

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

**MUNICIPIO DE HATILLO  
AUDITORÍA 2011-2012  
30 DE JUNIO DE 2012**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO**

**BASIC FINANCIAL STATEMENTS  
FOR THE FISCAL YEAR ENDED  
JUNE 30, 2012**

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
BASIC FINANCIAL STATEMENTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
BASIC FINANCIAL STATEMENTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Hatillo, as of and for the year ended June 30, 2012, 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, 2012, and the respective changes in financial position, thereof 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 February 12, 2013 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 and budgetary comparison information* on pages 3 to 10 and 46 to 47 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 obtained 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. The *schedule of expenditures of federal awards, as required by Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations (Circular A-133)* is presented for purposes of additional analysis 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 schedule of expenditures of federal awards* is fairly stated in all material respects in relation to the financial statements as a whole.

San Juan, Puerto Rico  
February 12, 2013

*Ortiz, Rivera, Rivera & Co.*

The stamp E52605 was  
to the original of this report



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ORTIZ, RIVERA, RIVERA & CO.

PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Commonwealth of Puerto Rico  
Municipality of Hatillo

Management's Discussion and Analysis

Year Ended June 30, 2012

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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 increased by \$200,742.
- In the fund financial statements, general fund revenues decreased by \$186,899 (or 1%).
- In the fund financial statements, general fund expenditures increased by \$526,657 (or 2%).
- The General Fund (the primary operating fund) reflected, on a current financial resources basis, a decrease of \$1,072,605.
- On a budgetary basis, actual expenditures exceed actual revenues by \$1,064,520.
- Capital expenditures amounted to \$4,973,793.

**Commonwealth of Puerto Rico  
Municipality of Hatillo**

**Management's Discussion and Analysis**

**Year Ended June 30, 2012**

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**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.

**Commonwealth of Puerto Rico  
Municipality of Hatillo**

**Management's Discussion and Analysis**

**Year Ended June 30, 2012**

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**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 \$40.2 million at the end of 2012, compared to \$40.0 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.

**Commonwealth of Puerto Rico  
Municipality of Hatillo**

**Management's Discussion and Analysis**

**Year Ended June 30, 2012**

**Municipality of Hatillo  
Condensed Statement of Net Assets  
June 30, 2012 and 2011**

	<b>2012</b>	<b>2011</b>
Current assets	\$ 15,257,393	\$ 13,739,420
Capital assets	54,791,426	51,356,775
Total assets	70,048,819	65,096,195
Current liabilities	6,783,806	6,118,275
Noncurrent liabilities	23,037,877	18,951,526
Total liabilities	29,821,683	25,069,801
Invested in capital assets, net of related debt	37,296,406	41,523,261
Restricted	4,378,302	3,994,609
Unrestricted	(1,447,572)	(5,491,476)
Total net assets	\$ 40,227,136	\$ 40,026,394

**Changes in Net Assets**

The net assets increased by \$200,742 in comparison with prior year. Approximately 42 percent of the Municipality's total revenue came from taxes while 27 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.

**Commonwealth of Puerto Rico  
Municipality of Hatillo**

**Management's Discussion and Analysis**

**Year Ended June 30, 2012**

**Municipality of Hatillo  
Condensed Statement of Activities  
June 30, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
<b>Program revenues:</b>		
Charges for services	\$ 7,592,855	\$ 7,623,460
Operating grants and contributions	961,154	1,744,599
Capital grants and contributions	6,304,374	1,593,578
<b>General revenues:</b>		
Property taxes	7,463,290	7,083,883
Municipal license tax	4,062,609	3,937,368
Grants and contributions not restricted to specific programs	354,156	5,368,987
Interest, fines and penalties	188,819	192,415
Miscellaneous	262,557	40,376
Total revenues	<u>27,189,814</u>	<u>27,584,666</u>
<b>Expenses:</b>		
General government	9,104,914	9,857,633
Public safety	1,294,233	1,026,635
Public work	9,187,225	8,919,649
Culture and recreation	4,103,496	3,426,611
Health and welfare	2,008,097	3,391,060
Economic development	-	216,687
Interest on long-term debt	777,557	611,657
Total expenses	<u>26,475,522</u>	<u>27,449,932</u>
Change in net assets	714,292	134,734
Net assets, beginning of year	<u>39,512,844</u>	<u>39,891,660</u>
Net assets, end of year	<u>\$ 40,227,136</u>	<u>\$ 40,026,394</u>

**Commonwealth of Puerto Rico  
Municipality of Hatillo**

**Management's Discussion and Analysis**

**Year Ended June 30, 2012**

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**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 \$9,635,691, an increase of \$933,364 in comparison with the prior year. There are reservations of fund balance amounting to \$12,124,736.

The general fund is included within the governmental funds; it is the chief operating fund of the Municipality. As of June 30, 2012, the general fund has a deficit of \$1,024,986. The superavit decreased by \$1,072,605 during fiscal year 2011-2012.

**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.

**Commonwealth of Puerto Rico  
Municipality of Hatillo**

**Management's Discussion and Analysis**

**Year Ended June 30, 2012**

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**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

The Municipality's investment in capital assets as of June 30, 2012, amounts to \$73.4 million, net of accumulated depreciation of \$18.6 million, leaving a net book value of \$54.8 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 \$4,973,793 of capital assets during the fiscal year 2011-2012 as follows:

- Building and building improvements - \$2,626,720
- Acquisition of equipment and vehicles - \$793,342
- Infrastructure - \$1,404,731

Other projects related to repair and maintenance of roads (not capitalized) was development during the fiscal year 2011-2012.

**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").

**Commonwealth of Puerto Rico  
Municipality of Hatillo**

**Management's Discussion and Analysis**

**Year Ended June 30, 2012**

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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, 2012

Assets

	<b>Governmental Activities</b>
Cash in bank (Notes 2 and 4)	\$ 2,518,303
Cash with fiscal agent (Notes 2 and 4)	7,897,886
Accounts receivable:	
Sales and use taxes	1,177,853
Other	542,990
Due from other agencies (Note 8)	922,582
Cash restricted (Notes 2 and 4)	2,197,779
Capital assets, net (Note 10)	54,791,426
 Total assets	 \$ 70,048,819

Liabilities and Net Assets

**Liabilities**

Accounts payable and accrued liabilities	\$ 1,099,023
Due to other agencies (Note 11)	224,638
Matured bonds and interest payable	1,244,633
Deferred revenues (Note 12):	
Municipal license tax	3,363,273
Noncurrent liabilities (Note 14):	
Due within one year	1,398,045
Due in more than one year	21,639,832
Accrued interest	852,239
Total liabilities	29,821,683

**Net Assets**

Investment in capital assets, net of related debt	37,296,406
Restricted for:	
Debt service	1,992,525
Capital projects	2,385,777
Unrestricted	(1,447,572)
Total net assets	40,227,136
 Total liabilities and net assets	 \$ 70,048,819

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



COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
BALANCE SHEET-GOVERNMENTAL FUNDS  
JUNE 30, 2012

<u>Assets</u>	General	Debt Service	Loan	Other Governmental Funds	Total Governmental Funds
			\$3,370,000		
Cash and cash equivalents (Notes 2 and 4)	\$ 359,665	-	-	\$ 2,158,638	\$ 2,518,303
Cash with fiscal agent (Notes 2 and 4)		3,039,761	2,415,477	2,442,648	7,897,886
Accounts receivable:					
Sales and uses taxes	1,177,853				1,177,853
Other	542,990				542,990
Due from other agencies (Note 8)	460,263	197,397		264,922	922,582
Due from other funds (Note 9)	571,011			5,000	576,011
Cash restricted (Notes 2 and 4)				2,197,779	2,197,779
<b>Total assets</b>	<u>\$ 3,111,782</u>	<u>\$ 3,237,158</u>	<u>\$ 2,415,477</u>	<u>\$ 7,068,987</u>	<u>\$ 15,833,404</u>

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
BALANCE SHEET-GOVERNMENTAL FUNDS  
JUNE 30, 2012

<u>Liabilities and Fund Balance (Deficit)</u>	<u>General</u>	<u>Debt Service</u>	<u>Loan</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
<b>Liabilities</b>					
Accounts payable and accrued liabilities	\$ 268,722	\$ -	\$ -	\$ 240,301	\$ 509,023
Due to other funds (Note 9)			29,700	546,311	576,011
Due to other agencies (Note 11)	224,638				224,638
General obligations: (Note 14)					
Bonds		925,000			925,000
Interest		319,633			319,633
Deferred revenues: (Note 12)					
Municipal license tax	3,363,273				3,363,273
Intergovernmental	280,135				280,135
Total liabilities	<u>4,136,768</u>	<u>1,244,633</u>	<u>29,700</u>	<u>786,612</u>	<u>6,197,713</u>
<b>Fund Balances (Deficit)</b>					
Restricted		1,992,525		4,182,904	6,175,429
Committed			2,385,777	2,395,154	4,780,931
Assigned	1,168,376				1,168,376
Unassigned	(2,193,362)			(295,683)	(2,489,045)
Total fund balances (deficit)	<u>(1,024,986)</u>	<u>1,992,525</u>	<u>2,385,777</u>	<u>6,282,375</u>	<u>9,635,691</u>
Total liabilities and fund balances	<u>\$ 3,111,782</u>	<u>\$ 3,237,158</u>	<u>\$ 2,415,477</u>	<u>\$ 7,068,987</u>	<u>\$ 15,833,404</u>

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
RECONCILIATION OF THE GOVERNMENTAL FUNDS  
BALANCE SHEET TO STATEMENT OF NET ASSETS  
JUNE 30, 2012

Total fund balances - governmental funds \$ 9,635,691

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. 54,791,426
- Other assets are not available to pay for current-period expenditures and therefore are deferred in the governmental funds balance sheet. 280,135
- Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. **(Note 3)** (24,480,116)

Net assets of governmental activities \$ 40,227,136

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

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, 2012

	General	Debt Service	Loan \$ 3,370,000	Other Governmental Funds	Total Governmental Funds
<b>REVENUES</b>					
Property taxes (Note 5)	\$ 5,557,518	\$ 1,905,772	\$ -	-	\$ 7,463,290
Municipal license taxes (Note 6)	4,062,609				4,062,609
Sales and uses taxes (Note 7)	4,645,024	728,570			5,373,594
Licenses, permits, and other local taxes	677,031				677,031
Charges for services	1,542,230				1,542,230
Intergovernmental revenues (Note 13):					
Federal grants and contributions				2,232,353	2,232,353
State contributions	5,033,175			354,156	5,387,331
Interest, fines, and penalties	183,867	2,202		2,750	188,819
Other revenues	256,408			6,149	262,557
Total revenues	<u>21,957,862</u>	<u>2,636,544</u>	<u>-</u>	<u>2,595,408</u>	<u>27,189,814</u>
<b>EXPENDITURES</b>					
Current:					
General government	8,823,494			110,845	8,934,339
Public safety	825,259			435,069	1,260,328
Health and welfare	976,432			1,031,665	2,008,097
Culture and recreation	3,896,427				3,896,427
Public works	8,713,861				8,713,861
Capital outlays	193,473		105,090	4,675,230	4,973,793
Debt service:					
Principal		1,006,630			1,006,630
Interest and other		673,172			673,172
Total expenditures	<u>23,428,946</u>	<u>1,679,802</u>	<u>105,090</u>	<u>6,252,809</u>	<u>31,466,647</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(1,471,084)</u>	<u>956,742</u>	<u>(105,090)</u>	<u>(3,657,401)</u>	<u>(4,276,833)</u>
<b>OTHER FINANCING SOURCES (USES)</b>					
Bond issuance	425,902			3,900,000	3,900,000
Transfers in	(27,423)	27,423			453,325
Transfers out	398,479	(425,902)			(453,325)
Total other financing sources (uses)	<u>(1,072,605)</u>	<u>(398,479)</u>		<u>3,900,000</u>	<u>3,900,000</u>
Excess (deficiency) of revenues over expenditures and other financing sources	<u>(1,072,605)</u>	<u>558,263</u>	<u>(105,090)</u>	<u>242,599</u>	<u>(376,833)</u>
<b>FUND BALANCE AT BEGINNING OF YEAR, AS RESTATED (Note 23)</b>	47,619	1,434,262	2,490,867	6,039,776	10,012,524
<b>FUND BALANCE (DEFICIT) AT END OF YEAR</b>	<u>\$ (1,024,986)</u>	<u>\$ 1,992,525</u>	<u>\$ 2,385,777</u>	<u>\$ 6,282,375</u>	<u>\$ 9,635,691</u>

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND  
CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS  
TO THE STATEMENT OF ACTIVITIES  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

Net change in fund balances - total governmental funds \$ (376,833)

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. 4,973,793
- 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. (1,378,395)
- Governmental funds report issuance of long-term as other financial sources because provides current financial resources. (3,900,000)
- Governmental funds report principal payments on long-term obligations as expenditures, whereas the principal payments reduces the long-term obligations in the statement of activities. 1,006,630
- Change in accrued interest expense which does not require the use of current financial resources. (104,385)
- 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. 493,482

Changes in net assets of governmental activities \$ 714,292

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
NOTES TO THE FINANCIAL STATEMENTS  
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**1. ORGANIZATION**

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

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

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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

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

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

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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.

**COMMONWEALTH OF PUERTO RICO**  
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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.

The Municipality implemented Government Accounting Standards Board Statement No. 54 (GASB 54), "*Fund Balance Reporting and Governmental Fund Type Definitions*" during fiscal year 2011. GASB 54 enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied, and it clarifies the existing governmental fund type definitions. It establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

GASB 54 also provides guidance for classifying stabilization amounts on the face of the balance sheet and requires disclosure of certain information about stabilization arrangements in the notes to the financial statements. The definitions of the General fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type are also clarified by the provisions in

**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.

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**MUNICIPALITY OF HATILLO**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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.

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.

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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.

**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.

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**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 for repairs and maintenance are expensed as incurred.

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

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

**g. Fund Balances**

During the fiscal year 2011, the Municipality adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB No. 54), which enhanced the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied. This statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which the Municipality is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

Pursuant to the provisions of GASB No. 54, the accompanying fund financial statements report fund balance amounts that are considered nonspendable, such as fund balance associated with inventories. Other fund balances have been

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reported as restricted, committed, assigned, and unassigned, based on the relative strength of the constraints that control how specific amounts can be spent, as described as follows:

- 1) *Nonspendable* - Represent resources that cannot be spent readily with cash or are legally or contractually required not be spent, including but not limited to inventories, prepaid items, and long term balances of interfund loans and accounts receivable.
- 2) *Restricted* - Represent resources that can be spent only for the specific purposes stipulated by constitutional provisions, external resource providers (externally imposed by creditors or grantors), or through enabling legislation (that is, legislation that creates a new revenue source and restricts its use). Effectively, restrictions may be changed or lifted only with the consent of resource providers.
- 3) *Committed* - Represent resources used for specific purposes, imposed by formal action of the Municipal's highest level of decision making authority (Municipal Legislature through resolutions and ordinances) and can only be changed by a similar law, ordinance or resolution, no later than the end of fiscal year.
- 4) *Assigned* - Represent resources intended to be used by the Municipality for specific purposes but do not meet the criteria to be classified as restricted or committed (generally executive orders approved by the Mayor). Intent can be expressed by the Municipal Legislature, the Mayor or by an official or body to which the Municipal Legislature delegates authority in conformity with the Autonomous Municipalities Act of Puerto Rico, as amended. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed.
- 5) *Unassigned* - Represent the residual classification for the Municipality's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification is used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.

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Negative fund balance amounts are assigned amounts reduced to the amount that will raise the fund balance to zero. Consequently, negative residual amounts in restricted, committed, and assigned fund balance classification have been reclassified to unassigned fund balances.

The Municipality reports resources constrained to stabilization as a specified purpose (restricted or committed fund balance in the general fund) only if: (1) such resources meet the other criteria for those classifications, as described above and (2) the circumstances or conditions that signal the need for stabilization are identified in sufficient detail and are not expected to occur routinely. However, the Municipality has not entered into any stabilization-like arrangements, nor has set aside material financial resources for emergencies and has not established formal minimum fund balance amounts as of and for the fiscal year ended June 30, 2012.

In situations when an expenditure is made for a purpose for which amounts are available in multiple fund balance classifications, the Municipality uses restricted resources first, and then unrestricted resources. Within unrestricted resources, the Municipality generally spends committed resources first, followed by assigned resources, and then unassigned resources when expenditures.

The classification of the Municipality's individual governmental funds among general, debt service, special revenue, and capital projects fund types used in prior fiscal years for financial reporting purposes was not affected by the implementation of GASB No. 54.

**h. Risk Financing**

The Municipality carries insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities of Puerto Rico. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (the "CRIM") for the year ended June 30, 2012 amounted to \$312,933. The current insurance policies have not been cancelled or terminated. The CRIM also deducted \$466,017 for workers' compensation insurance covering all municipal employees.

**COMMONWEALTH OF PUERTO RICO  
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
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**i. Compensated Absences**

Employees are entitled to 30 days vacations leave and 18 days sick leave per year. Sick leave is recorded as 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.

**k. Future Adoption of Accounting Pronouncements**

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

<u>Statement Number</u>	<u>Statement Name</u>	<u>Adoption Required in Fiscal Year</u>
60	Accounting and Financial Reporting for Service Concession Arrangements	2012-13

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<u>Statement Number</u>	<u>Statement Name</u>	<u>Adoption Requieres in Fiscal Year</u>
61	The Financial reporting entity: Omnibus – on amendment of GASB Statements No. 14 and 34	2012-13
62	Codification of Accounting and Financial Reporting Guidance Contained in Pre - November 30, 1989 FASB and AICPA Pronouncements	2012-13
63	Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position	2012-13
65	Items Previously Reported as Assets and Liabilities	2013-14
66	Technical Corrections - 2012- an amendment of GASB Statements No. 10 and 62	2013-14
67	Financial Reporting for Pension Plans - an amendment of GASB Statement No. 25	2013-14
68	Accounting and Financial Reporting for Pensions - and amendment of GASB Statement No. 27	2014-15
69	Government Combinations and Disposals of Government Operations.	2013-14

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

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**3. 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 \$24.5 million differences are as follows:

Bonds payable	\$ 17,495,020
Compensated absences	3,749,551
Other long-term liabilities	1,793,306
Accrued interest	852,239
Christmas bonus	<u>590,000</u>
 Net adjustment to reduce fund balance governmental funds to arrive at net assets of governmental activities	 <u><u>\$ 24,480,116</u></u>

**4. DEPOSITS**

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

The deposits at GDB of \$4,858,125, which are restricted principally for capital projects, and the \$3,039,761 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.

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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.

**5. 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:

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

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

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

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

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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 ensuing 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 2011-12, but not the final settlement as the six months period after fiscal year ends, provided by law to CRIM to issue this, has not yet expired.

Management believes, based in part on the experience from prior years, that when received, the final settlement from CRIM will not show a significant difference from the preliminary settlement and that such difference, if any, will not have a material effect on the financial condition of the Municipality.

Based on the preliminary settlement already received, during the year ended June 30, 2012, the amount collected by CRIM from taxpayers and charges exceeded the amount advanced by CRIM for the same period by \$180,128. Such amount is presented as due from CRIM in the accompanying financial statements. (See note 8).

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**6. 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, 2012. 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 \$3,363,273, corresponding to the next fiscal year municipal license.

**7. 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) to be invested in solid waste and recycling programs, capital improvements and health and public safety cost. Amount collected by the Commonwealth will be deposited in accounts of special funds in the

**COMMONWEALTH OF PUERTO RICO  
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Government Development Bank for Puerto Rico ("GDB"), subject to restrictions imposed and distributed as follows:

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

**8. DUE FROM OTHER AGENCIES**

Represents grants and contributions due from local and federal agencies:

Puerto Rico Treasury Department	\$ 280,135
Municipal Revenues Collection Center (General Fund)	180,128
Municipal Revenues Collection Center (Debt Service Fund)	197,397
Other governmental funds	<u>264,922</u>
Total	<u>\$ 922,582</u>

**9. INTERFUND TRANSACTIONS**

**a. Due From/To Other Funds:**

The due from and due to other fund balances as of June 30, 2012, are as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Governmental	\$ 541,311
General	Loan \$3,370,000	29,700
Funds	Governmental	<u>5,000</u>
		<u>\$ 576,011</u>

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The balance of \$541,311 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, 2012 consisted of the following:

<u>Transfer In</u>	<u>Transfer Out</u>	<u>Amount</u>
Debt Service	General Fund	\$ 27,423
General Fund	Debt Service	<u>425,902</u>
		<u>\$ 453,325</u>

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

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FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**10. CAPITAL ASSETS**

Capital asset activity for the Municipality for the year ended June 30, 2012 was as follows:

<u>Primary Government</u>	<u>Balance July 1, 2011, as restated</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2012</u>
<b>Governmental Activities:</b>				
Capital assets, not being depreciated:				
Land	\$ 24,541,244	\$ 149,000	\$ -	\$ 24,690,244
Construction in progress	1,468,269	2,460,720	969,535	2,959,454
Total capital assets, not being depreciated	<u>26,009,513</u>	<u>2,609,720</u>	<u>969,535</u>	<u>27,649,698</u>
Capital assets, being depreciated:				
Buildings and building improvements	24,059,212	1,135,535	-	25,194,747
Vehicles and equipment	6,842,814	793,342	-	7,636,156
Infrastructure	11,555,024	1,404,731	-	12,959,755
Total capital assets, being depreciated	<u>42,457,050</u>	<u>3,333,608</u>	<u>-</u>	<u>45,790,658</u>
Less accumulated depreciation for:				
Buildings and building improvements	6,219,557	397,005	-	6,616,562
Vehicles and equipment	5,333,911	823,491	-	6,157,402
Infrastructure	5,717,067	157,899	-	5,874,966
Total accumulated depreciation	<u>17,270,535</u>	<u>1,378,395</u>	<u>-</u>	<u>18,648,930</u>
Total capital assets, being depreciated, net	<u>25,186,515</u>	<u>1,955,213</u>	<u>-</u>	<u>27,141,728</u>
Governmental activities capital assets, net	<u>\$ 51,196,028</u>	<u>\$ 4,564,933</u>	<u>\$ 969,535</u>	<u>\$ 54,791,426</u>

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

General government	\$ 607,866
Public safety	70,013
Recreation	216,451
Public works	484,065
Total depreciation expense-governmental activities	<u>\$ 1,378,394</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**11. DUE TO OTHER AGENCIES**

Retirement System Administration	\$ 129,154
Municipal Revenues Collection Center	7,699
Puerto Rico Water and Sewer Authority	71,225
Treasury Department	7,335
General Services Administration	225
Internal Revenue Service	9,000
Total	\$ 224,638

**12. DEFERRED REVENUES**

**a. Municipal License Tax**

The deferred revenues of \$3,363,273 in the general fund related to municipal license tax collected in fiscal year 2011-12 that will be earned in fiscal year 2012-2013.

**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.

**13. INTERGOVERNMENTAL REVENUES**

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**14. LONG-TERM DEBTS**

Bonds and other long-term liabilities outstanding at June 30, 2012 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%.	\$ 395,000
\$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%.	2,145,000
\$550,000 series of 1998, payable in annual installments of \$14,000 to \$38,020 until January 1, 2020, interest at 4.5%.	263,020
\$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%.	1,885,000
\$624,000 series of 1998, payable in annual installments of \$17,000 to \$44,000 until January 1, 2022, interest at 4.50%.	359,000
\$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%.	1,685,000

**COMMONWEALTH OF PUERTO RICO  
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

\$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%.	\$ 3,000,000
\$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%.	1,410,000
\$1,055,000 series of 2011, payable in annual installments of \$40,000 to \$115,000 until July 1, 2025, interest from 6.00% to 7.50%.	970,000
\$1,560,000 series of 2012, payable in annual installments of \$180,000 to \$275,000 until July 1, 2018, interest from 6.00% to 7.50%.	1,380,000
\$712,000 series of 2012, payable in annual installments of \$19,728 to \$42,330 until January 1, 2037, interest at 3.375%.	712,000
\$436,000 series of 2012, payable in annual installments of \$12,080 to \$25,920 until January 1, 2037, interest at 3.375%.	436,000
\$1,193,000 series of 2011, payable in annual installments of \$151,045 to \$191,120 until January 1, 2018, interest at 4.000%.	1,193,000
\$470,000 series of 2011, payable in annual installments of \$12,448 to \$31,101 until January 1, 2036, interest at 4.250%.	470,000

**COMMONWEALTH OF PUERTO RICO  
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

\$162,000 series of 2012, payable in annual installments of \$4,418 to \$9,747 until January 1, 2037, interest at 3.500%.

\$ 162,000

\$1,030,000 series of 2012, payable in annual installments of \$28,998 to \$65,178 until January 1, 2036, interest at 3.750%.

1,030,000

Total bonds payable

\$ 17,495,020

The annual requirements for the amortization of long-term debts at June 30, 2012 are as follows:

	<i><b>Bonds Payable</b></i>	
	<u>Principal</u>	<u>Interest</u>
2013	\$ 998,045	\$ 852,239
2014	1,143,760	997,716
2015	1,221,886	929,515
2016	1,303,372	855,961
2017	1,396,228	777,000
2018-2022	5,647,515	2,660,191
2023-2027	3,152,896	1,252,348
2028-2032	1,772,160	444,532
2033-2037	859,158	83,990
	<u>\$ 17,495,020</u>	<u>\$8,853,492</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

Long-term liability activity for the year ended June 30, 2012 was as follows:

Primary Government	Beginning Balance, as restated	Additions	Payments	Ending Balance	Due Within One Year
<b>Governmental Activities:</b>					
Bonds payable	\$ 14,385,020	\$ 3,900,000	\$ 790,000	\$ 17,495,020	\$ 998,045
Notes payable	190,000		190,000	-	
Total long-term debts	<u>14,575,020</u>	<u>3,900,000</u>	<u>980,000</u>	<u>17,495,020</u>	<u>998,045</u>
<b>Other long-term liabilities:</b>					
CRIM - LIMS	26,630		26,630	-	
CRIM	260,284		260,284	-	
Landfill Obligation	1,692,398		254,612	1,437,786	
Puerto Rico Health Insurance Administration	304,731	50,789		355,520	
Compensated absences	<u>3,755,463</u>	<u>451,984</u>	<u>457,896</u>	<u>3,749,551</u>	<u>400,000</u>
Total other long-term liabilities	<u>6,039,506</u>	<u>502,773</u>	<u>999,422</u>	<u>5,542,857</u>	<u>400,000</u>
Total noncurrent liabilities, governmental activities	<u>\$ 20,614,526</u>	<u>\$ 4,402,773</u>	<u>\$ 1,979,422</u>	<u>\$ 23,037,877</u>	<u>\$ 1,398,045</u>

**15. FUND BALANCES**

	General	Debt Service	Loan \$3,370,000	Other Governmental Funds	Total
<b>Restricted:</b>					
General government	\$ -	\$ -	\$ -	\$ 209	\$ 209
Public safety				59,162	59,162
Health and welfare				241,120	241,120
Economic development				3,882,413	3,882,413
Debt service		1,992,525			1,992,525
<b>Committed:</b>					
Economic development			2,385,777	2,395,154	4,780,931
<b>Assigned:</b>					
General government	462,068				462,068
Public safety	53,948				53,948
Health and welfare	239,610				239,610
Culture and recreation	10,411				10,411
Public works	402,339				402,339
Unassigned	<u>(3,058,362)</u>			<u>(295,683)</u>	<u>(3,354,045)</u>
	<u>\$ (1,889,986)</u>	<u>\$ 1,992,525</u>	<u>\$ 2,385,777</u>	<u>\$ 6,282,375</u>	<u>\$ 8,770,691</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**16. NET ASSETS**

Net assets invested in capital assets, net of related debt is comprised of the following:

Capital assets, net of accumulated	\$ 54,791,426
Outstanding balance on capital related debt	<u>(17,495,020)</u>
Total invested in capital assets, net of related	<u><u>\$ 37,296,406</u></u>

**17. 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 retirement's systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Heads of 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.

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**MUNICIPALITY OF HATILLO**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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

Participants who have completed at least thirty (30) years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five (55) years of age will receive 65% of the average compensation or if they have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten (10) years of service. No benefit is payable if the participant receives a refund of his accumulated contributions.

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

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

**COMMONWEALTH OF PUERTO RICO  
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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, 2012 was \$647,542. The Municipality's payroll for employees covered by ERS was approximately \$5.6 million. The Municipality total payroll for all employees was approximately \$10.7 million.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2012, a copy of which can be obtained from the ERS, Minillas Station, PO Box 42003, San Juan, PR 00940.

**18. 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.

**19. 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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF HATILLO**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

- b. Total income from leases during the year ended June 30, 2012 was approximately \$91,050.
- 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.

**20. 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 \$1.4 million as of June 30, 2012. (See Note 14).

**21. 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.

**22. COMMITMENTS**

The Municipality of Hatillo had several outstanding or planned construction projects as of June 30, 2012. These projects are evidenced by contractual commitments with

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**23. RESTATEMENTS**

Fund balances at beginning of year have been adjusted to reflect the following restatements:

**a. Fund Balances**

The beginning fund balances of Loan \$3,370,000 and other governmental funds have been restated as follows:

	<u>Loan</u>	<u>Other Governmental Fund</u>
	<u>\$ 3,370,000</u>	
Beginning fund balances, as previously reported	\$ 2,560,347	\$ 4,660,099
Understatement of cash		1,310,197
Under/overstatement of accounts payable	(69,480)	69,480
Beginning fund balances, as restated	<u>\$ 2,490,867</u>	<u>\$ 6,039,776</u>

**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	\$ 40,026,394
Understatement of cash	1,310,197
Overstatement of capital assets	(160,747)
Understatement long-term debts	<u>(1,663,000)</u>
Net assets at beginning of year, as restated	<u>\$ 39,512,844</u>

**24. CLAIMS**

The Municipality of Hatillo has established a claim with the Puerto Rico Department of Treasury of Puerto Rico regarding a balance of sales and use tax due. The Puerto Rico Department of Treasury is the entity that receives payment from taxpayers and then the municipal portion is remitted to the Municipality. Since 2007, the Municipality has reported deficiencies between the balance collected by agency and the balance

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

remitted to the Municipality by them. The balance claimed is approximately \$1,000,000. Also, the Municipality established a claim for \$ 400,000 in respect of the municipal development fund. These deficiencies have caused the Municipality operates with less economic resources than budgeted. As of today these claims have not been received.

**25. SUBSEQUENT EVENTS**

In preparing these financial statements, the Municipality has evaluated events and transactions for potential recognition or disclosure through February 12, 2013, the date the financial statements were available to be issued.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

	Budgeted Amounts		Actual Amounts (Budgetary Basis) (See Note 1)	Variance with Final Budget- Positive (Negative)
	Original	Final		
<b>REVENUES</b>				
Property taxes	\$ 5,366,957	\$ 5,520,899	\$ 5,531,332	\$ 10,433
Municipal license taxes	4,000,000	4,140,025	2,637,118	(1,502,907)
Sales and uses taxes	4,700,000	4,700,000	5,899,077	1,199,077
Licences and permits	220,000	628,190	677,031	48,841
Charges for services and rent	185,000	185,000	137,064	(47,936)
Intergovernmental revenues:				
State contributions	4,593,798	5,210,266	5,033,175	(177,091)
Interest, fines, and penalties	150,000	150,000	184,769	34,769
Other revenues	170,100	1,987,399	219,636	(1,767,763)
Total revenues	<u>19,385,855</u>	<u>22,521,779</u>	<u>20,319,202</u>	<u>(2,202,577)</u>
<b>EXPENDITURES</b>				
Current:				
General government	7,548,648	8,953,947	8,743,733	210,214
Public safety	966,489	902,689	825,259	77,430
Public works	8,230,860	9,499,505	8,907,334	592,171
Recreation	1,785,242	2,550,342	2,305,964	244,378
Health and welfare	854,616	990,296	976,432	13,864
Total expenditures	<u>19,385,855</u>	<u>22,896,779</u>	<u>21,758,722</u>	<u>1,138,057</u>
<b>OTHER FINANCING SOURCES</b>				
Reprogramming funds	-	375,000	375,000	-
Excess of expenditures over revenues	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (1,064,520)</u>	<u>\$ (1,064,520)</u>
<b>Explanation of Differences:</b>				
<b>Sources/inflows of resources:</b>				
Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule				\$ 20,319,202
Differences - budget to GAAP:				
Net change in receivables				233,495
Non-budgeted revenues				1,405,165
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances (deficit)				<u>\$ 21,957,862</u>
<b>Uses/outflows of resources:</b>				
Actual amounts (budgetary basis) "total changes to appropriations" from the budgetary comparison schedule				\$ 21,758,722
Differences - budget to GAAP:				
Prior year encumbrances recorded as current year expenditures for GAAP basis				817,593
Net change in payables				(62,780)
Current year encumbrances recorded as expenditures for budgetary purposes				(675,051)
Non-budgeted expenditures				1,590,462
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances (deficit)				<u>\$ 23,428,946</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
NOTE TO BUDGETARY COMPARISON SCHEDULE – GENERAL FUND  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY**

**Budgetary Control**

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with accounting principles generally accepted in the United States of America, 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 certain appropriations within the budget known as Mayor's Executive Orders, do not require the approval of the Municipal Legislature. The Municipality prepares its annual budget including the operations of the general fund.

For budgetary purposes, encumbrance accounting is used. The encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For USGAAP 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. In addition, under the budgetary basis of accounting, revenues are recorded when cash is received.

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 as presented in the Budgetary Comparison Schedule – General Fund is the budget resolutions at June 30, 2012 representing the original budget.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

Federal Grantor/Program Title	Federal CFDA Number	Federal Disbursements/ Expenditures
<b>U.S. Department of Housing and Urban Development (HUD)</b>		
Direct Programs:		
Section 8 Housing Choice Vouchers	14.871	\$ 455,248
Pass-through Commissioner Office of Municipal Affairs - Community Development Block Grant-States: Program SBGP	14.228	942,353
Pass-through Department of Family: Emergency Shelter Grant Program	14.231	18,817
Homelessness Prevention and Rapid Re-Housing Program (Recovery Act Funded)	14.257	<u>163,551</u>
Subtotal U.S. Department of HUD		<u>1,579,969</u>
<b>U.S. Department of Agriculture</b>		
Pass-through Governor's Office of Child Services and Community Development: Child and Adult Care Food Program	10.558	31,878
Pass-through Rural Development Development: Community Facilities Loans and Grants	10.766	<u>1,081,813</u>
Subtotal U.S. Department of Agriculture		<u>1,113,691</u>
<b>U.S. Department of Health and Human Services (HHS)</b>		
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	62,837
Special Programs for the Aging Title III, Part E, National Family Caregivers Support	93.052	20,906
Pass-through the Office of Administration for Children and Families Child and Care and Development Block Grant	93.575	<u>256,774</u>
Subtotal U.S. Department of HHS		<u>340,517</u>
<b>U.S. Department of Justice</b>		
Pass-through the Puerto Rico Department of Justice Recovery Act - Edward Byrne Memorial Justice Assistance Grant Program	16.803	<u>53,947</u>
Subtotal U.S. Department of Justice		<u>53,947</u>
<b>U.S. Department of Transportation</b>		
Pass-through Transit Security Commission Federal Transit Formula Grants - ARRA	20.507	<u>435,069</u>
Subtotal U.S. Department of Transportation		<u>435,069</u>
<b>U.S. Department of Energy</b>		
Pass-through the Puerto Rico Administration of Energy Affairs: Energy Efficiency and Conservation Block Grant Program	81.128	<u>24,099</u>
Subtotal U.S. Department of Energy		<u>24,099</u>
<b>U.S. Department of Homeland Security</b>		
Pass-through the Federal Emergency Management Agency Disaster Grants - Public Assistance (Presidentially Declared Disasters)	97.036	<u>39,256</u>
Subtotal U.S. Department of Homeland Security		<u>39,256</u>
<b>TOTAL</b>		<u>\$ 3,586,548</u>

See notes to Schedule of Expenditures of Federal Awards.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**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 \$3,586,548 are included within Other Governmental Funds.

Expenditures as per basic financial statements:

Expenditures included in Other Governmental Funds	<u>\$ 3,586,548</u>
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Total expenditures per schedule of expenditures of federal awards	<u><u>\$ 3,586,548</u></u>
--	----------------------------

**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, 2012, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated February 12, 2013. 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

Management of the Municipality is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Municipality of Hatillo's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality of Hatillo's 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 other matters that we reported to management of the Municipality of Hatillo in a separate letter dated February 12, 2013.

This report is intended solely for the information and use of management, Commissioner Office of Municipal Affairs, others within the entity and the federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

San Juan, Puerto Rico  
February 12, 2013

*Ortiz, Rivera, Rivera & Co.*

The stamp E52606 was affixed  
to the original of this report.



**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 Municipality of Hatillo's compliance 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's major federal programs for the year ended June 30, 2012. Municipality of Hatillo's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Municipality of Hatillo's management. Our responsibility is to express an opinion on Municipality of Hatillo's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Municipality of Hatillo's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination 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, 2012. However, the results of our auditing procedures disclosed instances of non compliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 12-1 and 12-2.

#### Internal Control over Compliance

Management of Municipality of Hatillo is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Municipality of Hatillo 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.

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

This report is intended solely for the information of the management, Commissioner Office of Municipal Affairs, others within the entity and the federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

San Juan, Puerto Rico  
February 12, 2013

*Ortiz, Rivera, Rivera & Co.*

The stamp E52607 was affixed to the original of this report.



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**1. SUMMARY OF AUDIT RESULTS**

Financial Statements

Type of auditor's report issued: Unqualified

Internal control over financial reporting:

Material weakness (es) identified?      Yes   X   No

Significant deficiency (ies) identified?      Yes   X   No

Noncompliance material to financial statements noted?      Yes   X   No

Federal Awards

Internal control over major programs:

Material weakness (es) identified?      Yes   X   No

Significant deficiency (ies) identified?      Yes   X   No

Type of auditor's report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510 (a) of OMB Circular A-133?   X   Yes      No

Identification of major programs:

<u>CFDA Numbers</u>	<u>Name of Federal Programs or Cluster</u>
10.766	Community Facilities Loans and Grants
14.228	SBGP
14.871	Section 8 Housing Choice Vouchers
20.507	Federal Transit Formula Grant-ARRA



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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

- **Condition 12-2**

The Municipality did not comply with the requirement of preparing and filing the program income quarterly report for the period ended September 30, 2011 on a timely basis. During our examination, we noted that the Municipality did not send on time the program income report for the following period ended:

<u>Report</u>	<u>Report Period</u>	<u>Due Date</u>	<u>Submitted</u>
Quarterly Annual	July 2011 to June 2012	07-31-11	05-09-12
Quarterly	September 30, 2011	10-31-11	05-09-12

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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

Criteria

The Municipality is not in compliance with the Office of Municipal Affairs Circular Memorandum 2008-11, which requires federal fund recipients to annually submit an Estimated Program Income Report on July 31 of every year. Quarterly report must be submitted within thirty day after quarter end.

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

**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, 2012**

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.

**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, 2012**

<u>Program</u>	<u>Finding /Non compliance</u>	<u>Status</u>
<b>SBGP - CFDA No. 14.228</b>	<b>Condition 11-1</b>  The Municipality was unable to provide evidence on the filing of the Estimated Program Income Report for the fiscal year 2010-2011 and Quarterly Report of Program Income for September 30, 2010.	Condition still prevails.
<b>ARRA Child Care-CFDA No. 93.715</b>	<b>Condition 11-2</b>  The Municipality does not have effective internal controls over compliance with the requirement to ensure that all laborers and mechanics employed by contractors or subcontractors to work on construction contracts in excess of \$2,000 financed by Federal assistance funds are paid wages not less than those established for the locality of the project (prevailing wage rates) by the Department of Labor (DOL) (40 USC 276a to 276a-7).	Condition was corrected.
<b>Child Care - CFDA No. 93.575</b>	<b>Condition 11-3</b>  The Municipality's internal control failed in spent on administrative expenses more than the five (5) percent of the total award expended.	Condition was corrected.
<b>Child Care - CFDA No. 93.575</b>	<b>Condition 11-4</b>  The Quarterly Reports were submitted after the time required.	Condition was corrected.

**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, 2012**

<u>Program</u>	<u>Finding /Non compliance</u>	<u>Status</u>
<b>SBGP - CFDA</b> <b>No. 14.228</b>	<b>Condition 10-1</b>  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.	Condition was corrected.
<b>SBGP - CFDA</b> <b>No. 14.228</b>	<b>Condition 10-2</b>  The Federal Program Office does not 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.	Condition still prevails.
<b>SBGP - CFDA</b> <b>No. 14.228</b>	<b>Condition 10-3</b>  The Municipality did not comply with the requirement of preparing and filing the program income quarterly report for the period ended March 31, 2010 on a timely basis.	Condition still prevails.

## **CORRECTIVE ACTION PLAN**



Estado Libre Asociado de Puerto Rico  
**Gobierno Municipal Hatillo**

*Programas Federales*



**CORRECTIVE ACTION PLAN**

February 12, 2013

Cognizant or Oversight Agency for Audit:

Municipality of Hatillo respectfully submits the following corrective action plan for the year ended June 30, 2012.

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, 2012.

The findings from the June 30, 2012 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 12-1: SBGP - CFDA 14.228**

Reportable Condition: See Condition 12-1

Recommendation

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

Action Taken

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

Apartado #8  
Hatillo PR 00659  
898-3840  
898-3035  
Fax 820-3747

GRAN CIUDAD DE TRADICIÓN Y CULTURA