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

MUNICIPIO DE HATILLO
AUDITORÍA 2009-2010

30 DE JUNIO DE 2010

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO

BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED
JUNE 30, 2010

ORTIZ, RIVERA, RIVERA & CO.
CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES
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MUNICIPALITY OF HATILLO
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

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ORR & Co.
Ortiz, Rivera, Rivera & Co.
Certified Public Accountants and Business Advisors

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

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, 2010, 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, 2010, 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 December 13, 2010 on our consideration of the Municipality's internal control over financial reporting and on 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 10 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtain during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Hatillo financial statements as a whole. 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 not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

San Juan, Puerto Rico
December 13, 2010

Ortiz, Rivera, Rivera & Co.

The stamp 2586316 was affixed
to the original of this report.

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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 $80,569.
- In the fund financial statements, general fund revenues decreased by $989,372 (or 5%).
- The General Fund (the primary operating fund) reflected, on a current financial resources basis, an increase of $6,156.
- On a budgetary basis, actual expenditures exceed actual revenues by $1,871,753.
- Capital expenditures amounted to $1,440,000.

Government-Wide Financial Statements

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

The Statement of Net Assets presents information on all of the Municipality's assets and liabilities, with the difference 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 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 $39.3 million at the end of 2010, compared to $39.4 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.

Municipality of Hatillo
Condensed Statement of Net Assets
June 30, 2010 and 2009

	2010	2009
Current assets	$ 14,796,647	$ 15,282,467
Capital assets	49,644,130	49,017,993
Total assets	64,440,777	64,300,460
Currrent liabilities	6,373,034	7,228,718
Noncurrent liabilities	18,783,355	17,681,259
Total liabilities	25,156,389	24,909,977
Invested in capital assets, net of related debt	37,414,110	49,017,993
Restricted	4,248,194	5,847,391
Unrestricted	(2,377,916)	(15,474,901)
Total net assets	$ 39,284,388	$ 39,390,483

Changes in Net Assets

The net assets decreased by $89,569 in comparison with prior year. Approximately 44 percent of the Municipality's total revenue came from taxes while 21 percent resulted from grants and contributions, including federal aid. The Municipality's expenses cover a range of services. The largest expenses were for general government, public work, culture and recreation, and health and welfare.

Municipality of Hatillo
Condensed Statement of Activities
June 30, 2010 and 2009

	2010	2009
Program revenues		
Charges for services	$ 6,855,828	$ 6,588,097
Operating grants and contributions	1,009,156	967,190
Capital grants and contributions	1,284,414	2,913,662
General revenues		
Property taxes	7,244,536	6,923,174
Municipal license tax	4,038,564	4,251,760
Sales and use taxes		
Grants and contributions not restricted to specific programs	5,219,168	4,714,387
Interest, fines and penalties	84,568	247,139
Miscellaneous	183,578	204,090
Total revenues	25,919,812	26,809,499
Expenses		
General government	10,007,728	10,514,500
Public safety	938,014	1,038,538
Public work	7,991,051	8,236,994
Health and welfare	2,801,985	3,439,290
Culture and recreation	2,540,370	2,947,229
Economic Development	1,217,189	251,021
Interest on long-term debt	504,044	1,488,021
Total expenses	26,000,381	27,915,593
Change in net assets	(80,569)	(1,106,094)
Net assets, beginning of year, as restated	39,364,957	40,496,577
Net assets, end of year	$ 39,284,388	$ 39,390,483

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 $9,311,528, a decrease of $817,398 in comparison with the prior year. There are reservations of fund balance amounting to $4,856,221.

The general fund is included within the governmental funds; it is the chief operating fund of the Municipality. As of June 30, 2010, the general fund has a superavit of $248,328. The superavit increased by $6,156 during fiscal year 2009-2010.

Notes to 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 Services Funds.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2010, amounts to $65.7 million, net of accumulated depreciation of $16.1 million, leaving a net book value of $49.6 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.

The Municipality acquired a total of $1,336,471 of capital assets during the fiscal year 2009-2010 as follows:

- Construction in progress - $398,335
- Building and building improvements - $552,274
- Acquisition of equipment and vehicles - $634,973
- Infrastructure - $149,224

Other projects related to repair and maintenance of roads (not capitalized) was development during the fiscal year 2009-2010.

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 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, 2010

Assets	**Governmental Activities**
Cash in bank **(Notes 2 and 5)**	$ 5,602,382
Cash with fiscal agent **(Notes 2 and 5)**	7,173,020
Accounts receivable:	
Sales and use taxes	534,313
Due from other agencies **(Note 9)**	1,486,932
Capital assets, net **(Note 11)**	49,644,130
Total assets	$ 64,440,777

Liabilities and Net Assets	
Liabilities	
Accounts payable and accrued liabilities	$ 867,654
Due to other agencies **(Note 12)**	498,238
Matured bonds and interest payable	1,148,109
Deferred revenues **(Note 13):**	
Municipal license tax	3,176,780
Noncurrent liabilities **(Note 15)**:	
Due within one year	1,489,355
Due in more than one year	17,294,000
Accrued interest	682,253
Total liabilities	25,156,389
Net Assets	
Investment in capital assets, net of related debt	$ 37,414,110
Restricted for:	
Debt service	1,389,175
Capital projects	2,859,019
Unrestricted	(2,377,916)
Total net assets	39,284,388
Total liabilities and net assets	$ 64,440,777

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 ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

Functions/Programs	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions	Net (Expense) Revenue and Changes in Net Assets Primary Government: Governmental Activities
Primary Government:					
General government	$ 10,007,728	$ 1,493,443	$ -	$ -	$ (8,514,285)
Public safety	938,014				(938,014)
Culture and recreation	2,801,985				(2,801,985)
Health and welfare	2,540,370		1,009,156		(1,531,214)
Public work	7,991,051			1,284,414	(6,706,637)
Economic development	1,217,189				(1,217,189)
Interest on long-term debt	504,044				(504,044)
Total primary government	$ 26,000,381	$ 1,493,443	$ 1,009,156	$ 1,284,414	(22,213,368)
General revenues:					
Property taxes **(Note 6)**					7,244,536
Municipal license tax **(Note 7)**					4,038,564
Sales and use tax **(Note 8)**					5,362,385
Grants and contributions not restricted to specific programs					5,219,168
Interest, fines and penalties					84,568
Miscellaneous					183,578
Total general revenues					22,132,799
Change in net assets					(80,569)
Net assets at beginning of year as restated **(Note 22)**					39,364,957
Net assets at end of year					$ 39,284,388

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

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2010

Assets	General	Debt Service	Loan $ 3,370,000	Other Governmental Funds	Total Governmental Funds
Cash and cash equivalents **(Notes 2 and 5)**	$ 2,577,273	$ -	$ -	$ 3,025,109	$ 5,602,382
Cash with fiscal agent **(Notes 2 and 5)**		2,299,052	2,859,019	2,014,949	7,173,020
Accounts recievable:					
Sales and use taxes	534,313				534,313
Due from other agencies **(Note 9)**	879,658	238,232		369,042	1,486,932
Due from other funds **(Note 10)**	353,488				353,488
Total assets	$ 4,344,732	$ 2,537,284	$ 2,859,019	$ 5,409,100	$ 15,150,135

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

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2010

Liabilities and Fund Balance	General	Debt Service	Loan $ 3,370,000	Other Governmental Funds	Total Governmental Funds
Liabilities					
Accounts payable and accrued liabilities	$ 81,060	$ -	$ -	$ 240,606	$ 321,666
Due to other funds **(Note 10)**				353,488	353,488
Due to other agencies **(Note 12)**	498,238				498,238
General obligations: **(Note 15)**					
Bonds		880,000			880,000
Interest		268,109			268,109
Deferred revenues: **(Note 13)**					
Municipal license tax	3,176,780				3,176,780
Intergovernmental	340,326				340,326
Total liabilities	4,096,404	1,148,109	-	594,094	5,838,607
Fund Balances					
Reserved for:					
Encumbrances	608,027				608,027
Debt service		1,389,175			1,389,175
Capital projects			2,859,019	-	2,859,019
Unreserved fund balance	(359,699)			4,815,006	4,455,307
Total fund balance	248,328	1,389,175	2,859,019	4,815,006	9,311,528
Total liabilities and fund balance	$ 4,344,732	$ 2,537,284	$ 2,859,019	$ 5,409,100	$ 15,150,135

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

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO STATEMENT OF NET ASSETS
JUNE 30, 2010

Total fund balances - governmental funds	$ 9,311,528
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	49,644,130
• Other assets are not available to pay for current-period expenditures and therefore are deferred in the governmental funds balance sheet	340,326
• Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds **(Note 4)**	(20,011,596)
Net assets of governmental activities	$ 39,284,388

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, 2010

	General	Debt Service	Loan $ 3,370,000	Other Governmental Funds	Total Governmental Funds
REVENUES					
Property taxes **(Note 6)**	$ 5,501,940	$ 1,742,596	$ -	$ -	$ 7,244,536
Municipal license taxes **(Note 7)**	4,038,564				4,038,564
Sales and use taxes **(Note 8)**	4,504,002	858,383			5,362,385
Licenses, permits, and other local taxes	169,367				169,367
Charges for services	1,324,076				1,324,076
Intergovernmental revenues **(Note 14)**:					
Federal grants and contributions				2,293,570	2,293,570
State contributions	3,742,779			1,476,389	5,219,168
Interest, fines, and penalties	59,361	563		24,644	84,568
Other revenues	167,769			15,809	183,578
Total revenues	19,507,858	2,601,542	-	3,810,412	25,919,812
EXPENDITURES					
Current:					
General government	8,418,394			287,345	8,705,739
Public safety	895,464			9,181	904,645
Health and welfare	765,496			1,774,874	2,540,370
Culture and recreation	2,689,998				2,689,998
Public works	7,678,067				7,678,067
Economic development			235,498	981,691	1,217,189
Capital outlays				1,440,000	1,440,000
Debt service:					
Principal		979,072			979,072
Interest and other		582,130			582,130
Total expenditures	20,447,419	1,561,202	235,498	4,493,091	26,737,210
Excess (deficiency) of revenues over (under) expenditures	(939,561)	1,040,340	(235,498)	(682,679)	(817,398)
OTHER FINANCING SOURCES (USES)					
Transfers in	1,000,563	54,846			1,055,409
Transfers out	(54,846)	(1,000,563)			(1,055,409)
Total other financing sources	945,717	(945,717)	-	-	-
Excess (deficiency) of revenues over expenditures and other financing sources	6,156	94,623	(235,498)	(682,679)	(817,398)
FUND BALANCE AT BEGINNING OF YEAR AS RESTATED (Note 22)	242,172	1,294,552	3,094,517	5,497,685	10,128,926
FUND BALANCE AT END OF YEAR	$ 248,328	$ 1,389,175	$ 2,859,019	$ 4,815,006	$ 9,311,528

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

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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, 2010

Net change in fund balances - total governmental funds	$ (817,398)
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.	1,440,000
• 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.	(813,863)
• 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.	979,072
• Change in accrued interest expense which does not require the use of current financial resources.	78,086
• 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.	(946,466)
Changes in net assets of governmental activities	$ (80,569)

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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, 2010

	General Fund				Debt Service Fund			
	Budgeted Amounts			Variance with Final Budget- Positive	Budgeted Amounts			Variance with Final Budget- Positive
	Original	Final	Actual	(Negative)	Original	Final	Actual	(Negative)
REVENUES								
Property taxes	$ 5,465,157	$ 5,465,157	$ 5,459,557	$ (5,600)	$ 1,541,040	$ 1,541,040	$ 1,742,596	$ 201,556
Municipal license taxes	4,200,000	4,512,030	4,225,415	(286,615)				
Sales taxes	3,650,000	4,654,276	4,610,922	(43,354)			858,383	858,383
Licenses and permits	175,000	153,087	169,367	16,280				
Charges for services	160,000	1,248,102	349,055	(899,047)				
Intergovernmental revenues:								
State contributions	3,206,555	3,843,762	1,909,970	(1,933,792)				
Interest, fines, and penalties	200,000	57,714	63,344	5,630			563	563
Other revenues	140,100	189,960	263,599	73,639				
Total revenues	17,196,812	20,124,088	17,051,229	(3,072,859)	1,541,040	1,541,040	2,601,542	1,060,502
EXPENDITURES								
Current:								
General government	7,680,035	8,590,880	8,745,140	(154,260)				
Public safety	2,358,204	901,468	898,569	2,899				
Public works	4,893,717	7,584,886	6,239,960	1,344,926				
Recreation	713,223	2,273,484	2,267,284	6,200				
Health and welfare	1,551,633	773,370	772,029	1,341				
Debt service:								
Principal					670,824	670,824	979,072	(308,248)
Interest					870,216	870,216	582,130	288,086
Total expenditures	17,196,812	20,124,088	18,922,982	1,201,106	1,541,040	1,541,040	1,561,202	(20,162)
Excess of (expenditures) revenues over revenues (expenditures)	$ -	$ -	$ (1,871,753)	$ (1,871,753)	$ -	$ -	$ 1,040,340	$ 1,040,340

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

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

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 and 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).

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- 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.

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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, ins 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 of 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 is 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.

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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.

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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) 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.

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.

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.

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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.

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:

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	Useful Life
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.

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 RicoTreasury 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, 2010 amounted to approximately $283,067. The current insurance policies have not been cancelled or terminated. The CRIM also

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deducted approximately $441,880 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 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.

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k. Future Adoption of Accounting Pronouncements

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

Statement Number	Statement Name	Adoption Required in Fiscal Year
54	Fund Balance Reporting and Governmental Fund Type Definitions	2010-11
57	OPEB Measurements by Agent Employers and Agent Multiple – Employer Plans	2011-12
59	Financial Instrument Omnibus	2010-11
60	Accounting and Financial Reporting for Service Concession Arrangements	2012-13
61	The Financial reporting entity: Omnibus – on amendment of GASB Statements No. 14 and 34	2012-13

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

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Revenues and Expenditures - Budget and Actual (Budgetary Basis), accordingly, include 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, 2010 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, 2010 is presented below for the general and debt service funds:

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	Debt Service
Excess of expenditures over revenues - budgetary basis	$ 1,040,340
Entity differences:	
Non-budgeted transfers in	54,846
Non-budgeted transfers out	(1,000,563)
Excess of revenues over expenditures - GAAP basis	$ 94,623

Explanation of differences:

Sources/inflows of resources	**General Fund**
Actual amounts (budgetary basis) "available appropriation" from the budgetary comparison schedule	$ 17,051,229
Differences - budget to GAAP:	
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes	(1,000,563)
Non-budgeted revenues	3,457,192
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances	$ 19,507,858
Uses/outflows of resources	
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule	$ 18,922,982
Differences-budget to GAAP:	
Current year encumbrances recorded as expenditures for budgetary purposes	(608,027)
Prior year encumbrances	205,552
Transfers to other funds are outflow of budgetary uses but are not expenditures for financial reporting purposes	(54,846)
Non budgeted expenditures	1,981,758
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances	$ 20,447,419

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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 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	$ 12,230,020
Compensated absences	4,120,005
Other long-term liabilities	2,063,330
Note payable	370,000
Accrued interest	678,383
Christmas bonus	545,988
Net adjustment to reduce fund balance governmental funds to arrive at net assets of governmental activities	$ 20,007,726

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).

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The deposits at GDB of approximately $2,859,019 and $625,657 are restricted principally for capital projects, and the $2,299,052 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.

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	(0.2%)	(0.2%)
	7.80%	5.80%

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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 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 2009-10, 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.

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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, 2010, the amount advanced by CRIM exceeded the amount collected by CRIM from taxpayers and charges for the same period by approximately $69,436. Such amount is presented as a long-term liability in the government wide financial statements. (See Note 15).

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, 2010. 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.

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 $3,176,780, corresponding to the next fiscal year municipal license.

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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 Commonweath's Legislature.

9. DUE FROM OTHER AGENCIES

Represents grants and contributions due from local and federal agencies:

Puerto Rico Treasury Department	$ 340,322
Municipal Revenues Collection Center (General Fund)	109,498
Transit Security Commission (FTA Program)	167,500
Government Development Bank	262,338
Municipal Revenues Collection Center (Debt Service Fund)	238,232
Other governmental funds	369,042
Total	$1,486,932

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10. INTERFUND TRANSACTIONS

a. Due From/To Other Funds:

The due from and due to other fund balances as of June 30, 2010, are as follows:

Receivable Fund	Payable Fund	Amount
General	Other Governmental Funds	$ 353,488

The balance of $353,488 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.

b. Interfund Transfers:

Interfund transfers for the year ended June 30, 2010 consisted of the following:

Transfer In	Transfer Out	Amount
Debt Service	General Fund	$ 54,846
General Fund	Debt Service	1,000,563
		$ 1,055,409

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.

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11. CAPITAL ASSETS

Capital asset activity for the Municipality for the year ended June 30, 2010 was as follows:

Primary Government	Balance June 30, 2009	Increases	Decreases	Balance June 30, 2010
Governmental Activities:				
Capital assets, not being depreciated:				
Land	$ 24,541,244	$ -	$ -	$ 24,541,244
Construction in progress	683,469	398,335	294,806	786,998
Total capital assets, not being depreciated	25,224,713	398,335	294,806	25,328,242
Capital assets, being depreciated:				
Buildings and building improvements	22,507,588	552,274	-	23,059,862
Vehicles and equipment	6,506,550	634,973	-	7,141,523
Infrastructure	10,061,985	149,224	-	10,211,209
Total capital assets, being depreciated	39,076,123	1,336,471	-	40,412,594
Less accumulated depreciation for:				
Buildings and building improvements	5,410,333	284,227	-	5,694,560
Vehicles and equipment	4,398,874	416,010	-	4,814,884
Infrastructure	5,473,636	113,626	-	5,587,262
Total accumulated depreciation	15,282,843	813,863	-	16,096,706
Total capital assets, being depreciated, net	23,793,280	522,608	-	24,315,888
Governmental activities capital assets, net	$ 49,017,993	$ 920,943	$ 294,806	$ 49,644,130

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

General government	$ 355,523
Public safety	33,369
Recreation	111,987
Public works	312,984
Total depreciation expense-governmental activities	$ 813,863

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12. DUE TO OTHER AGENCIES

Due to other agencies at June 30, 2010 are as follows:

Retirement System Administration	$ 188,610
Municipal Revenues Collection Center	152,853
Puerto Rico Water and Sewer Authority	64,191
Treasury Department	6,888
General Services Administration	75
Puerto Rico State Insurance Fund Corporation	75,695
Internal Revenue Service	9,926
Total	$ 498,238

13. DEFERRED REVENUES

a. Municipal License Tax

The deferred revenues of approximately $3,176,780 in the general fund related to municipal license tax collected in fiscal year 2009-10 that will be earned in fiscal year 2010-2011.

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.

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15. LONG-TERM DEBTS

Bonds and other long-term liabilities outstanding at June 30, 2010 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%.	$ 460,000
$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%.	2,505,000
$550,000 series of 1998, payable in annual installments of $14,000 to $38,020 until January 1, 2020, interest at 4.5%	316,020
$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%.	2,085,000
$624,000 series of 1998, payable in annual installments of $17,000 to $44,000 until January 1, 2022, interest at 4.50%.	414,000
$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%.	1,820,000
$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%.	3,165,000
$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%.	1,465,000
Total bonds payable	$ 12,230,020

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Notes Payable

$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%.	$ 370,000
Total notes payable	$ 370,000

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 sen to the Municipality by the Municipal Revenue Collection Center (CRIM).	$ 77,605
Total other long-term liabilities	$ 77,605

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The annual requirements for the amortization of long-term debts at June 30, 2010, are as follows:

	Bonds and Notes		*Note Payable*	
	Principal	**Interest**	**Principal**	**Interest**
2011	$ 523,000	$ 661,080	$ 180,000	$ 17,303
2012	565,000	768,290	190,000	8,987
2013	612,000	731,410		
2014	654,000	694,396		
2015	703,000	654,449		
2016-2020	4,427,020	2,524,512		
2021-2025	2,886,000	1,243,665		
2026-2030	1,505,000	443,625		
2031-2035	355,000	54,750		
	$ 12,230,020	$7,776,177	$ 370,000	$ 26,290

Long-term liability activity for the year ended June 30, 2010 was as follows:

Primary Government	Beginning Balance	Additions	Payments	Ending Balance	Due within One Year
Governmental Activities:					
Bonds payable	$ 12,721,020	$ -	$ 491,000	$ 12,230,020	$ 523,000
Notes payable	810,000		440,000	370,000	180,000
Total long-term debt	13,531,020	-	931,000	12,600,020	703,000
Other long-term liabilities:					
CRIM - LIMS	125,677		48,072	77,605	50,975
CRIM	-	69,436		69,436	69,436
Landfill Obligation	1,662,346			1,662,346	
Puerto Rico Health Insurance Administration	-	253,943		253,943	253,943
Compensated absences	3,281,287	1,399,671	560,953	4,120,005	412,001
Total other long-term liabilities	5,069,310	1,723,050	609,025	6,183,335	786,355
Total noncurrent liabilities, governmental activities	$ 18,600,330	$ 1,723,050	$ 1,540,025	$ 18,783,355	$ 1,489,355

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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.
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

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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.

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, 2010 was approximately $586,068. The Municipality's payroll for employees covered by ERS was approximately $5.6 million. The Municipality total payroll for all employees was approximately $10.2 million.

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Additional information on the ERS is provided in its financial statements for the year ended June 30, 2010, 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 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, 2010 was approximately $125,440.

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.

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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, 2010. (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.

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, 2010. These projects are evidenced by contractual commitments with contractors. The construction projects are commitments of the Other Governmental Funds that amounted to approximately $215,098.

22. RESTATEMENTS

a. Fund Balance

The beginning fund balance of the other governmental funds has been restated to recognize corrections of accounting errors. The following schedule reconciles the fund balance at July 1, 2009 as previously reported to the beginning fund balance, as restated:

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Beginning fund balances, as previously reported	$ 2,433,680
Understatement accounts payable	(25,526)
To reclassify fund balances	3,089,531
Beginning fund balances, as restated	$ 5,497,685

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	$ 39,390,483
Understatement accounts payable	(25,526)
Net assets at beginnig of year as restated	$ 39,364,957

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

Federal Grantor/Program Title	Federal CFDA Number	Federal Disbursements/ Expenditures
U.S. Department of Housing and Urban Development (HUD)		
Direct Programs:		
Section 8 Housing Choice Vouchers	14.871	$ 444,897
Pass-through Commissioner Office of Municipal Affairs - Community Development Block Grant-States:		
Program SBGP	14.228	1,098,452
Program SBGP-Recovery Act Funded	14.255	138,440
Pass-through Department of Family:		
Homelessness Prevention and Rapid Re-Housing Program (Recovery Act Funded)	14.257	74,081
Subtotal U.S. Department of HUD		1,755,870
U.S. Department of Agriculture		
Pass-through Governor's Office of Child Services and Community Development:		
Child and Adult Care Food Program	10.558	28,095
Subtotal U.S. Department of Agriculture		28,095
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	70,854
Special Programs for the Aging Title III, Part E, National Family Caregivers Support	93.052	63,694
Pass-through the Office of Administration for Children and Families		
Child and Care and Development Block Grant	93.575	251,397
Subtotal U.S. Department of HHS		385,945
U.S. Department of Justice		
Pass-through the Puerto Rico Department of Justice		
Edward Byrne Memorial Justice Assistance Grant Program	16.738	2,055
Subtotal U.S. Department of Justice		2,055
U.S. Department of Transportation		
Pass-through Transit Security Commission		
Federal Transit Formula Grants	20.507	7,126
Subtotal U.S. Department of Transportation		7,126
U.S. Department of Energy		
Pass-through the Puerto Rico Administration of Energy Affairs:		
Energy Efficiency and Conservation Block Grant Program	81.128	11,360
Subtotal U.S. Department of Energy		11,360
TOTAL		$ 2,190,451

See notes to Schedule of Expenditures of Federal Awards.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

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 $2,190,451 are included within Other Governmental Funds.

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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, 2010, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated December 13, 2010. 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.

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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 December 13, 2010.

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.

Ortiz, Rivera, Rivera & Co.

San Juan, Puerto Rico
December 13, 2010

The stamp 2586317 was affixed to the original of this report.

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON 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 could have a direct and material effect on each Municipality of Hatillo' major federal programs for the year ended June 30, 2010. 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 an 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 compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2010. However, the results

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of our auditing procedures discloses instances of non compliance 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 and questioned costs as items 10-1, 10-2 and 10-3.

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 to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance 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 compliance that might be deficiencies, 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.

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.

Ortiz, Rivera, Rivera & Co

San Juan, Puerto Rico
December 13, 2010

The stamp 2586318 was affixed
to the original of this report.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

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 programs tested as major program are:

- SBGP - CFDA No. 14.228
- SBGP Recovery Act Funded - CFDA No. 14.255

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

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

a. SBGP - CFDA No. 14.228

- **Condition 10-1**

The Municipality is not in compliance with the procedures established by the federal regulation to minimize the time elapsing between the transfer of funds and their disbursement.

Cause

The Municipality does not keep adequate cash forecasting procedures because the Municipality has requested and received federal funds in excess of its immediate needs.

Effect

The continued occurrences of this condition may expose the Municipality to the assessment of interest cost relation to the excess cash on hand which would be paid from local funds.

Criteria

The 45CFR 92.20 (b)(7) establishes that the federal funds recipient will adopt the necessary policies and procedures to minimize the time between the receipt of funds and the disbursements for expenditures.

Recommendation

The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next three days, as established by federal regulations. Federal Funds should only be requested when they are going to be disbursing.

Questioned Costs

None

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- **Condition 10-2**

The Federal Program Office does no request the extension of the contracts for the year program 2007 into the 45 days required. The extension for FC contract was due on March 28, 2010 and is still in process. The Municipality operates approximately three 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 2007 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.

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

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- **Condition 10-3**

The Municipality did not comply with the requirement of preparing and filing the program income quarterly report for the period ended March 31, 2010 in a timely basis. During our examination, we noted that the Municipality did not send on time the quarterly report for the following period ended:

Report	Report Period	Due Date	Submitted
March 2010	January to March 2010	04-30-10	07-02-10

Cause

The above situation occurred because the Municipality did not ensure to verify the due date to submit this report to the Agency.

Effect

The program is not in compliance with the program income regulations.

Criteria

Based on the OCAM Circular 2008-11, the program income quarterly report for period ended March 31 of each year, must be submitted on April 30.

Recommendation

The Federal Program Offices should establish a schedule of the due date of the required reports by the Agency in order to comply with all of them.

Questioned Costs

None

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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, 2010

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.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

Program	Finding /Non compliance	Status
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.	Condition still prevails.
SBGP – CFDA No. 14.228	**Condition 09-2**	
	The Municipality did not comply with the requirement of preparing and filling its federal financial reports on a timely basis.	Condition still prevails.

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EXHIBIT I

CORRECTIVE ACTION PLAN

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Estado Libre Asociado de Puerto Rico
Gobierno Municipal Hatillo
Oficina del Alcalde

CORRECTIVE ACTION PLAN

December 13, 2010

Cognizant or Oversight Agency for Audit:

Municipality of Hatillo respectfully submits the following corrective action plan for the year ended June 30, 2010.

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, 2010.

The findings from the June 30, 2010 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 10-1: SBGP - CFDA 14.228

Reportable Condition: See Condition 10-1

Recommendation

The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next three days, as established by federal regulations. Federal Funds should only be requested when they are going to be disbursing.

Action Taken

The Municipality has established a procedure to minimize the time between the receipt of funds and the disbursement of expenditures (not to exceed three (3) business days).

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544-1017
820-4417
898-2416
898-3840
ext. 258, 290
Fax. 898-2295

Reportable Condition: See Condition 10-2

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 requirement.

Reportable Condition: See Condition 10-3

Recommendation

The Federal Program Offices should establish a schedule of the due date of the required reports by the Agency in order to comply with all of them.

Action Taken

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

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 Z. Rosa Padilla

Ana Zahir Rosa Padilla
Federal Program Director