the following major governmental funds:

1) General Fund

This is the operating fund of the Municipality and accounts for all financial resources, except those required to be accounted for in another fund.

2) Debt Service Fund

This fund is used to account for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

3) Joint Resolution

Joint resolution fund is used to account for revenues sources for appropriations of the Commonwealth of Puerto Rico legislative assembly for the development of viable urban communities and social development.

4) Loan \$3,370,000

The Loan \$3,370,000 fund is used to account for the financial resources for the acquisition of personal property and/or construction of major improvements which are not financed by other funds.

5) Loan \$1,510,000

The Loan \$1,510,000 fund is used to account for the financial resources for the construction of major improvements which are not financed by other funds.

Private-section 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 a general rule the effect of interfund activity has been eliminated from the government-wide financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

Amounts reported as *program revenues* include 1) charges to customers or applicants for goods, services, licenses, permits, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as *general revenues* rather than as program revenues. Likewise, general revenues include all taxes.

When both restricted and unrestricted resources are available for use, it is the government's policy to use restricted resources first, than unrestricted resources as they are needed.

d. Cash and Cash with Fiscal Agent

The Municipality's Finance Director is responsible for investing available resources. The Municipality is restricted by law to invest only in savings accounts with banks qualified as a depository of public funds by the Puerto Rico Treasury Department (PRTD) or in instruments of the Government Development Bank for Puerto Rico (GDB).

Cash with fiscal agent in the capital projects fund consists of unused proceeds from appropriations from the Legislature of Puerto Rico, for the payment of current liabilities, and bonds and notes issued for the acquisition and construction of major capital improvements. Cash with fiscal agent in the debt service fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

e. Interfund Receivables and Payables

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

f. Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure (which is normally immovable and of value only to the Municipality, such as roads, bridges, streets' sidewalks, and drainage system), are reported in the applicable governmental or component units columns in the government-wide financial statements.

Capital assets purchased or acquired are carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date donated. Additions, improvements and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred.

Depreciation in capital assets is calculated on the straight-line basis over the following estimated useful lives:

	<u>Useful Life</u>
Infrastructure	20-50 years
Buildings and building improvements	20-50 years
Furniture and fixtures	5-20 years
Vehicles and equipment	5-20 years

g. Reservation of Fund Balance

Reservations of fund balance represent portions of 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:

1) Encumbrances

Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.

2) Debt Service

Represents net assets available to finance future debt service payments.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

3) Capital Project Fund

Represents the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. The committed amounts generally will become liabilities in future periods as the projects are completed.

h. Risk Financing

The Municipality carries insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities of Puerto Rico. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (the "CRIM") for the year ended June 30, 2009 amounted to approximately \$254,065. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$273,772 for workers' compensation insurance covering all municipal employees.

i. Compensated Absences

Employees are entitled to 30 days vacations leave and 18 days sick leave per year. Sick leave is recorded as an expenditure in the year paid. Employees are entitled to payment of unused sick leave upon retirement if have been employed for at least 10 years in the municipal government. On July 1997, state Law 152 supra amended the Article 12.016, Section b (2) of the Municipal Law, authorizing the Municipality to pay any excess of vacations and sick leave accumulated over the maximum previously permitted by law. Calculations must be made until December 31 of every year. Excess of sick leave must be paid until March 31 next every natural year. Excess of vacations can be paid after July 1 of every fiscal year.

j. Use of Estimates

The preparation of financial statements in conformity 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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. The most significant estimates consist of the contribution received from the Puerto Rico Electric Power Authority and the Municipal Revenue Collection Center caused by the delay of the notification of the actual revenues and expenditures to the presented in the financial statements of the agencies mentioned above.

k. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board (GASB) has issued the following statements that the Municipality has not yet adopted:

<u>Statement Number</u>	<u>Statement Name</u>	<u>Adoption Required in Fiscal Year</u>
51	Accounting and Financial Reporting for Intangible Assets	2009-10
53	Accounting and Financial Reporting for Derivative Instruments	2009-10
54	Fund Balance Reporting and Governmental Fund Type Definitions	2010-11

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

3. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

a. Budgetary Control

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP, and represents departmental appropriations recommended by the Mayor and approved by the Municipal Legislature prior to the beginning of the fiscal year. Amendments to the budget require the approval of the Municipal Legislature. Transfers of appropriations within the budget, known as Mayor's Resolutions, do not require the approval of the Municipal Legislature.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

The Municipality prepares its annual budget including the operations of the general and the debt service funds.

Revenues and Expenditures - Budget and Actual (Budgetary Basis), accordingly, includes only the operations of the general and the debt service funds. The amounts budgeted under the Special Revenue Fund were excluded since they are received and expended over a period of time which generally exceeds the current year.

For budgetary purposes, encumbrance accounting is used. The encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year.

The unencumbered balance of any appropriation at the end of the fiscal year will lapse at the end of such fiscal year. Other appropriations, mainly capital project appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The annual budget is presented in the Combined Statement of Revenues and Expenditures - Budget and Actual (Budgetary Basis) is the budget ordinance to June 30, 2009 representing the original budget.

b. Budget/GAAP Reconciliation

The following schedule presents comparisons of the legally adopted budget with actual data on a budget basis. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of entity and timing differences in the excess of revenues and other financing sources over expenditures and other financing use for the year ended June 30, 2009 is presented below for the general and debt service funds:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

	<u>Debt Service</u>
Excess of expenditures over revenues - budgetary basis	\$ 124,791
Entity differences:	
Non-budgeted transfers in	268,421
Non-budgeted transfers out	<u>(7,132)</u>
Excess of revenues over expenditures - GAAP basis	<u>\$ 386,080</u>

Explanation of differences:

Sources/inflows of resources

General Fund

Actual amounts (budgetary basis) "available appropriation" from the budgetary comparison schedule	\$ 19,101,876
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Differences - budget to GAAP:

Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes	(12,418)
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Non-budgeted revenues	890,193
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Reprogrammed funds	<u>517,579</u>
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Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances	<u>\$ 20,497,230</u>
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Uses/outflows of resources

Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule	\$ 20,229,240
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Differences-budget to GAAP:

Current year encumbrances recorded as expenditures for budgetary purposes	(205,552)
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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

Prior year encumbrances	460,407
Transfers to other funds are outflow of budgetary uses but are not expenditures for financial reporting purposes	(268,421)
Non budgeted expenditures	<u>378,734</u>
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances	<u><u>\$ 20,594,408</u></u>

c. Legal Compliance

The legal level of budgetary control is at the individual department level for general fund expenditures, and principal and interest due for the debt service fund.

4. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

The governmental fund balance sheet includes a reconciliation between fund balance-governmental funds and net assets of governmental activities as reported in the government-wide statement of net assets. One element of that reconciliation explains that some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. The details of the approximately \$20 million differences are as follows:

Bonds payable	\$ 12,721,020
Compensated absences	3,281,287
Note payable	810,000
Accrued interest	760,339
Other long-term liabilities	1,939,721
Christmas bonus	<u>545,988</u>
Net adjustment to reduce fund balance governmental funds to arrive at net assets of governmental activities	<u><u>\$ 20,058,355</u></u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

5. DEPOSITS

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. Under Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The deposits at GDB of approximately \$3,094,517 and \$907,528 are restricted principally for capital projects, and the \$2,272,979 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

The Municipality maintains its investments in two (2) banks located at Puerto Rico. All kind of deposit is guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000.

The excess is covered by collateral provided by banks and held by the Treasury Department of the Commonwealth of Puerto Rico pursuant to applicable laws and regulations.

6. PROPERTY TAXES

The Municipal Revenues Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible by law for the assessment, levy and collection of all real and personal property taxes. The tax on personal property is self assessed by the taxpayer. The assessment is made in a return which must be filed with the CRIM by May 15 of each year. The tax on real property is assessed by the CRIM. The assessment is made as of January 1 of each year and is based on estimated current values of the property as of year 1957. The tax on personal property must be paid in full together with the return on or before May 15. The tax on real property is due in two equal installments in July 1 and January 1, following the assessment date.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

The rates are 7.80% for real property and 5.80% for personal property. The composition is as follows:

	Real	Personal
Basic property	5.72%	3.72%
Additional special property - state	1.03%	1.03%
Additional special property - municipal	1.25%	1.25%
Discounts made by state to tax payer	<u>(0.2%)</u>	<u>(0.2%)</u>
	<u>7.80%</u>	<u>5.80%</u>

The Municipality's basic property tax rate represents the portion which is appropriated for general purposes and accounted for in the general fund.

The "Additional special property tax - municipal" is restricted for debt service and retained by GDB for such purposes and it is recorded as revenue in the Debt Service Fund when collected by the CRIM and reported to the Municipality.

The "Additional special property tax - state" is collected by the CRIM for the payment of principal and interest of general obligation bonds and certain other obligations issued by the state government.

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Department of Treasury assumes payment of the basic tax to the Municipality, except for property assessed at less than \$3,500, for which no payment is made. Revenue related to the basic tax on exempt property is recorded in the General Fund when payments are received from the CRIM.

Complete exemption from personal property taxes up to an assessment of \$50,000 is granted to merchants with an annual volume of net sales less than \$150,000.

Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuring fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the

**COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year ends. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30.

Currently, the Municipality has received the preliminary settlement from CRIM related to fiscal year 2008-09, but not the final settlement as the six months period after fiscal year ends, provided by law to CRIM to issue this, has not yet expired. Management believes, based in part on the experience from prior years, that when received, the final settlement from CRIM will not show a significant difference from the preliminary settlement and that such difference, if any, will not have a material effect on the financial condition of the Municipality.

Based on the preliminary settlement already received, during the year ended June 30, 2009, the amount advanced by CRIM exceeded the amount collected by CRIM from taxpayers and charges for the same period by approximately \$151,698. Such amount is presented as a long-term liability in the government wide financial statements. (See Note 12).

7. MUNICIPAL LICENSE TAX

Municipal License Tax receivables are recorded in the fiscal year in which payment is due and, accordingly, represent taxes which are due and uncollected at June 30, 2009. The annual Municipal License Tax is determined based on the gross income of all commerce and industrial organizations who have operations in the Municipality of Hatillo, and are not totally or partially exempt under the Industrial Incentive Law of Puerto Rico.

An annual return of business volume should be filed on or before April 15 of each year and payable in two equal installments due on July 1 and January 1. A discount of 5% is allowed when full payment is made on or before April 15.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

The rates of municipal license in the Municipality of Hatillo, are as follows:

Savings and loans associations	= 1.00%
Financial institutions	= 1.50%
Other organizations:	
Up to \$100,000	= .30%
\$100,000 up to \$200,000	= .40%
Over \$200,000	= .50%

The amounts collected in advance are recorded as deferred revenues in the General Fund. The Municipality invoiced and collected in advance during the current year approximately \$3,055,092, corresponding to the next fiscal year municipal license.

8. SALES AND USE TAXES

On July 29, 2007 the Commonwealth Legislature approved Act. No. 80 ("Act. 80") which imposed to all the Municipalities of Puerto Rico a uniform municipal sales and use tax of 1.5%. Effective August 1, 2007 1% of the 1.5% will be collected by the Puerto Rico Department of Treasury.

Act 80 also provides for restrictions on the use of the resources (including the .5 of 1.5% collected by the Commonwealth Government) to be invested in solid waste an recycling programs, capital improvements and health and public safety cost. Amount collected by the Commonwealth Government will be deposited in accounts of special funds in the Government Development Bank of Puerto Rico ("GDB"), subject to restrictions imposed and distributed as follows:

- a. .2% of the .5% will be deposited in a "Municipal Development Fund" to finance costs as restricted by the Act.
- b. .2% of the .5% will be deposited in a "Municipal Redemption Fund" to finance loans to municipalities subject to restrictions imposed by the Act and,
- c. .1% of the .5% will be deposited in a "Municipal Improvement Fund" to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth's Legislature.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

9. DUE FROM OTHER AGENCIES

Represents grants and contributions due from local and federal agencies:

Represents grants and contributions due from local and federal agencies:

Puerto Rico Treasury Department	\$ 276,394
Municipal Revenues Collection Center (General Fund)	67,114
Municipal Revenues Collection Center (Debt Service Fund)	249,232
Commissioner Office of Municipal Affairs	<u>538,760</u>
 Total	 <u><u>\$1,131,500</u></u>

10. INTERFUND TRANSACTIONS

a. Due From/To Other Funds:

The due from and due to other fund balances as of June 30, 2009, are as follows:

Receivable Fund	Payable Fund	Amount
General	Other Governmental Funds	<u>\$ 584,955</u>

The balance of \$584,955 due to the general fund from the Other Governmental Fund represents disbursements made to several funds to cover payroll and related fringe benefits, which will be reimbursed to the general fund within approximately 90 days period after year end.

Remaining transfers are used to use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

b. Interfund Transfers:

Interfund transfers for the year ended June 30, 2009 consisted of the following:

<u>Transfer In</u>	<u>Transfer Out</u>	<u>Amount</u>
Debt Service	General Fund	\$ 268,421
General Fund	Debt Service	7,132
General Fund	Other Governmental Funds	5,286
		<u>\$ 280,839</u>

The transfers are used to (1) move revenues from the fund that statute or budget revenues to collect them to the fund that statute or budget requires to expend them, (2) move receipts restricted to debt service from the fund collection the receipts to the debt service fund as debt service payments become due, and (3) use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

11. CAPITAL ASSETS

Capital asset activity for the Municipality for the year ended June 30, 2009 was as follows:

<u>Primary Government</u>	<u>Balance June 30, 2009</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2009</u>
Governmental Activities:				
Capital assets, not being depreciated:				
Land	\$ 24,541,244	\$ -	\$ -	\$ 24,541,244
Construction in progress	297,137	386,332		683,469
Total capital assets, not being depreciated	<u>24,838,381</u>	<u>386,332</u>	<u>-</u>	<u>25,224,713</u>
Capital assets, being depreciated:				
Buildings and building improvements	22,370,890	136,698	-	22,507,588
Vehicles and equipment	6,428,905	77,645	-	6,506,550
Infrastructure	8,862,238	1,199,747	-	10,061,985
Total capital assets, being depreciated	<u>37,662,033</u>	<u>1,414,090</u>	<u>-</u>	<u>39,076,123</u>
Less accumulated depreciation for:				
Buildings and building improvements	5,125,997	284,336	-	5,410,333
Vehicles and equipment	3,958,629	440,245	-	4,398,874
Infrastructure	5,373,692	99,944	-	5,473,636
Total accumulated depreciation	<u>14,458,318</u>	<u>824,525</u>	<u>-</u>	<u>15,282,843</u>
Total capital assets, being depreciated, net	<u>23,203,715</u>	<u>589,565</u>	<u>-</u>	<u>23,793,280</u>
Governmental activities capital assets, net	<u>\$ 48,042,096</u>	<u>\$ 975,897</u>	<u>\$ -</u>	<u>\$ 49,017,993</u>

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

General government	\$ 360,180
Public safety	33,806
Recreation	113,454
Public works	<u>317,084</u>
Total depreciation expense-governmental activities	<u>\$ 824,525</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

12. DUE TO OTHER AGENCIES

Due to other agencies at June 30, 2009 are as follows:

	<u>Governmental Funds</u>	<u>Government Wide</u>
Retirement System Administration	\$ 173,511	\$ 173,511
Municipal Revenues Collection Center	58,509	210,207
Puerto Rico Water and Sewer Authority	56,317	56,317
Treasury Department	27,247	27,247
General Services Administration	50	50
Internal Revenue Service	13,830	13,830
	<u> </u>	<u> </u>
Total	<u>\$ 329,464</u>	<u>\$ 481,162</u>

13. DEFERRED REVENUES

a. Municipal License Tax

The deferred revenues of approximately \$3,055,092 in the general fund related to municipal license tax collected in fiscal year 2008-09 that will be earned in fiscal year 2009-2010.

b. Federal Government

The deferred revenues presented as federal government represents the portion of federal grants received for which qualifying expenditures have not been incurred. The amounts were determined taking into consideration the specific years of the grant.

14. INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the general and capital projects funds consist mainly of collections from the Commonwealth of Puerto Rico and the CRIM, and payments in lieu of taxes from the Puerto Rico Electric Power Authority.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

15. LONG-TERM DEBTS

Bonds and other long-term liabilities outstanding at June 30, 2009 are as follows:

Bonds

\$715,000 series of 1996, payable in annual installments of \$10,000 to \$65,000 until July 1, 2020, interest from 6.75% to 6.56%.	\$ 490,000
\$3,875,000 series of 1997, payable in annual installments of \$65,000 to \$345,000 until July 1, 2020, interest from 6.69% to 6.56%.	2,665,000
\$550,000 series of 1998, payable in annual installments of \$14,000 to \$38,020 until January 1, 2020, interest at 4.5%	341,020
\$2,810,000 series of 1998, payable in annual installments of \$40,000 to \$250,000 until July 1, 2023, interest from 6.31% to 6.56%.	2,175,000
\$624,000 series of 1998, payable in annual installments of \$17,000 to \$44,000 until January 1, 2022, interest at 4.50%.	\$ 440,000
\$2,265,000 series of 2001, payable in annual installments of \$30,000 to \$200,000 until July 1, 2025, interest from 6.13% to 5.60%.	1,880,000
\$3,370,000 series of 2007, payable in annual installments of \$60,000 to \$295,000 until July 1, 2029, interest from 3.93% to 7.50%.	3,240,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

\$1,510,000 series of 2008, payable in annual installments of \$20,000 to \$130,000 until July 1, 2023, interest from 2.43% to 7.50%.	<u>1,490,000</u>
Total bonds payable	<u>12,721,020</u>
\$1,140,000 series of 2005, payable in annual installments of \$140,000 to \$190,000 until July 1, 2012, interest from 4.23% to 4.73%.	540,000
\$760,000 series of 2007, payable in annual installments of \$235,000 to \$270,000 until July 1, 2010, interest from 3.93% to 7.50%.	<u>270,000</u>
Total notes payable	<u>810,000</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

Other Long-Term Liabilities

Note payable to CRIM (LIMS) - On November 28, 2001, the Municipality entered into a financing agreement with the CRIM in the amount of \$408,924 for the payment of the Municipality's share of the cost of a management information system (LIMS) acquired by the CRIM for the management of taxpayer's properties located in Puerto Rico. The note is payable in semiannual installments of \$27,423, including interest of 5.95% and is due on November 28, 2011. Amount is financed with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center (CRIM).

\$ 125,677

Total other long-term liabilities

\$ 125,677

The annual requirements for the amortization of long-term debts at June 30, 2009, are as follows:

	<i>Bonds and Notes</i>		<i>Note Payable</i>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2010	\$ 871,000	\$ 760,340	\$ 48,072	\$ 6,773
2011	678,000	840,728	50,975	3,870
2012	705,000	792,713	26,630	792
2013	597,000	751,607		
2014	614,000	711,622		
2015-2019	3,827,000	2,910,278		
2020-2024	3,584,020	1,588,996		
2025-2029	1,900,000	651,652		
2030-2034	755,000	120,562		
	<u>\$ 13,531,020</u>	<u>\$9,128,498</u>	<u>\$ 125,677</u>	<u>\$ 11,435</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

Long-term liability activity for the year ended June 30, 2009 was as follows:

Primary Government	Beginning Balance (As restated)	Additions	Payments	Adjustment	Ending Balance	Due within One Year
Governmental Activities:						
Bonds payable	\$ 11,764,020	\$ 1,510,000	\$ 553,000	\$ -	\$ 12,721,020	\$ 456,000
Notes payable	1,400,000		590,000		810,000	415,000
Total long-term debt	<u>13,164,020</u>	<u>1,510,000</u>	<u>1,143,000</u>	<u>-</u>	<u>13,531,020</u>	<u>871,000</u>
Other long-term liabilities:						
CRIM - LIMS	171,012		45,335		125,677	48,072
Landfill Obligation	1,728,958			(66,612)	1,662,346	
Christmas Bonus	382,927			(382,927)	-	
Compensated absences	<u>1,821,562</u>	<u>1,929,124</u>	<u>469,399</u>		<u>3,281,287</u>	
Total other long-term liabilities	<u>4,104,459</u>	<u>1,929,124</u>	<u>514,734</u>	<u>(449,539)</u>	<u>5,069,310</u>	<u>48,072</u>
Total noncurrent liabilities, governmental activities	<u>\$ 17,268,479</u>	<u>\$ 3,439,124</u>	<u>\$ 1,657,734</u>	<u>\$ (449,539)</u>	<u>\$ 18,600,330</u>	<u>\$ 919,072</u>

16. RETIREMENT PLAN

a. Plan Description

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. The System was created under the ACT 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952.

ERS covers all regular employees of the Commonwealth of Puerto Rico and its instrumentalities and of certain municipalities and components units not covered by their own retirements systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Heads for Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of Puerto Rico, Gubernatorial Board and Committee appointees and Experimental Service Station employees.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

ERS provides retirement, death and disability benefits. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

Members who have attained an age of at least fifty-five (55) years and have completed at least twenty-five (25) years of creditable service or members who have attained an age of at least fifty-eight (58) years and have completed at least ten (10) years of creditable service, are entitled to an annual benefit, payable monthly for life.

The amounts of the annuity will be one and one-half percent of the average compensation multiplied by the number of years of creditable service up to twenty years, plus 2% of the average compensation multiplied by the number of years of creditable service in excess of twenty years. In no case the annuity will be less than \$200 per month.

Participants who have completed at least thirty (30) years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five (55) years of age will receive 65% of the average compensation or if they have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten (10) years of service.

No benefit is payable if the participant receives a refund of his accumulated contributions.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created ERS, was enacted with the purpose of establishing a new pension program (System 2000). Employees participating in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining the Municipality on or after January 2000, will only be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth of Puerto Rico. 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 upon 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 rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

b. Contribution Requirements

Commonwealth legislation requires employees to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600. The Municipality's contributions are 9.275% of gross salary. Contributions' requirements are established by law. The actuarially determined contribution requirement and contributions actually made for the year ended June 30, 2009 was approximately \$516,809. The Municipality's payroll for employees covered by ERS was approximately \$5.6 million. The Municipality total payroll for all employees was approximately \$9.9 million.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2009, a copy of which can be obtained from the ERS, Minillas Station, PO Box 42003, San Juan, PR 00940.

17. RISK MANAGEMENT

The Risk Management Division of the Municipality's Legal Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Risk Management Division compiles the information of all property owned and its respective market value. After evaluating this information, the Risk Management Division submits the data regarding the Municipality's properties to the Area of Public Insurance at the Department of the Treasury of the Commonwealth of Puerto Rico

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

who is responsible for purchasing all property and casualty insurance policies of all municipalities.

18. LEASES

Operating Leases

Leasing Arrangement with the Municipality as Lessor:

- a. The Municipality leases spaces in its Market Place under operating lease agreements with terms ranging from one to five years.
- b. Total income from leases during the year ended June 30, 2009 was approximately \$122,434.
- c. The Municipality retains title to its leased property. The lessee pays taxes, licenses, insurance, and maintenance costs of the leased assets.

The Municipality is obligated under noncancellable operational leases, with periods not longer than one year.

19. MUNICIPAL SOLID WASTE LANDFILL POSTCLOSURE

The Municipality discontinued its landfill operations and ceased to accept solid waste of its landfill. State and Federal laws and regulations require the Municipality to perform certain postclosure procedures on its solid waste landfill after discontinuing of operations and perform certain maintenance and monitoring functions at the landfill site for thirty years. Postclosure care procedures were assumed by the Municipality and directed by an external consultant. The total estimated liability for postclosure care costs has been determined in approximately \$1.7 million as of June 30, 2009. (See Note 15).

20. CONTINGENCIES

- a. The Municipality receives Federal Grants for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under the terms of the grants, management believes that any required reimbursements would not be material.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

- b. The Municipality is a defendant and/or co-defendant in various lawsuits which claims for actual damages. Some of these lawsuits are covered by insurance. The Municipality's management and outside counsels believe that is probable that any potential liability that might exist, if any, in excess of the insurance, will not affect significantly the financial position of the Municipality.

21. COMMITMENTS

The Municipality of Hatillo had several outstanding or planned construction projects as of June 30, 2009. These projects are evidenced by contractual commitments with contractors. The construction projects are commitments of the Other Governmental Funds that amounted to approximately \$297,137.

22. RESTATEMENTS

a. Fund Balance

The beginning fund balance of the general fund, joint resolutions, debt service fund and other governmental funds has been restated to recognize corrections of accounting errors. The following schedule reconciles the fund balance at July 1, 2008 as previously reported to the beginning fund balance, as restated:

	General	Joint Resolutions	Debt Service	Other Governmental Fund
Beginning fund balances, as previously reported	\$ 2,088,433	\$ 397,102	\$ 445,217	\$ 3,571,043
Understatement cash balances		406,505		
Overstatement due from/to other funds	(748,284)	407,365		340,919
Overstatement account receivable	(744,796)			
To reclassify fund balances			463,255	(463,255)
Fund not recorded				(2,007)
Beginning fund balances, as restated	<u>\$ 595,353</u>	<u>\$ 1,210,972</u>	<u>\$ 908,472</u>	<u>\$ 3,446,700</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

b. Net Assets

Net assets at beginning of year have been adjusted to reflect the following restatements:

Net assets at beginning of year as previously reported	\$41,545,310
Understatement long term debts	(708,435)
Overstatement account receivable	(744,796)
Understatement cash balances	406,505
Fund not recorded	(2,007)
Net assets at beginning of year as restated	<u>\$40,496,577</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

<u>Federal Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Disbursements/ Expenditures</u>
U.S. Department of Housing and Urban Development (HUD)		
Direct Programs:		
Section 8 Housing Choice Vouchers	14.871	\$ 431,688
Pass-through Commissioner Office of Municipal Affairs - Community Development Block Grant-States:		
Program SBGP	14.228	<u>1,915,535</u>
Subtotal U.S. Department of HUD		<u>2,347,223</u>
U.S. Department of Agriculture		
Pass-through Governor's Office of Child Services and Community Development:		
Child and Adult Care Food Program	10.558	40,888
Subtotal U.S. Department of Agriculture		<u>40,888</u>
U.S. Department of Health and Human Services (HHS)		
Pass-through the Commonwealth of Puerto Rico Governor's Office (Elderly Affairs Office):		
Special Programs for the Aging Title III, Part B, Grants for Supportive Services and Senior Centers	93.044	108,283
Special Programs for the Aging Title III, Part E, National Family Caregivers Support	93.052	22,030
Pass-through the Office of Administration for Children and Families		
Child and Care and Development Block Grant	93.575	206,115
Subtotal U.S. Department of HHS		<u>336,428</u>
U.S. Department of Homeland Security		
Pass-through the Commonwealth of Puerto Rico Governor's Office (Governor's Authorized Representative GAR)		
Natinl Incident Management System	96.067	35,000
State Domestic Preparedness Equipment Support Program	97.004	125,347
Subtotal U.S. Department of Homeland Security		<u>160,347</u>
TOTAL		<u>\$ 2,884,886</u>

See notes to Schedule of Expenditures of Federal Awards.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

1. SIGNIFICANT ACCOUNTING POLICIES

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Hatillo and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

2. BASIS OF PRESENTATION

The expenditures of the schedule are included in the Municipality's basic financial statements in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances-Governmental Funds. Expenditures in the basic financial statements amounting to \$2,884,886 are included within Other Governmental Funds.



ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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CPA Marco Antonio Rivera Zúñiga
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American Institute of Certified
Public Accountants (AICPA)
Puerto Rico Board of Certified
Public Accountants

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

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

We have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Hatillo, as of and for the year ended June 30, 2009, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated November 12, 2009. 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.

Internal Control over Financial Reporting

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

A deficiency in internal control 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 material weakness is a control deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatements of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality of Hatillo' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our test disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

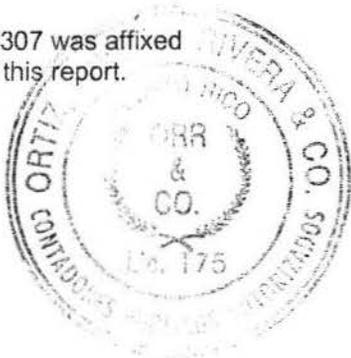
We noted certain matters that we have reported to management of the Municipality of Hatillo in a separate letter dated November 12, 2009.

This report is intended solely for the information and use of the audit committee, Commissioner Office of Municipal Affairs, management and the 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
November 12, 2009

Ortiz, Rivera, Rivera & Co.

The stamp 2459307 was affixed to the original of this report.





ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

CPA Orlando Luis Ortiz Cabrera
CPA Marco Antonio Rivera Zúñiga
CPA Luis Rivera Zúñiga
CPA Zoraida Cruz Claudio

Members:
American Institute of Certified
Public Accountants (AICPA)
Puerto Rico Board of Certified
Public Accountants

**INDEPENDENT AUDITORS' 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 Honorable Mayor
and Municipal Legislature
Municipality of Hatillo
Hatillo, Puerto Rico

Compliance

We have audited the compliance of 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, 2009. Municipality of Hatillo' 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' management. Our responsibility is to express and opinion on Municipality of Hatillo' 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 *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that 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' 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 on Municipality of Hatillo compliance with those requirements.

In our opinion, the Municipality of Hatillo complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal program for the year ended June 30, 2009. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings as questioned costs as item 09-1 and 09-2.

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 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 the Municipality's internal control over compliance.

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

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

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 material weaknesses, as defined above.

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

This report is intended solely for the information of the audit committee, Commissioner Office of Municipal Affairs, management and the 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
November 12, 2009

Ortiz, Rivera, Rivera & Co.

The stamp 2459308 was affixed to the original of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

1. SUMMARY OF AUDIT RESULTS

- a. The auditors' report expresses an unqualified opinion on the basic financial statements of the Municipality of Hatillo.
- b. There were no significant deficiencies on internal controls over financial reporting.
- c. No instances of noncompliance material to the financial statements of Municipality of Hatillo were disclosed during the audit.
- d. There were no significant deficiencies on internal controls over major programs.
- e. The auditor's report on compliance with requirements applicable to federal award programs for Municipality of Hatillo express an unqualified opinion.
- f. Audit findings relative to the major federal award programs for the Municipality of Hatillo are reported in number 3 of this schedule.
- g. The program tested as major program is:
 - SBGP - CFDA No. 14.228
- h. The threshold for distinguishing types A and B programs was \$300,000.
- i. Municipality of Hatillo was determined to be a low-risk auditee.

2. FINDINGS - FINANCIAL STATEMENTS AUDIT

None

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

**3. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAM
AUDIT**

a. SBGP - CFDA No. 14.228

• **Condition 09-1**

The Federal Program Office does not request the extension of the contracts for the year program 2006 into the 45 days required. The extension for contracts was made on June 22, 2009, which due on February 6, 2009. The Municipality operates approximately four months without a signed contract.

Cause

The federal program did not maintain a due date schedule for request the extension for the contracts.

Effect

The program is not in compliance with the OCAM contract clauses. The program operates without a valid contract.

Criteria

The federal funds of SBGP can be available through a signed contract into the Municipality and OCAM for each program year. Based on the ninth clause of the SBGP Program 2006 contract, the funds are available for 24 month after the contract is signed. Then, based on the fourth clause, the Municipality can request an extension that should be realized at least 45 days before end the contract.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

Recommendation

The Federal Program Office should establish a due date schedule for monitoring the due date of each program year contract in order to request the extensions into the time required.

Questioned Costs

None

• **Condition 09-2**

The Municipality did not comply with the requirement of preparing and filing its federal financial reports on a timely basis. During our examination of the Federal Financial Reports, we noted that the Municipality did not send on time the quarterly report for the following period ended:

<u>Report</u>	<u>Report Period</u>	<u>Due Date</u>	<u>Date Submitted</u>
Quarterly	September 2008	11-13-08	12-05-08
Quarterly	December 2008	02-11-09	02-13-09

Criteria

The Municipality is not in compliance with 24 CFR 85.40 (b) (1) which requires federal fund recipients to periodically monitor the performance of grant-supported activities to ensure that time schedules are being met, projected work units by time periods are being accomplished, and other performance goals are being achieved by the preparation of federal financial reports. To achieve these goals, program management should prepare accurate and timely federal financial reports. The Municipality should submit quarterly or semi-annual reports 30 days after the reporting period. The Office of Municipal Affairs granted ten days to this reporting requirement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

Cause

The above situation occurred because the Municipality did not ensure to verify and understand its reporting requirements for this program.

Effect

The continued failure to file the required reports may result in sanctions by the Federal grantor, such as grant payment withholdings.

Recommendation

The Municipality should verify and become familiar with all administrative requirements applicable to each federal financial assistance program, especially when new grants are received. This can be achieved by obtaining the information applicable to the program from the pass-thru grantor, federal grantor, or the Catalog of Federal Domestic Assistance ("CFDA"), which is available from the federal government.

Questioned Costs

None

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

During the current examination, follow-up was given to the findings informed to the Municipality in prior years. It was noted that corrective action has been taken, except for certain conditions that still exist and require further action. These are included in the accompanying Schedule of Prior Year Audits Findings and Questioned Costs.

CORRECTIVE ACTION PLAN

ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

Estado Libre Asociado de Puerto Rico
Gobierno Municipal Hatillo
Programas Federales



CORRECTIVE ACTION PLAN

November 12, 2009

Cognizant or Oversight Agency for Audit:

Municipality of Hatillo respectfully submits the following corrective action plan for the year ended June 30, 2009.

Name and address of independent public accounting firm: Ortiz, Rivera, Rivera & Co., Suite 152, PO Box 70250, San Juan, Puerto Rico 00936-7250.

Audit period: Fiscal year ended June 30, 2009.

The findings from the June 30, 2009 schedule of findings and questioned costs are discussed below. The findings are numbered consistently with the numbers assigned in the schedule.

FINDINGS - FEDERAL AWARD PROGRAM AUDITS, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Finding 09-1: SBGP - CFDA 14.228

Reportable Condition: See Condition 09-1

Recommendation

The Federal Program Office should establish a due date schedule for monitoring the due date of each program year contract in order to request the extensions into the time required.

Action Taken

The Federal Program Office Director is monitoring all due dates, in order to give the follow-up necessary to comply with the requirements.

Apartado #8
Hatillo PR 00659
898-3840
898-3835
Fax. 820-3747

Reportable Condition: See Condition 09-2

Recommendation

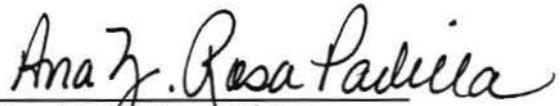
The Municipality should verify and become familiar with all administrative requirements applicable to each federal financial assistance program, especially when new grants are received. This can be achieved by obtaining the information applicable to the program from the pass-thru grantor, federal grantor, or the Catalog of Federal Domestic Assistance ("CFDA"), which is available from the federal government.

Action Taken

The Federal Program Office Director is monitoring all due dates, in order to give the follow-up necessary to comply with the requirements.

If the Cognizant or Oversight Agency for Audit has questions regarding this plan, please call Ana Zahir Rosa Padilla at (787) 820-0712.

Cordially,



Ana Zahir Rosa Pádilla
Federal Program Director