

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

**MUNICIPIO DE HATILLO  
AUDITORÍA 2013-2014  
30 DE JUNIO DE 2014**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO**

**BASIC FINANCIAL STATEMENTS  
FOR THE FISCAL YEAR ENDED  
JUNE 30, 2014**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
BASIC FINANCIAL STATEMENTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
BASIC FINANCIAL STATEMENTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

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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, 2014, 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 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 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 the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Hatillo, as of June 30, 2014, and the respective changes in financial position, thereof 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 48 to 49 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'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.

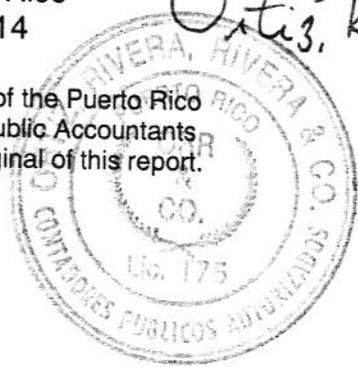
### **Other Reporting Required by Government Auditing Standards**

In accordance with *Government Auditing Standards*, we have also issued our report dated December 23, 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  
December 23, 2014

*Ortiz, Rivera, Rivera & Co.*

The stamp E135687 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, 2014**

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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 positions increased by \$3,079,930.
- In the fund financial statements, general fund revenues increased by \$3,209,753.
- The general fund has a surplus of \$647,062.
- On a budgetary basis, actual revenues exceed actual expenditures by \$1,315,825.
- Capital expenditures amounted to \$1,118,822.

**Commonwealth of Puerto Rico  
Municipality of Hatillo**

**Management's Discussion and Analysis**

**Year Ended June 30, 2014**

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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 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, 2014**

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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 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 \$40.2 million at the end of 2014, compared to \$38.2 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, 2014**

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**Municipality of Hatillo  
Condensed Statement of Net Position  
June 30, 2014 and 2013**

	<u>2014</u>	<u>2013</u>
Current assets	\$ 13,247,900	\$ 11,117,012
Capital assets	54,872,493	56,116,475
Total assets	<u>68,120,393</u>	<u>67,233,487</u>
Current liabilities	2,860,470	2,595,409
Noncurrent liabilities	21,544,314	23,143,041
Total liabilities	<u>24,404,784</u>	<u>25,738,450</u>
Deferred inflows of resources	3,496,491	3,297,040
Total deferred inflows of resources	<u>3,496,491</u>	<u>3,297,040</u>
Invested in capital assets, net of related debt	39,504,473	39,468,455
Restricted	4,981,781	5,952,292
Unrestricted	(4,267,136)	(7,222,750)
Total net positions	<u>\$ 40,219,118</u>	<u>\$ 38,197,997</u>

**Changes in Net Positions**

The net positions increased by \$3,079,930 in comparison with prior year. Approximately 77 percent of the Municipality's total revenue came from taxes while 19 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, 2014**

**Municipality of Hatillo  
Condensed Statement of Activities  
June 30, 2014 and 2013**

	<b>2014</b>	<b>2013</b>
<b>Program revenues:</b>		
Charges for services	\$ 1,718,446	\$ 1,404,265
Operating grants and contributions	990,547	856,345
Capital grants and contributions	1,147,285	1,217,230
 <b>General revenues:</b>		
Property taxes	8,497,559	6,752,394
Municipal license taxes	4,442,054	4,262,366
Sales and uses taxes	5,918,776	5,710,542
Grants and contributions not restricted to specific programs	4,082,291	3,510,895
Interest, fines and penalties	89,813	130,625
Miscellaneous	802,962	94,137
Total revenues	27,689,733	23,938,799
 <b>Expenses:</b>		
General government	10,551,023	11,076,480
Public safety	1,231,006	1,423,599
Public work	7,518,988	8,062,743
Culture and recreation	2,587,755	2,674,249
Health and welfare	2,145,635	2,102,966
Interest on long-term debt	575,396	627,901
Total expenses	24,609,803	25,967,938
 Change in net position	3,079,930	(2,029,139)
 Net positions beginning of year, as restated	37,139,188	39,512,844
 Net positions, end of year	\$ 40,219,118	\$ 37,483,705

**Commonwealth of Puerto Rico  
Municipality of Hatillo**

**Management's Discussion and Analysis**

**Year Ended June 30, 2014**

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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 \$7,230,804, an increase of \$1,686,561 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, 2014, the general fund has a surplus of \$647,062. The prior year deficit was eliminated during fiscal year 2013-2014.

**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 Fund.

**Commonwealth of Puerto Rico  
Municipality of Hatillo**

**Management's Discussion and Analysis**

**Year Ended June 30, 2014**

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**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

The Municipality's investment in capital assets as of June 30, 2014, amounts to \$76.5 million, net of accumulated depreciation of \$21.6 million, leaving a net book value of \$54.9 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 \$1,711,325 of capital assets during the fiscal year 2013-2014 as follows:

- Construction in progress - \$1,048,345
- Building and building improvements - \$592,503
- Acquisition of equipment and vehicles - \$70,477

Other projects related to repair and maintenance of roads (not capitalized) was development during the fiscal year 2013-2014.

**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, 2014**

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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. Antonio Alvarez 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, 2014**

**Assets**

	<b>Governmental Activities</b>
Cash in bank (Notes 2 and 4)	\$ 2,193,129
Cash with fiscal agent (Notes 2 and 4)	8,748,050
Accounts receivable:	
Sales and use taxes	455,679
Property taxes	23,191
Other	65,750
Due from other agencies (Note 8)	1,762,101
Capital assets, net (Note 10)	54,872,493
Total assets	68,120,393

**Liabilities, Deferred Inflows of Resources, and Net Position**

**Liabilities**

Accounts payable and accrued liabilities	1,348,362
Due to other agencies (Note 11)	372,533
Matured bonds and interest payable	1,119,075
Provision for claims and judgments	20,500
Noncurrent liabilities (Note 14):	
Due within one year	1,650,254
Due in more than one year	19,060,065
Accrued interest	833,995
Total liabilities	24,404,784

**Deferred Inflows of Resources (Note 6 and 12)**

Unearned revenues from:	
Municipal license taxes	3,496,491
Total deferred inflows of resources	3,496,491

**Net Position**

Investment in capital assets, net of related debt	39,504,473
Restricted for:	
Debt service	901,996
Capital projects	4,079,785
Unrestricted	(4,267,136)
Total net position	\$ 40,219,118

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, 2014**

<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</u>			<u>Governmental Activities</u>
			<u>Grants and Contributions</u>	<u>Capital Grants and Contributions</u>		
<b>Primary Government:</b>						
General government	\$ 10,551,023	\$ 1,718,446	\$ -	\$ -	(8,832,577)	
Public safety	1,231,006				(1,231,006)	
Culture and recreation	2,587,755				(2,587,755)	
Health and welfare	2,145,635		990,547		(1,155,088)	
Public work	7,518,988			1,147,285	(6,371,703)	
Interest on long-term debts	575,396				(575,396)	
Total primary government	<u>\$ 24,609,803</u>	<u>\$ 1,718,446</u>	<u>\$ 990,547</u>	<u>\$ 1,147,285</u>	<u>(20,753,525)</u>	
General revenues:						
Property taxes (Note 5)					8,497,559	
Municipal license taxes (Note 6)					4,442,054	
Sales and use taxes (Note 7)					5,918,776	
Grants and contributions not restricted to specific programs					4,082,291	
Interest, fines, and penalties					89,813	
Miscellaneous					802,962	
Total general revenues					<u>23,833,455</u>	
Change in net position					<u>3,079,930</u>	
Net position at beginning of year, as restated (Note 23)					<u>37,139,188</u>	
Net position at end of year					<u>\$ 40,219,118</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, 2014**

<u>Assets</u>	<u>General</u>	<u>Debt Service</u>	<u>Loans and Bonds</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Cash and cash equivalents (Notes 2 and 4)	\$ 1,241,642	-		\$ 951,487	\$ 2,193,129
Cash with fiscal agent (Notes 2 and 4)		4,581,078	4,156,661	10,311	8,748,050
Accounts receivable:					
Sales and use taxes	377,648	78,031			455,679
Property taxes		23,191			23,191
Other	65,702	48			65,750
Due from other agencies (Note 8)	682,363			1,079,738	1,762,101
Due from other funds (Note 9)	2,941,566			9,182	2,950,748
<b>Total assets</b>	<b>\$ 5,308,921</b>	<b>\$ 4,682,348</b>	<b>\$ 4,156,661</b>	<b>\$ 2,050,718</b>	<b>\$ 16,198,648</b>

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, 2014

Liabilities, Deferred Inflows of Resources, and Fund Balances	General	Debt Service	Loans and Bonds	Other Governmental Funds	Total Governmental Funds
<b>Liabilities</b>					
Accounts payable and accrued liabilities	\$ 488,200	\$ -	\$ -	\$ 236,162	\$ 724,362
Due to other funds (Note 9)			76,876	212,595	2,950,748
Due to other agencies (Note 11)	372,533	2,661,277			372,533
General obligations: (Note 14)					
Bonds		850,000			850,000
Interest		269,075			269,075
Provision for claims and judgments	20,500				20,500
Total liabilities	<u>881,233</u>	<u>3,780,352</u>	<u>76,876</u>	<u>448,757</u>	<u>5,187,218</u>
<b>Deferred Inflows of Resources</b>					
Municipal license taxes (Note 12)	3,496,491				3,496,491
Intergovernmental	284,135				284,135
Total deferred inflows of resources	<u>3,780,626</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>3,780,626</u>
<b>Fund Balances</b>					
Restricted		901,996		1,582,685	2,484,681
Committed			4,079,785	19,276	4,099,061
Assigned	353,843				353,843
Unassigned	293,219				293,219
Total fund balances	<u>647,062</u>	<u>901,996</u>	<u>4,079,785</u>	<u>1,601,961</u>	<u>7,230,804</u>
Total liabilities, deferred inflows of resources, and fund balances	<u>\$ 5,308,921</u>	<u>\$ 4,682,348</u>	<u>\$ 4,156,661</u>	<u>\$ 2,050,718</u>	<u>\$ 16,198,648</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, 2014**

Total fund balances - governmental funds	\$ 7,230,804
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Amounts reported for governmental activities in the statement of net position are different because:

- |   |                     |
|---|---------------------|
| <ul style="list-style-type: none"> <li>• Capital assets, net used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet.</li> </ul> | 54,872,493          |
| <ul style="list-style-type: none"> <li>• Other assets are not available to pay for current-period expenditures and therefore are deferred in the governmental funds balance sheet.</li> </ul>                       | 284,135             |
| <ul style="list-style-type: none"> <li>• Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. <b>(Note 3)</b></li> </ul>           | <u>(22,168,314)</u> |

Net position of governmental activities	<u><u>\$ 40,219,118</u></u>
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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, 2014

	General	Debt Service	Loans and Bonds	Other Governmental Funds	Total Governmental Funds
<b>REVENUES</b>					
Property taxes (Note 5)	\$ 5,830,053	\$ 2,667,506	\$ -	\$ -	\$ 8,497,559
Municipal license tax (Note 6)	4,442,054				4,442,054
Sales and use tax (Note 7)	5,019,045	899,731			5,918,776
Licenses, permits, and other local taxes	709,073				709,073
Charges for services	1,009,373				1,009,373
Intergovernmental revenues (Note 13):					
Federal grants and contributions	3,975,016			2,137,832	2,137,832
State contributions	82,083	2,850		93,460	4,068,476
Interest, fines, and penalties	783,417			4,880	89,813
Other revenues				19,545	802,962
Total revenues	<u>21,850,114</u>	<u>3,570,087</u>	<u>-</u>	<u>2,255,717</u>	<u>27,675,918</u>
<b>EXPENDITURES</b>					
Current:					
General government	9,985,859			2,851	9,988,710
Public safety	879,439			195,088	1,074,527
Health and welfare	1,222,011			923,624	2,145,635
Culture and recreation	2,231,905			42,891	2,274,796
Public works	6,984,350		168,026	525,122	7,677,498
Capital outlays				1,118,822	1,118,822
Debt service:					
Principal		1,100,000			1,100,000
Interest and other		609,369			609,369
Total expenditures	<u>21,303,564</u>	<u>1,709,369</u>	<u>168,026</u>	<u>2,808,398</u>	<u>25,989,357</u>
Excess (deficiency) of revenues over (under) expenditures	<u>546,550</u>	<u>1,860,718</u>	<u>(168,026)</u>	<u>(552,681)</u>	<u>1,686,561</u>
<b>OTHER FINANCING SOURCES (USES)</b>					
Transfers in	2,663,203	(2,663,203)			2,663,203
Transfers out		(2,663,203)			(2,663,203)
Total other financing sources (uses)					
Net change in fund balances	3,209,753	(802,485)	(168,026)	(552,681)	1,686,561
<b>FUND BALANCES (DEFICIT) AT BEGINNING OF YEAR</b>	<u>(2,562,691)</u>	<u>1,704,481</u>	<u>4,247,811</u>	<u>2,154,642</u>	<u>5,544,243</u>
<b>FUND BALANCES AT END OF YEAR</b>	<u>\$ 647,062</u>	<u>\$ 901,996</u>	<u>\$ 4,079,785</u>	<u>\$ 1,601,961</u>	<u>\$ 7,230,804</u>

*[Handwritten Signature]*

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, 2014**

Net change in fund balances - total governmental funds	\$ 1,686,561
Amounts reported for governmental activities in the statement of activities are different because:	
<ul style="list-style-type: none"> <li>• 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.</li> </ul>	1,118,822
<ul style="list-style-type: none"> <li>• 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.</li> </ul>	(1,303,995)
<ul style="list-style-type: none"> <li>• Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the fund financial statements.</li> </ul>	13,815
<ul style="list-style-type: none"> <li>• 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.</li> </ul>	1,100,000
<ul style="list-style-type: none"> <li>• Change in accrued interest expense which does not require the use of current financial resources.</li> </ul>	33,973
<ul style="list-style-type: none"> <li>• 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.</li> </ul>	<u>430,754</u>
Changes in net position of governmental activities	<u><u>\$ 3,079,930</u></u>

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

**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, 2014**

- 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 financially 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, 2014**

- 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, 2014.

**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, 2014**

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.

**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 the 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.

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF HATILLO**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

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 interests 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 when 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, and then 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.

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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

3) 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 Assembly 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 withheld 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 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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

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.

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF HATILLO**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

(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.

Negative fund balance amounts are amounts assigned to eliminate the deficit. 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 indicate 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 any

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF HATILLO**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

formal minimum fund balance amounts as of and for the fiscal year ended June 30, 2014.

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.

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, 2014 amounted to \$421,263. The current insurance policies have not been cancelled or terminated. The CRIM also deducted \$419,654 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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

**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 has issued the following statements that the Municipality has not yet adopted:

<b>Statement Number</b>	<b>Statement Name</b>	<b>Adoption Required in Fiscal Year</b>
68	Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27	2014-15
71	Pension Transition for Contribution Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68.	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, 2014**

**I. Deferred inflows**

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, 2014 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, 2014**

current period and therefore are not reported in the funds. The details of the approximately \$22.2 million differences are as follows:

Bonds payable	\$ 15,368,020
Compensated absences	3,395,647
Other long-term liabilities	1,946,652
Accrued interest	833,995
Christmas bonus	<u>624,000</u>
Net adjustment to reduce fund balance governmental funds to arrive at net position of governmental activities	<u>\$ 22,168,314</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 \$4,166,972 which are restricted principally for capital projects and the \$4,581,078 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, 2014**

**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 9.05% for real property and 7.05% 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	2.50%	2.50%
Discounts made by state to tax payer	<u>(0.2%)</u>	<u>(0.2%)</u>
	<u>9.05%</u>	<u>7.05%</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, 2014**

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.

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 final settlement received from CRIM related to fiscal year 2013-2014 on the six-month period after fiscal year ends, the amount collected by CRIM from taxpayers and charges exceeded the amount advanced by CRIM for the same period by \$398,229. 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, 2014**

**6. MUNICIPAL LICENSE TAXES**

Municipal License Taxes receivable are recorded in the fiscal year in which payment is due and, accordingly, represent taxes which are due and uncollected at June 30, 2014. 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 inflows of resources in the General Fund. The Municipality invoiced and collected in advance during the current year \$3,496,491, corresponding to the next fiscal year municipal license.

**7. SALES AND USE TAX**

On July 29, 2007, the Commonwealth Legislature approved Act. No. 80 ("Act 80"). The Act 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 (RD) (Other Governmental Funds)	\$ 675,316
Municipal Revenue Collection Center (CRIM) (General Fund)	398,229
OCAM (SBGP Program) (Other Governmental Funds)	384,754
Puerto Rico Treasury Department (General Fund)	284,134
Puerto Rico Labor Department (Other Governmental Funds)	15,875
Puerto Rico Family Department (Other Governmental Funds)	3,793
	\$ 1,762,101
Total	\$ 1,762,101

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FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

**9. INTERFUND TRANSACTIONS**

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

The due from and due to other fund balances as of June 30, 2014 are as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Debt Services Fund	\$ 2,661,277
General	Other Governmental Funds	203,413
General	Loans and Bonds	76,876
Other Governmental Funds	Other Governmental Funds	<u>9,182</u>
		<u>\$ 2,950,748</u>

The balance of \$203,413 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, 2014 consisted of the following:

<u>Transfer In</u>	<u>Transfer Out</u>	<u>Amount</u>
General Fund	Debt Service	<u>\$ 2,663,203</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 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, 2014**

**10. CAPITAL ASSETS**

Capital asset activity for the Municipality for the year ended June 30, 2014 was as follows:

<u>Primary Government</u>	<u>Balance July 1, 2013, As Restated</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2014</u>
<b>Governmental Activities:</b>				
Capital assets, not being depreciated:				
Land	\$ 24,690,244	\$ -	\$ -	\$ 24,690,244
Construction in progress	3,957,870	1,048,345	592,503	4,413,712
Total capital assets, not being depreciated	<u>28,648,114</u>	<u>1,048,345</u>	<u>592,503</u>	<u>29,103,956</u>
Capital assets, being depreciated:				
Buildings and building improvements	25,366,664	592,503		25,959,167
Vehicles and equipment	8,147,938	70,477		8,218,415
Infrastructure	13,224,116			13,224,116
Total capital assets, being depreciated	<u>46,738,718</u>	<u>662,980</u>	<u>-</u>	<u>47,401,698</u>
Less accumulated depreciation for:				
Buildings and building improvements	7,082,542	590,049		7,672,591
Vehicles and equipment	6,604,534	245,428		6,849,962
Infrastructure	6,642,090	468,518		7,110,608
Total accumulated depreciation	<u>20,329,166</u>	<u>1,303,995</u>	<u>-</u>	<u>21,633,161</u>
Total capital assets, being depreciated, net	<u>26,409,552</u>	<u>(641,015)</u>	<u>-</u>	<u>25,768,537</u>
Governmental activities capital assets, net	<u>\$ 55,057,666</u>	<u>\$ 407,330</u>	<u>\$ 592,503</u>	<u>\$ 54,872,493</u>

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

General government	\$ 260,799
Public safety	156,479
Recreation	312,959
Health and welfare	39,120
Public works	<u>534,638</u>
Total depreciation expense-governmental activities	<u>\$ 1,303,995</u>

**COMMONWEALTH OF PUERTO RICO  
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FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

**11. DUE TO OTHER AGENCIES**

Puerto Rico Water and Sewer Authority	\$ 205,037
Retirement System Administration	133,714
State Employment Association ("AEELA")	22,560
Treasury Department	10,972
General Services Administration	<u>250</u>
Total	<u><u>\$ 372,533</u></u>

**12. DEFERRED INFLOWS OF RESOURCES**

**a. Municipal License Taxes**

The deferred inflows of resources of \$3,496,491 in the general fund related to municipal license tax collected in fiscal year 2013-2014 that will be earned in fiscal year 2014-2015.

**b. Federal Government**

The deferred inflows of resources 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  
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

**14. LONG-TERM DEBTS**

Bonds and other long-term liabilities outstanding at June 30, 2014 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%.	\$ 320,000
\$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%.	1,725,000
\$550,000 series of 1998, payable in annual installments of \$14,000 to \$38,020 until January 1, 2020, interest at 4.50%.	206,020
\$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%.	1,650,000
\$624,000 series of 1998, payable in annual installments of \$17,000 to \$44,000 until January 1, 2022, interest at 4.50%.	300,000
\$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%.	1,520,000
\$3,370,000 series of 2007, payable in annual installments of \$60,000 to \$295,000 until July 1, 2029, interest from 3.93% to 7.50%.	2,805,000

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\$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%.	\$ 1,350,000
\$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%.	875,000
\$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%.	985,000
\$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%.	826,000
\$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%.	158,000
\$1,030,000 series of 2012, payable in annual installments of \$28,998 to \$65,178 until January 1, 2036, interest at 3.75%.	<u>1,030,000</u>
Total bonds payable	<u><u>\$ 15,368,020</u></u>

**COMMONWEALTH OF PUERTO RICO  
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

The annual requirements for the amortization of long-term debts at June 30, 2014 are as follows:

	<b><i>Bonds Payable</i></b>	
	<b><u>Principal</u></b>	<b><u>Interest</u></b>
2015	\$ 1,250,254	\$ 833,995
2016	1,332,944	855,129
2017	1,426,733	774,978
2018	1,526,626	688,422
2019	1,109,627	595,171
2020-2024	4,370,184	2,022,161
2025-2029	2,609,692	893,755
2030-2034	1,174,912	273,398
2035-2037	567,048	46,420
	<b><u>\$ 15,368,020</u></b>	<b><u>\$6,983,429</u></b>

Long-term liability activity for the year ended June 30, 2014 was as follows:

<b><u>Primary Government</u></b>	<b><u>Beginning Balance</u></b>	<b><u>Adjustment</u></b>	<b><u>Payments</u></b>	<b><u>Ending Balance</u></b>	<b><u>Due Within One Year</u></b>
<b>Governmental Activities:</b>					
Bonds payable	\$ 16,648,020	\$ (180,000)	\$ 1,100,000	\$ 15,368,020	\$ 1,250,254
Total long-term debts	<u>16,648,020</u>	<u>(180,000)</u>	<u>1,100,000</u>	<u>15,368,020</u>	<u>1,250,254</u>
<b>Other long-term liabilities:</b>					
Landfill obligation	1,356,615		81,171	1,275,444	
Puerto Rico Health Insurance Administration	671,208			671,208	
Compensated absences	3,599,230		203,583	3,395,647	400,000
Total other long-term liabilities	<u>5,627,053</u>	<u>-</u>	<u>284,754</u>	<u>5,342,299</u>	<u>400,000</u>
Total noncurrent liabilities, governmental activities	<u>\$ 22,275,073</u>	<u>\$ (180,000)</u>	<u>\$ 1,384,754</u>	<u>\$ 20,710,319</u>	<u>\$ 1,650,254</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

**15. FUND BALANCES**

	<u>General</u>	<u>Debt Service</u>	<u>Loans and Bonds</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Restricted:					
General government	\$ -	\$ -	\$ -	\$ -	\$ -
Public safety				43,353	43,353
Health and welfare				194,080	194,080
Economic development				1,345,252	1,345,252
Debt service		901,996			901,996
Committed:					
Economic development			4,079,785	19,276	4,099,061
Assigned:					
General government	33,315				33,315
Public safety	1,192				1,192
Health and welfare	240,904				240,904
Culture and recreation	53,138				53,138
Public works	25,294				25,294
Unassigned	293,219				293,219
	<u>\$ 647,062</u>	<u>\$ 901,996</u>	<u>\$ 4,079,785</u>	<u>\$ 1,601,961</u>	<u>\$ 7,230,804</u>

**16. NET POSITION**

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

Capital assets, net of accumulated depreciation	\$ 54,872,493
Outstanding balance on capital related debt	<u>(15,368,020)</u>
Total invested in capital assets, net of related debt	<u>\$ 39,504,473</u>

**COMMONWEALTH OF PUERTO RICO  
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

**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.

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

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FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

(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 2000. The employer's contribution (12.275% 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 12.275% of gross salary. Contributions' requirements are established by law. The actuarially determined contribution

**COMMONWEALTH OF PUERTO RICO  
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

requirement and contributions actually made for the year ended June 30, 2014 was \$611,811. The Municipality's payroll for employees covered by ERS was approximately \$5.0 million. The Municipality total payroll for all employees was approximately \$10.6 million.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2014, 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.
- b. Total income from leases during the year ended June 30, 2014 was approximately \$53,992.
- 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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

**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 \$1.3 million as of June 30, 2014. (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, 2014. These projects are evidenced by contractual commitments with contractors. The construction projects are commitments to approximately \$4,163,948.

**COMMONWEALTH OF PUERTO RICO  
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

**23. RESTATEMENT**

The beginning net position of the statement of net position for the Governmental Activities has been restated to correct balances of capital assets.

	<u><b>Governmental Activities</b></u>
Beginning net position, as previously reported	\$ 38,197,997
Overstatement of capital assets	<u>(1,058,809)</u>
Beginning net position, as restated	<u><u>\$ 37,139,188</u></u>

**24. SUBSEQUENT EVENTS**

In preparing these financial statements, the Municipality has evaluated events and transactions for potential recognition or disclosure through December 23, 2014, the date on which the financial statements were available to be issued.

**PART II – REQUIRED SUPPLEMENTARY INFORMATION**

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF HATILLO**  
**BUDGETARY COMPARISON SCHEDULE - GENERAL FUND**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with</u>
	<u>Original</u>	<u>Final</u>	<u>(Budgetary Basis)</u>	<u>Final Budget-</u>
			<u>(See Note 1)</u>	<u>Positive</u>
				<u>(Negative)</u>
<b>REVENUES</b>				
Property taxes	\$ 5,431,824	\$ 5,726,430	\$ 5,830,053	\$ 103,623
Municipal license taxes	4,400,000	4,400,000	4,442,054	42,054
Sales and use taxes	4,983,329	4,983,329	5,046,872	63,543
Licenses and permits	274,501	374,501	709,073	334,572
Charges for services and rent	70,000	70,000	116,818	46,818
Intergovernmental revenues:				
State contributions	5,327,325	4,885,932	4,886,099	167
Interest, fines, and penalties	140,000	140,000	84,010	(55,990)
Other revenues	150,100	843,493	955,300	111,807
Total revenues	<u>20,777,079</u>	<u>21,423,685</u>	<u>22,070,279</u>	<u>646,594</u>
<b>EXPENDITURES</b>				
Current:				
General government	8,107,695	9,127,322	8,914,977	212,345
Public safety	1,025,075	927,805	880,630	47,175
Public works	8,488,538	7,708,689	7,409,815	298,874
Recreation	1,983,227	2,400,325	2,309,443	90,882
Health and welfare	1,172,544	1,259,544	1,239,589	19,955
Total expenditures	<u>20,777,079</u>	<u>21,423,685</u>	<u>20,754,454</u>	<u>669,231</u>
Excess of revenues over expenditures	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,315,825</u>	<u>\$ 1,315,825</u>
<b>Explanation of Differences:</b>				
<b>Sources/inflows of resources:</b>				
Actual amounts (budgetary basis) *available for appropriation* from the budgetary comparison schedule				\$ 22,070,279
Differences - budget to GAAP:				
Net change in receivables				(463,827)
Non-budgeted revenues				243,662
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances (deficit)				<u>\$ 21,850,114</u>
<b>Uses/outflows of resources:</b>				
Actual amounts (budgetary basis) *total changes to appropriations* from the budgetary comparison schedule				\$ 20,754,454
Differences - budget to GAAP:				
Prior year encumbrances recorded as current year expenditures for GAAP basis				952,709
Net change in payables				198,537
Current year encumbrances recorded as expenditures for budgetary purposes				(353,843)
Non-budgeted expenditures				(248,293)
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances (deficit)				<u>\$ 21,303,564</u>

See note to Budgetary Comparison Schedule.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
NOTE TO BUDGETARY COMPARISON SCHEDULE – GENERAL FUND  
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

**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, 2014 representing the original budget.

**PART III - SINGLE AUDIT SECTION**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HATILLO  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

<u>Federal Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Disbursements/ Expenditures</u>
<b>U.S. Department of Housing and Urban Development (HUD)</b>		
Direct Programs:		
Section 8 Housing Choice Vouchers	14.871	\$ 457,208
Pass-through Commissioner Office of Municipal Affairs - Community Development Block Grant-States:		
Program SBGP	14.228	877,791
Pass-through Department of Family: Emergency Shelter Grant Program	14.231	63,089
Subtotal U.S. Department of HUD		<u>1,398,088</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	42,846
Pass-through Governmental Bank (Rural Development): Community Facilities Loans and Grants	10.766	468,562
Subtotal U.S. Department of Agriculture		<u>511,408</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	93.044	6,609
Special Programs for the Aging Title III, Part C	93.045	30,806
Nutrition Services Incentive Program (NSIP)	93.053	16,671
Pass-through the Office of Administration for Children and Families:		
Child and Care and Development Block Grant	93.575	252,570
Subtotal U.S. Department of HHS		<u>306,656</u>
<b>U.S. Department of Transportation</b>		
Pass-through Transit Security Commission:		
Federal Transit Formula Grants	20.507	89,554
Federal Transit Formula Grants - ARRA	20.507	96,467
Subtotal U.S. Department of Transportation		<u>186,021</u>
<b>U.S. National Endowment for the Humanities</b>		
Pass-through the Puerto Rico Education Department:		
Promotion of the Humanities - Federal/State Partnership	45.129	24,431
Subtotal U.S. National Endowment for the Humanities		<u>24,431</u>
<b>TOTAL</b>		<u>\$ 2,426,604</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, 2014**

**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. The reconciliation of expenditures in the basic financial statements to the Schedule of Expenditures of Federal Awards is as follows:

	<u><b>Expenditures</b></u>
Total federal expenditures per schedule	<u>\$ 2,426,604</u>
Federal expenditures per basic financial statement includes within:	
Federal expenditures included in other governmental funds	<u>\$ 2,426,604</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, in accordance with the 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, 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, 2014, and the related notes to the financial statements, which collectively comprise the Municipality's basic financial statements, and have issued our report thereon dated December 23, 2014.

**Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Municipality's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control.

*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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than

a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free from 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 tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

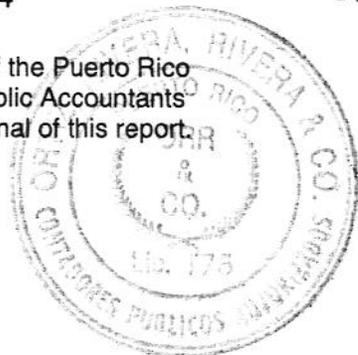
### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

San Juan, Puerto Rico  
December 23, 2014

*Ortiz, Rivera, Rivera & Co.*

The stamp E135688 of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR  
PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE  
REQUIRED BY OMB CIRCULAR A-133**

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

**Report on Compliance for each Major Federal Program**

We have audited Municipality of Hatillo's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Municipality's major federal programs for the year ended June 30, 2014. Municipality's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

**Management's Responsibility**

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

**Auditors' Responsibility**

Our responsibility is to express an opinion on compliance for each of Municipality's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test

basis, evidence about Municipality'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 on compliance for each major federal program. However, our audit does not provide a legal determination of Municipality's compliance.

### **Opinion on Each Major Federal Program**

In our opinion, the Municipality complied, in all material respects, with the types of 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, 2014.

### **Report on Internal Control over Compliance**

Management of the Municipality is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Municipality's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program 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 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 a 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. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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 material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that

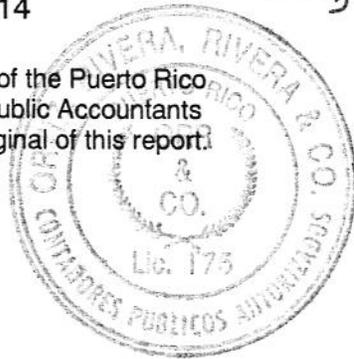
we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

San Juan, Puerto Rico  
December 23, 2014

*Ortiz, Rivera, Rivera & Co.*

The stamp E135689 of the Puerto Rico  
Society of Certified Public Accountants  
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, 2014**

**1. SUMMARY OF AUDIT RESULTS**

Financial Statements

Type of auditors' report issued: Unmodified opinion

Internal control over financial reporting:

Material weakness (es) identified?      Yes   X   No

Significant deficiency (ies) identified?      Yes   X   None reported

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   None reported

Type of auditors' report issued on compliance for major programs: Unmodified opinion

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

Identification of major programs:

CFDA Numbers

Name of Federal Programs or Cluster

14.228

Community Development Block Grant Program



**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, 2014**

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, 2014**

<u>Program</u>	<u>Finding /Non compliance</u>	<u>Status</u>
<b>Community Facilities Loans and Grants – CFDA No. 10.766</b>	<b>Condition 13-1</b>  The Municipality did not perform the required procedures of reviews of Davis Bacon Act.	Condition was corrected.
<b>SBGP - CFDA No. 14.228</b>	<b>Condition 12-1</b>  The Federal Program Office does no request the extension of the contracts into the 45 days required.	Condition was corrected.
<b>SBGP - CFDA No. 14.228</b>	<b>Condition 12-2</b>  The Federal Program Office does not comply with the requirement of preparing and filling the program income quarterly report.	Condition was corrected.
<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 was corrected.