

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

**MUNICIPIO DE HATILLO
AUDITORÍA 2012-2013
30 DE JUNIO DE 2013**

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO**

**BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED
JUNE 30, 2013**

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

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PART I - FINANCIAL SECTION

INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

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, 2013, and the related notes to the financial statements, which collectively comprise the Municipality's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors

consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Hatillo, as of June 30, 2013, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 4 to 11, and 50 to 51 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.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Hatillo's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of

additional analysis as required by U. S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is not a required part of the basic 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 basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic 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 basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 26, 2014, on our consideration of the Municipality of Hatillo's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Municipality of Hatillo's internal control over financial reporting and compliance.

San Juan, Puerto Rico
February 26, 2014

Ortiz, Rivera, Rivera & Co.

The stamp E96413 of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.



**Commonwealth of Puerto Rico
Municipality of Hatillo**

Management's Discussion and Analysis

Year Ended June 30, 2013

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 positions decreased by \$2,029,139.
- In the fund financial statements, general fund revenues decreased by \$2,655,674.
- In the fund financial statements, general fund expenditures decreased by \$2,159,921.
- The general fund (the primary operating fund) reflected, on a current financial resources basis, a decrease of \$1,537,705.
- On a budgetary basis, actual expenditures exceed actual revenues by \$586,542.
- Capital expenditures amounted to \$2,436,649.

**Commonwealth of Puerto Rico
Municipality of Hatillo**

Management's Discussion and Analysis

Year Ended June 30, 2013

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 Positions presents information on all of the Municipality's assets and liabilities, with the difference between both reported as net positions. Over time, increases or decreases in net positions 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 positions changed during the most recent fiscal year. All changes in net positions 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, 2013

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 Positions

As noted earlier, net positions may serve over time as a useful indicator of a government's financial position. The Municipality's net positions totaled \$38.2 million at the end of 2013, compared to \$40.2 million at the end of the previous year.

The largest portion of the Municipality's net positions 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 positions, 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, 2013

**Municipality of Hatillo
Condensed Statement of Net Position
June 30, 2013 and 2012**

	<u>2013</u>	<u>2012</u>
Current assets	\$ 11,117,012	\$ 15,257,393
Capital assets	56,116,475	54,791,426
Total assets	<u>67,233,487</u>	<u>70,048,819</u>
Current liabilities	5,892,449	6,783,806
Noncurrent liabilities	23,143,041	23,037,877
Total liabilities	<u>29,035,490</u>	<u>29,821,683</u>
Invested in capital assets, net of related debt	39,468,455	39,467,682
Restricted	5,952,292	4,566,604
Unrestricted	(7,222,750)	(22,706,518)
Total net positions	<u>\$ 38,197,997</u>	<u>\$ 21,327,768</u>

Changes in Net Positions

The net positions decreased by \$2,029,139 in comparison with prior year. Approximately 70 percent of the Municipality's total revenue came from taxes while 15 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, 2013

**Municipality of Hatillo
Condensed Statement of Activities
June 30, 2013 and 2012**

	<u>2013</u>	<u>2012</u>
Program revenues:		
Charges for services	\$ 1,404,265	\$ 2,219,261
Operating grants and contributions	856,345	961,154
Capital grants and contributions	1,217,230	6,304,374
General revenues:		
Property taxes	6,752,394	7,463,290
Municipal license taxes	4,262,366	4,062,609
Sales and uses taxes	5,710,542	5,373,594
Grants and contributions not restricted to specific programs	3,510,895	354,156
Interest, fines and penalties	130,625	188,819
Miscellaneous	94,137	262,557
Total revenues	<u>23,938,799</u>	<u>27,189,814</u>
Expenses:		
General government	11,076,480	9,104,914
Public safety	1,423,599	1,294,233
Public work	8,062,743	9,187,225
Culture and recreation	2,674,249	4,103,496
Health and welfare	2,102,966	2,008,097
Interest on long-term debt	627,901	777,557
Total expenses	<u>25,967,938</u>	<u>26,475,522</u>
Change in net position	(2,029,139)	714,292
Net positions, beginning of year	<u>40,227,136</u>	<u>39,512,844</u>
Net positions, end of year	<u>\$ 38,197,997</u>	<u>\$ 40,227,136</u>

**Commonwealth of Puerto Rico
Municipality of Hatillo**

Management's Discussion and Analysis

Year Ended June 30, 2013

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 \$5,544,243, a decrease of \$4,091,448 in comparison with the prior year.

The general fund is included within the governmental funds; it is the chief operating fund of the Municipality. As of June 30, 2013, the general fund has a deficit of \$2,562,691. The deficit increased by \$1,537,705 during fiscal year 2012-2013.

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, 2013

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2013, amounts to \$84.8 million, net of accumulated depreciation of \$19.7 million, leaving a net book value of \$56.1 million. This investment in capital assets includes land, buildings, improvements, equipment, intangibles, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

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

The Municipality acquired a total of \$1,438,233 of capital assets during the fiscal year 2012-2013 as follows:

- Building and building improvements - \$838,525
- Acquisition of equipment and vehicles - \$335,347
- Infrastructure - \$264,361

Other projects related to repair and maintenance of roads (not capitalized) was development during the fiscal year 2012-2013.

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, 2013

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. Antonio Álvarez Medina, Chief Financial Officer on the Finance Offices in the Central Town, Hatillo, Puerto Rico.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
STATEMENT OF NET POSITION
JUNE 30, 2013**

Assets

	Governmental Activities
Cash in bank (Notes 2 and 4)	\$ 1,394,652
Cash with fiscal agent (Notes 2 and 4)	7,052,735
Accounts receivable:	
Sales and use taxes	465,140
Property taxes	26,200
Other	223,926
Due from other agencies (Note 8)	1,954,359
Capital assets, net (Note 10)	56,116,475
 Total assets	 \$ 67,233,487

Liabilities and Net Position

Liabilities

Accounts payable and accrued liabilities	\$ 1,123,786
Due to other agencies (Note 11)	344,257
Matured bonds and interest payable	1,080,871
Deferred revenues (Note 12):	
Municipal license tax	3,297,040
Provision for claims and judgments	46,495
Noncurrent liabilities (Note 14):	
Due within one year	1,573,254
Due in more than one year	20,701,819
Accrued interest	867,968
Total liabilities	29,035,490

Net Position

Investment in capital assets, net of related debt	39,468,455
Restricted for:	
Debt service	1,704,481
Capital projects	4,247,811
Unrestricted	(7,222,750)
Total net position	38,197,997
 Total liabilities and net position	 \$ 67,233,487

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

<u>Functions/Programs</u>	<u>Program Revenues</u>			<u>Net (Expense) Revenue and Changes in Net Position</u>
	<u>Expenses</u>	<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	
Primary Government:				
General government	\$ 11,076,480	\$ 1,404,265	\$ -	\$ (9,672,215)
Public safety	1,423,599			(1,423,599)
Culture and recreation	2,674,249	856,345		(2,674,249)
Health and welfare	2,102,966			(1,246,621)
Public work	8,062,743		1,217,230	(6,845,513)
Interest on long-term debts	627,901			(627,901)
Total primary government	\$ 25,967,938	\$ 1,404,265	\$ 856,345	\$ 1,217,230
				(22,490,098)
				6,752,394
				4,262,366
				5,710,542
				3,510,895
				130,625
				94,137
				20,460,959
				(2,029,139)
				40,227,136
				\$ 38,197,997

General revenues:

Property taxes (Note 5)	6,752,394
Municipal license tax (Note 6)	4,262,366
Sales and use taxes (Note 7)	5,710,542
Grants and contributions not restricted to specific programs	3,510,895
Interest, fines, and penalties	130,625
Miscellaneous	94,137
Total general revenues	20,460,959
Change in net position	(2,029,139)
Net position at beginning of year	40,227,136
Net position at end of year	\$ 38,197,997

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, 2013

<u>Assets</u>	<u>General</u>	<u>Debt Service</u>	<u>Rural Development</u>	<u>Loans and Bonds</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Cash and cash equivalents (Notes 2 and 4)	\$ 249,255	-	\$ 66,510	-	\$ 1,078,887	\$ 1,394,652
Cash with fiscal agent (Notes 2 and 4)		2,699,438		4,324,687	28,610	7,052,735
Accounts receivable:						
Sales and uses taxes	405,475	59,665				465,140
Property taxes		26,200				26,200
Other	223,877	49				223,926
Due from other agencies (Note 8)	541,209		1,111,615		301,535	1,954,359
Due from other funds (Note 9)	377,889					377,889
Total assets	<u>\$ 1,797,705</u>	<u>\$ 2,785,352</u>	<u>\$ 1,178,125</u>	<u>\$ 4,324,687</u>	<u>\$ 1,409,032</u>	<u>\$ 11,494,901</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, 2013

Liabilities and Fund Balance (Deficit)	General	Debt Service	Rural Development	Loans and Bonds	Other Governmental Funds	Total Governmental Funds
Liabilities						
Accounts payable and accrued liabilities	\$ 402,284	\$ -	\$ -	\$ -	\$ 131,502	\$ 533,786
Due to other funds (Note 9)			42,674	76,876	258,339	377,889
Due to other agencies (Note 11)	344,257					344,257
General obligations: (Note 14)						
Bonds		790,000				790,000
Interest		290,871				290,871
Deferred revenues: (Note 12)						
Municipal license tax	3,297,040					3,297,040
Intergovernmental	270,320					270,320
Provision for claims and judgements	46,495					46,495
Total liabilities	<u>4,360,396</u>	<u>1,080,871</u>	<u>42,674</u>	<u>76,876</u>	<u>389,841</u>	<u>5,950,658</u>
Fund Balances (Deficit)						
Restricted		1,704,481			990,825	2,695,306
Committed				4,247,811	28,366	4,276,177
Assigned	952,709		1,135,451			2,088,160
Unassigned	(3,515,400)					(3,515,400)
Total fund balances (deficit)	<u>(2,562,691)</u>	<u>1,704,481</u>	<u>1,135,451</u>	<u>4,247,811</u>	<u>1,019,191</u>	<u>5,544,243</u>
Total liabilities and fund balances	<u>\$ 1,797,705</u>	<u>\$ 2,785,352</u>	<u>\$ 1,178,125</u>	<u>\$ 4,324,687</u>	<u>\$ 1,409,032</u>	<u>\$ 11,494,901</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 POSITION
JUNE 30, 2013**

Total fund balances - governmental funds \$ 5,544,243

Amounts reported for governmental activities in the statement of net position 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. 56,116,475

• Other assets are not available to pay for current-period expenditures and therefore are deferred in the governmental funds balance sheet. 270,320

• Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. **(Note 3)** (23,733,041)

Net position of governmental activities \$ 38,197,997

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, 2013

	General	Debt Service	Rural Development	Loans and Bonds	Other Governmental Funds	Total Governmental Funds
REVENUES						
Property taxes (Note 5)	\$ 5,458,159	\$ 1,294,235	\$ -	\$ -	\$ -	\$ 6,752,394
Municipal license tax (Note 6)	4,262,366					4,262,366
Sales and use taxes (Note 7)	4,556,688	1,153,854				5,710,542
Licenses, permits, and other local taxes	326,690					326,690
Charges for services	1,077,575					1,077,575
Intergovernmental revenues (Note 13):						
Federal grants and contributions	3,414,585				2,073,575	2,073,575
State contributions	118,550	2,172			106,125	3,520,710
Interest, fines, and penalties	87,575				9,903	130,625
Other revenues	19,302,188	2,450,261	-	-	6,562	94,137
Total revenues	<u>19,302,188</u>	<u>2,450,261</u>	<u>-</u>	<u>-</u>	<u>2,196,165</u>	<u>23,948,614</u>
EXPENDITURES						
Current:						
General government	9,911,254	850,000			3,830	10,765,084
Public safety	822,605				469,829	1,292,434
Health and welfare	1,198,189				904,777	2,102,966
Culture and recreation	2,406,095					2,406,095
Public works	6,550,572		377,095	496,657	153,338	7,577,662
Capital outlays	380,311		1,057,731		998,607	2,436,649
Debt service:						
Principal	847,000					847,000
Interest and other	612,172					612,172
Total expenditures	<u>21,269,026</u>	<u>2,309,172</u>	<u>1,434,826</u>	<u>496,657</u>	<u>2,530,381</u>	<u>28,040,062</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(1,966,838)</u>	<u>141,089</u>	<u>(1,434,826)</u>	<u>(496,657)</u>	<u>(334,216)</u>	<u>(4,091,448)</u>
OTHER FINANCING SOURCES (USES)						
Transfers in	429,133					429,133
Transfers out	(429,133)					(429,133)
Total other financing sources (uses)	<u>429,133</u>	<u>(429,133)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net change in fund balances	(1,537,705)	(288,044)	(1,434,826)	(496,657)	(334,216)	(4,091,448)
FUND BALANCE (DEFICIT) AT BEGINNING OF YEAR	<u>1,024,986</u>	<u>1,992,525</u>	<u>2,570,277</u>	<u>4,744,468</u>	<u>1,353,407</u>	<u>9,635,691</u>
FUND BALANCE (DEFICIT) AT END OF YEAR	<u>\$ (2,562,691)</u>	<u>\$ 1,704,481</u>	<u>\$ 1,135,451</u>	<u>\$ 4,247,811</u>	<u>\$ 1,019,191</u>	<u>\$ 5,544,243</u>

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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, 2013**

Net change in fund balances - total governmental funds \$ (4,091,448)

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. 2,436,649
- 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. (1,111,600)
- 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. 847,000
- Change in accrued interest expense which does not require the use of current financial resources. (15,729)
- 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. (94,011)

Changes in net position of governmental activities \$ (2,029,139)

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

1. ORGANIZATION

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

- Statement of Net Position - The statement of net position is designed to display the financial position of the Municipality, including capital assets and infrastructure. The net position 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

A reporting entity is comprised of the primary government, component units and other organizations that are included to ensure that financial statements are not misleading. The primary government consists of all funds, departments, boards and agencies that are not legally separate from the Municipality and for which the Municipality is financial accountable.

The Municipality's management has considered all potential component units (whether governmental, not-for-profit, or profit-oriented) for which it may be financially accountable, and other legally separate organizations for which the Municipality is not financially accountable but the nature and significance of their relationship with the Municipality may be such that exclusion of their basic financial statements from those of the Municipality would cause the accompanying basic financial statements to be misleading or incomplete. Accordingly, a legally separate organization would be reported as a component unity of the Municipality if all of the following criteria are met:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

- 1) The Mayor appoints a voting majority of an organization's governing body and, either (1) the Municipality has the ability to impose its will on that organization or (2) the organization has the potential to provide specific financial benefits to, or impose specific financial burdens on, the Municipality.
- 2) The economic resources, for which the Municipality is entitled, either received or held by the separate organization, are entirely or almost entirely for the direct benefit of the Municipality or its constituents.

GAAP details two methods of presentation: blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component units' financial data in columns separate from the Municipality's balances and transactions.

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality for the fiscal year ended June 30, 2013.

b. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net position and the statement of changes in net position) report information on all the activities of the Municipality. For the most part, the effect of interfund activity has been removed from these statements.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

The effect of all inter-fund activities (assets, liabilities, revenues, expenditures and other financing sources/uses among governmental funds) have been eliminated from the governmental-wide financial statements.

Separate fund financial statements are provided for governmental funds. Major governmental funds are reported on separate columns to 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.

On July 1, 2012, the Municipality adopted the provision of GASB 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. GASB 63 provides guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position and related disclosures. The statement of net positions is renamed the statement of net position and includes four components: assets, deferred outflows of resources, liabilities and deferred inflows of resources.

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

The accounting and financial reporting treatment is determined by the applicable measurement focus and basis of accounting. Measurement focus indicates the type of resources being measured such as *current financial resources* or *economic resources*. The basis of accounting indicates the timing of transactions or events for recognition in the financial statements.

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

The governmental fund financial statements are reported using the *current financial resources measurements focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. 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. General capital asset acquisitions are reported as expenditures in governmental funds. Issuance of long-term debt and acquisitions under capital leases are reported as other financing sources.

Property taxes, sales 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. Entitlements are recorded as revenues when all eligibility requirements are met, including any time requirements, and the amount is received during the period or within the availability period for this revenue source (within 60 days or year-end). Expenditures-driven grants are recognized as revenue when the qualifying expenditures have been incurred and all other eligibility requirements have been met, and the amount is received during the period or within the availability period for this revenue source (within 60 days of year-end). All other revenue items are considered to be measurable and available only when cash is received by the government.

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.

The Municipality reports the following major governmental funds:

1) General Fund

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

2) Debt Service Fund

The 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) Rural Development Fund

The fund is used to account the available amount for the Rural Development loans for the acquisition of property and to develop various projects into the Municipality.

4) Loans and Bonds Fund

The loans and bonds fund is used to account for the financial resources for the loans through the Governmental Bank for the acquisition of property and/or construction of major improvements which are not financed by other funds.

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 and certificates of deposit 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

Activity 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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

funds (i.e., the current portion of interfund loans) or advances to/from other funds (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as due to/from other funds.

f. Capital Assets

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

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

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

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 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

- 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.

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, 2013.

In situations when 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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

property tax collections by the Municipal Revenue Collection Center (the "CRIM") for the year ended June 30, 2013 amounted to \$382,426. The current insurance policies have not been cancelled or terminated. The CRIM also deducted \$425,480 for workers' compensation insurance covering all municipal employees.

i. Compensated Absences

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

k. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board 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>
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
70	Accounting for Financial Reporting for Non-exchange Financial Guarantees	2013-14
71	Pension Transition for Contribution Made Subsequent to the Measurement Date	2014-15

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

I. Deferred inflows

On July 1, 2012, the Municipality adopted the provisions of GASB Statement No. 63, *Financial Reporting of deferred Outflows of resources, Deferred Inflows of Resources, and Net Position* (GASB No. 63).

In the GFFS, deferred inflows arise when one of the following situations occur:

- Potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period (reported as “*earned but unavailable revenue*” in the accompanying balance sheet-governmental funds). As previously discussed, available is defined as due (or past due) at June 30, 2013 and collected within 90 days (60 days for property taxes) thereafter to pay obligations due at June 30. In subsequent periods, when both criteria (measurable and available) are met, the liability for deferred revenue is removed and revenue is recognized.
- The Municipality receives resources before it has a legal claim to them (reported as “*unearned revenue*” in the accompanying balance sheet-governmental funds). In subsequent periods, when the revenue recognition criterion is met, the liability for deferred inflows is removed and revenue is recognized.

Deferred inflows at the government-wide level arise only when the Municipality receives resources before it has a legal claim to them (reported as “*unearned revenue*” in the accompanying statement of net position). No “*earned but unavailable revenue*” is accounted for in the accompanying statement of net position.

3. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

The governmental fund balance sheet includes reconciliation between fund balance-governmental funds and net positions of governmental activities as reported in the government-wide statement of net positions. One element of that reconciliation explains that some liabilities, including bonds payable, are not due and payable in the

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

current period and therefore are not reported in the funds. The details of the approximately \$23.7 million differences are as follows:

Bonds payable	\$ 16,648,020
Compensated absences	3,599,230
Other long-term liabilities	2,027,823
Accrued interest	867,968
Christmas bonus	<u>590,000</u>
 Net adjustment to reduce fund balance governmental funds to arrive at net position of governmental activities	 <u><u>\$ 23,733,041</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 \$4,353,297, which are restricted principally for capital projects and the \$2,699,438 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 three (3) banks located at Puerto Rico. All kind of deposit is guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

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.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

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 2012-2013, 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, 2013, the amount collected by CRIM from taxpayers and charges exceeded the amount advanced by CRIM for the same period by \$270,889. Such amount is presented as due from CRIM in the accompanying financial statements. (See note 8).

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HATILLO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

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, 2013. 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 \$3,297,040, 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

Government Development Bank (Rural Development)	\$ 1,111,615
Municipal Revenue Collection Center (CRIM) (General Fund)	270,889
Puerto Rico Treasury Department (General Fund)	270,320
Other governmental funds	<u>301,535</u>
Total	<u><u>\$ 1,954,359</u></u>

9. INTERFUND TRANSACTIONS

a. Due From/To Other Funds:

The due from and due to other fund balances as of June 30, 2013, are as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Other Governmental Funds	\$ 258,339
General	Loans and Bonds	76,876
General	Rural Development	<u>42,674</u>
		<u><u>\$ 377,889</u></u>

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The balance of \$258,339 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, 2013 consisted of the following:

Transfer In	Transfer Out	Amount
General Fund	Debt Service	\$ 429,133

The transfers are used to (1) move revenues from the fund that statute or budget requires 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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10. CAPITAL ASSETS

Capital asset activity for the Municipality for the year ended June 30, 2013 was as follows:

<u>Primary Government</u>	<u>Balance July 1, 2012,</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2013</u>
Governmental Activities:				
Capital assets, not being depreciated:				
Land	\$ 24,690,244	\$ -	\$ -	\$ 24,690,244
Construction in progress	2,959,454	1,736,303	737,887	3,957,870
Total capital assets, not being depreciated	<u>27,649,698</u>	<u>1,736,303</u>	<u>737,887</u>	<u>28,648,114</u>
Capital assets, being depreciated:				
Buildings and building improvements	25,194,747	838,525		26,033,272
Vehicles and equipment	7,636,156	335,347		7,971,503
Infrastructure	12,959,755	264,361		13,224,116
Total capital assets, being depreciated	<u>45,790,658</u>	<u>1,438,233</u>	<u>-</u>	<u>47,228,891</u>
Less accumulated depreciation for:				
Buildings and building improvements	6,616,562	429,203	-	7,045,765
Vehicles and equipment	6,157,402	519,211	-	6,676,613
Infrastructure	5,874,966	163,186	-	6,038,152
Total accumulated depreciation	<u>18,648,930</u>	<u>1,111,600</u>	<u>-</u>	<u>19,760,530</u>
Total capital assets, being depreciated, net	<u>27,141,728</u>	<u>326,633</u>	<u>-</u>	<u>27,468,361</u>
Governmental activities capital assets, net	<u>\$ 54,791,426</u>	<u>\$ 2,062,936</u>	<u>\$ 737,887</u>	<u>\$ 56,116,475</u>

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

General government	\$ 227,200
Public safety	131,165
Recreation	268,154
Health and welfare	23,203
Public works	<u>461,878</u>
Total depreciation expense-governmental activities	<u>\$ 1,111,600</u>

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11. DUE TO OTHER AGENCIES

Retirement System Administration	\$ 121,791
Internal Revenue Service	98,072
Puerto Rico Water and Sewer Authority	95,162
State Employment Association ("AEELA")	19,833
Treasury Department	8,999
General Services Administration	400
Total	\$ 344,257

12. DEFERRED REVENUES

a. Municipal License Tax

The deferred revenues of \$3,297,040 in the general fund related to municipal license tax collected in fiscal year 2012-2013 that will be earned in fiscal year 2013-2014.

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.

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14. LONG-TERM DEBTS

Bonds and other long-term liabilities outstanding at June 30, 2013 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%.	\$ 360,000
\$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%.	1,945,000
\$550,000 series of 1998, payable in annual installments of \$14,000 to \$38,020 until January 1, 2020, interest at 4.50%.	235,020
\$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%.	1,770,000
\$624,000 series of 1998, payable in annual installments of \$17,000 to \$44,000 until January 1, 2022, interest at 4.50%.	330,000
\$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%.	1,605,000

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\$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%.	\$ 2,905,000
\$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%.	1,380,000
\$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%.	925,000
\$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%.	1,190,000
\$712,000 series of 2012, payable in annual installments of \$19,728 to \$42,330 until January 1, 2037, interest at 3.37%.	712,000
\$436,000 series of 2012, payable in annual installments of \$12,080 to \$25,920 until January 1, 2037, interest at 3.37%.	436,000
\$1,193,000 series of 2010, payable in annual installments of \$180,000 to \$219,000 until January 1, 2018, interest at 4.00%.	1,193,000
\$470,000 series of 2011, payable in annual installments of \$12,448 to \$31,101 until January 1, 2036, interest at 4.25%.	470,000
\$162,000 series of 2012, payable in annual installments of \$4,000 to \$10,000 until January 1, 2037, interest at 3.50%.	162,000

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\$1,030,000 series of 2012, payable in annual installments of \$28,998 to \$65,178 until January 1, 2036, interest at 3.75%.

\$ 1,030,000

Total bonds payable

\$ 16,648,020

The annual requirements for the amortization of long-term debts at June 30, 2013 are as follows:

	<i>Bonds Payable</i>	
	<u>Principal</u>	<u>Interest</u>
2014	\$ 1,173,254	\$ 867,968
2015	1,252,944	919,787
2016	1,335,734	852,341
2017	1,429,628	772,086
2018	1,529,627	1,003,424
2019-2023	4,997,437	2,207,232
2024-2028	2,753,606	904,507
2029-2033	1,538,809	215,507
2034-2038	636,981	3,430
	<u>\$ 16,648,020</u>	<u>\$7,746,282</u>

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Long-term liability activity for the year ended June 30, 2013 was as follows:

Primary Government	Beginning Balance	Additions	Payments	Ending Balance	Due Within One Year
Governmental Activities:					
Bonds payable	\$ 17,495,020	\$ -	\$ 847,000	\$ 16,648,020	\$ 1,173,254
Total long-term debts	17,495,020	-	847,000	16,648,020	1,173,254
Other long-term liabilities:					
Landfill obligation	1,437,786		81,171	1,356,615	
Puerto Rico Health Insurance Administration	355,520	315,688		671,208	
Compensated absences	3,749,551		150,321	3,599,230	400,000
Total other long-term liabilities	5,542,857	315,688	231,492	5,627,053	400,000
Total noncurrent liabilities, governmental activities	<u>\$ 23,037,877</u>	<u>\$ 315,688</u>	<u>\$ 1,078,492</u>	<u>\$ 22,275,073</u>	<u>\$ 1,573,254</u>

15. FUND BALANCES

	General	Debt Service	Rural Development	Loans and Bonds	Other Governmental Funds	Total
Restricted:						
General government	\$ -	\$ -	\$ -	\$ -	\$ 12,984	\$ 12,984
Public safety					70	70
Health and welfare					199,249	199,249
Economic development			1,135,451		778,522	1,913,973
Debt service		1,704,481				1,704,481
Committed:						
Economic development				4,247,811	28,366	4,276,177
Assigned:						
General government	271,805					271,805
Public safety	6,323					6,323
Health and welfare	23,629					23,629
Culture and recreation	322,847					322,847
Public works	328,105					328,105
Unassigned	(3,515,400)					(3,515,400)
	<u>\$ (2,562,691)</u>	<u>\$ 1,704,481</u>	<u>\$ 1,135,451</u>	<u>\$ 4,247,811</u>	<u>\$ 1,019,191</u>	<u>\$ 5,544,243</u>

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
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16. FUND BALANCE DEFICIT

The following fund had a deficit in fund balance at June 30, 2013:

Fund	Deficit
General Fund	<u>\$ 2,562,691</u>

The deficit of the General Fund will be covered by future budgetary appropriations.

17. NET POSITION

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

Capital assets, net of accumulated	\$ 56,116,475
Outstanding balance on capital related debt	<u>(16,648,020)</u>
Total invested in capital assets, net of related	<u><u>\$ 39,468,455</u></u>

18. 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

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Governor, the Comptroller of Puerto Rico, Gubernatorial Board and Committee appointees and Experimental Service Station employees.

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

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

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

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

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System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth of Puerto Rico.

The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary upon to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

b. Contribution Requirements

Commonwealth legislation requires employees to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600. The Municipality's contributions are 11.275% of gross salary. Contributions' requirements are established by law. The actuarially determined contribution requirement and contributions actually made for the year ended June 30, 2013 was \$657,421. The Municipality's payroll for employees covered by ERS was approximately \$5.8 million. The Municipality total payroll for all employees was approximately \$10.9 million.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2013, a copy of which can be obtained from the ERS, Minillas Station, PO Box 42003, San Juan, PR 00940.

19. 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

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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.

20. LEASES

Operating Leases

Leasing Arrangement with the Municipality as Lessor:

- a. The Municipality leases spaces in its Market Place under operating lease agreements with terms ranging from one to five years.
- b. Total income from leases during the year ended June 30, 2013 was approximately \$66,797.
- 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.

21. 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, 2013. (See Note 14).

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22. 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.

23. COMMITMENTS

The Municipality of Hatillo had several outstanding or planned construction projects as of June 30, 2013. These projects are evidenced by contractual commitments with contractors. The construction projects are commitments to approximately \$5,383,262.

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 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.

In addition, the Municipality expect to receive in the year 2013-14 the excess of cash from the CAE fund corresponding for the year 2012-13 by the amount of \$564,000.

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25. SUBSEQUENT EVENTS

In preparing these financial statements, the Municipality has evaluated events and transactions for potential recognition or disclosure through February 26, 2014, the date the financial statements were available to be issued.

PART II – REQUIRED SUPPLEMENTARY INFORMATION