LLM&D, PSC
165 Ponce de León Ave.,
Second Floor
San Juan, Puerto Rico
00917-1233

# CORPORATION FOR THE DEVELOPMENT OF THE ARTS, SCIENCE AND FILM INDUSTRY OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

BASIC FINANCIAL STATEMENTS ANS SUPPLEMENTARY INFORMATION

JUNE 30, 2010

(WITH INDEPENDENT AUDITORS' REPORT)

CERTIFIED PUBLIC ACCOUNTANTS • BUSINESS AND TAX CONSULTANTS
Member Firm of The American Institute and the Puerto Rico Society of Certified Public Accountants

Tel. 787.777.0660 • Fax. 787.765.8033 • www.llmdcpa.com

**CORPORATION FOR THE DEVELOPMENT OF THE ARTS**
**SCIENCE AND FILM INDUSTRY OF PUERTO RICO**
(A COMPONENT UNIT OF THE COMMONWEALTH OF PUERTO RICO)

JUNE 30, 2010

## Table of Contents


| | |
|---|---|
| Management's Discussion and Analysis | I –III |
| Independent Auditor's Report | 1 |
| Government-wide Financial Statements: | |
| Statement of Net Assets | 3 |
| Statement of Activities and Changes in Net Assets | 4 |
| Fund Financial Statements: | |
| Balance Sheet | 5 |
| Statement of Revenue, Expenditures, and Changes in Fund Balance | 6 |
| Reconciliation of the Statement of Revenue, Expenditures, and Changes in Fund Balances to the Statement of Activities | 7 |
| Statement of Revenue and Expenditures –Budget and Actual | 8 |
| Notes to Financial Statements | 9 |

# CORPORATION FOR THE DEVELOPMENT OF THE ARTS, SCIENCE AND FILM INDUSTRY OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis

As management of the Corporation for the Development of the Arts, Science and Film Industry of Puerto Rico (the Corporation), we offer readers of the Corporation's financial statements our discussion and analysis of the Corporation's financial performance during the fiscal year ended June 30, 2010. Please read it in conjunction with the financial statements, which follow this section.

## Financial highlights

- The accompanying financial statements present the financial position of the Corporation as of June 30, 2010 and the results of operations. As of June 30, 2010, the Corporation's net assets increased by $957,851.
- The Corporation's total assets increased by $819,247 and total liabilities decreased by $138,604 over the course of the current fiscal year.

## NET ASSETS

To begin our analysis, the condensed Statements of Net Assets is presented below:

| | June 30 | | Change | |
|---|---|---|---|---|
| | 2010 | 2009 | In Dollars | Percentage |
| Current and other assets - total assets | $ 14,578,240 | $ 13,758,993 | 819,247 | 5.95% |
| Current liabilities | 318,359 | 474,261 | (155,902) | (32.87)% |
| Long-term liabilities | 139,112 | 121,814 | 17,298 | 14.20% |
| Total liabilities | 457,471 | 596,075 | (138,604) | (23.25)% |
| Net assets: | | | | |
| Restricted for film industry development activities | 13,512,763 | 12,516,983 | 995,780 | 7.96% |
| Unrestricted | 608,006 | 645,935 | (37,929) | (5.87)% |
| Total net assets | $ 14,120,769 | $ 13,162,918 | 957,851 | 7.28% |



(Continued)

The condensed Statement of Activities and Changes in Net Assets for the years ended June 30, 2010 and 2009 are presented below:

| | Years ended June 30, | | Change | |
|---|---|---|---|---|
| | 2010 | 2009 | In dollars | Percentage |
| Expenses: | | | | |
| General and administrative | $ 598,929 | $ 653,376 | (54,447) | (8.33)% |
| Film industry promotion | 2,603,065 | 3,063,064 | (459,999) | (15.02)% |
| Total expenses | 3,201,994 | 3,716,440 | (514,446) | (13.84)% |
| Revenue: | | | | |
| Program revenue: | | | | |
| Legislative appropriations | 561,000 | 687,000 | (126,000) | (18.34)% |
| Charges for service | 341,622 | 492,196 | (150,574) | (30.59)% |
| General revenue: | | | | |
| Collections from the sales and use tax | 3,240,000 | 3,240,000 | - | 0.00% |
| Other revenue | 17,223 | 96,414 | (79,191) | (82.14)% |
| Total revenue | 4,159,845 | 4,515,610 | (355,765) | (7.88)% |
| Change in net assets | 957,851 | 799,170 | 158,681 | 19.86% |
| Net assets, beginning of the year | 13,162,918 | 12,363,748 | 799,170 | 6.46% |
| Net assets, end of the year | $ 14,120,769 | $ 13,162,918 | 957,851 | 7.28% |

## Financial Analysis of the Corporation

The Corporation provides incentives to the film industry for the production of movies and development of the film industry within Puerto Rico. The Corporation's net assets as of June 30, 2010 amounted to $14,120,769. Revenue of the Corporation includes legislative appropriations, and collections from the sale and use tax.

For fiscal year 2010, total revenues of the Corporation decreased by $355,765. This decrease is mainly due the effect of a decrease in license fee income of 1% of the budget of any film project proposed by film entities of approximately $150,000, a decrease in interest income of approximately $79,000 and a decrease in Commonwealth's appropriations to the General fund of approximately $126,000. The Corporation's total expenses during the year ended June 30, 2010 decreased by $514,446 when compared with the year ended June 30, 2009. This decrease was mainly due to a decrease in bad debt expense and the provision for loss on loan guarantees of approximately $236,000 and $307,000 respectively. During the year, the Corporation lent approximately $2,346,000 to film producers to invest in the production of movies and development of the film industry in Puerto Rico.

The Corporation has entered into contracts with producers and distributors of films for the purchase of film rights amounting to approximately $1,608,000. During the years ended June 30, 2010 and 2009 the Corporation fully reserved the investment in film rights to its net realizable value. Also during the year ended June 30, 2010 there was a charge of $61,123 and $439,271 to increase the valuation reserve of film rights and the allowance for doubtful accounts on notes receivables, respectively, presented within film industry promotion expenses in the statement of activities and in the statements of revenues, expenditures and changes in fund balances.



(Continued)

**Contacting the Corporation's Management**

This financial report is designed to provide our customers and creditors with a general overview of the Corporation's finances and to demonstrate its accountability for the monies it receives. If you have questions about this report or need additional financial information, contact the Corporation for the Development of the Arts, Sciences and Film Industry of Puerto Rico, PO Box 362350, San Juan, Puerto Rico, 00936-2350.

LLM&D, PSC
165 Ponce de León Ave.,
Second Floor
San Juan, Puerto Rico
00917-1233

# INDEPENDENT AUDITORS' REPORT

**Corporation for the Development of the Arts,**
**Science and Film Industry of Puerto Rico**
**San Juan, Puerto Rico**

We have audited the accompanying basic financial statements of Corporation for the Development of the Arts, Science and Film Industry of Puerto Rico (The Corporation), a component unit of the Commonwealth of Puerto Rico, as of and for the year ended June 30, 2010. These basic financial statements are the responsibility of Corporation's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects the financial position of the Corporation for the Development of the Arts, Science and Film Industry of Puerto Rico as of June 30, 2010 and the results of its operations and cash flows for the year then ended in conformity with accounting principles generally accepted in the Unites States of America.

Accounting principles generally accepted in the Unites States of America require that the management's discussion and analysis, included on pages I through III be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements is required by Government Accounting Standards Board, who considers it to be an essential part of financial reporting. 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 regarding the methods of measurement and presentation of the supplementary information.

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.

LLM&D, P.S.C.

January 28, 2011
San Juan, Puerto Rico

License No. 90
Expiration date: December 1st, 2013

Stamp No. 2550861 of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.

**CORPORATION FOR THE DEVELOPMENT OF THE ARTS, SCIENCE AND FILM INDUSTRY OF PUERTO RICO**

(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Net Assets

June 30, 2010

| | | Governmental Activities |
|---|---|---|
| **Assets** | | |
| Cash | $ | 12,406,598 |
| Notes receivables, net | | 1,901,642 |
| Due from Commonwealth's Treasury Department | | 270,000 |
| Investment in film rights (notes 11 and 12) | | - |
| Total assets | | 14,578,240 |
| **Liabilities and Net Assets** | | |
| Accounts payable and accrued liabilities | | 153,790 |
| Due to Puerto Rico Industrial Development Company | | 164,569 |
| Compensated absences and sick leave obligations | | 139,112 |
| Total liabilities | | 457,471 |
| Net assets: | | |
| Restricted for film industry development activities | | 13,512,763 |
| Unrestricted | | 608,006 |
| Total net assets | $ | 14,120,769 |

See accompanying notes to basic financial statements.

**CORPORATION FOR THE DEVELOPMENT OF THE ARTS, SCIENCE AND FILM INDUSTRY OF PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Activities and Changes in Net Assets

Year ended June 30, 2010

| | | Program revenue | | Net (expense)/revenue and changes in net assets |
|---|---|---|---|---|
| | Expenses | Charges for services | Operating grants and contributions | Governmental activities |
| **Functions/Programs** | | | | |
| Governmental activities: | | | | |
| General and administrative | $ 598,929 | — | 561,000 | (37,929) |
| Film industry promotion | 2,603,065 | 341,622 | — | (2,261,443) |
| Total governmental activities | 3,201,994 | 341,622 | 561,000 | (2,299,372) |

| | |
|---|---|
| General revenue: | |
| Collections from the sale and use tax | 3,240,000 |
| Other income | 17,223 |
| Total general revenue | 3,257,223 |
| Changes in net assets | 957,851 |
| Net assets, beginning of year | 13,162,918 |
| Net assets, end of year | $ 14,120,769 |

See accompanying notes to basic financial statements.

**CORPORATION FOR THE DEVELOPMENT OF THE ARTS, SCIENCE AND FILM INDUSTRY OF PUERTO RICO**

(A Component Unit of the Commonwealth of Puerto Rico)

Balance Sheet – Governmental Funds

June 30, 2010

| | | | Film Industry Development Funds | | |
|---|---|---|---|---|---|
| **Assets** | | **General** | **Law 121** | **Law 362** | **Total governmental funds** |
| Cash | $ | 1,290,576 | 11,116,022 | — | 12,406,598 |
| Notes receivable | | — | 1,875,142 | 26,500 | 1,901,642 |
| Investment in film rights (notes 11 and 12) | | — | — | — | — |
| Due from Commonwealth's Treasury Department | | — | 270,000 | — | 270,000 |
| Due from other funds | | — | 274,533 | 259,563 | 534,096 |
| Total assets | $ | 1,290,576 | 13,535,697 | 286,063 | 15,112,336 |
| **Liabilities and Fund Balances** | | | | | |
| Accounts payable and accrued liabilities | $ | 70,698 | 60,948 | 22,144 | 153,790 |
| Due to Puerto Rico Industrial Development Company | | 164,569 | — | — | 164,569 |
| Due to other funds | | 308,191 | 76,372 | 149,533 | 534,096 |
| Total liabilities | | 543,458 | 137,320 | 171,677 | 852,455 |
| Fund balances reserved for: | | | | | |
| Encumbrances | | 27,542 | — | — | 27,542 |
| Film industry development activities | | — | 13,398,377 | 114,386 | 13,512,763 |
| Unreserved | | 719,576 | — | — | 719,576 |
| Total fund balances | | 747,118 | 13,398,377 | 114,386 | 14,259,881 |
| Total liabilities and fund balances | $ | 1,290,576 | 13,535,697 | 286,063 | |

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

| | | |
|---|---|---|
| Accrued compensated absences are not due and payable in the current period and therefore, are not reported in the funds. | | (139,112) |
| Net assets of governmental activities | $ | 14,120,769 |

See accompanying notes to basic financial statements.

**CORPORATION FOR THE DEVELOPMENT OF THE ARTS, SCIENCE AND FILM INDUSTRY OF PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Revenue, Expenditures, and Changes in Fund Balance
Governmental Funds

Year ended June 30, 2010

| | | Film Industry Development Funds | | |
|---|---|---|---|---|
| | General | Law 121 | Law 362 | Total governmental funds |
| Revenue: | | | | |
| Legislative appropriations | $ 561,000 | — | — | 561,000 |
| Collections from the sale and use tax | — | 3,240,000 | — | 3,240,000 |
| Charges for servises | — | — | 341,622 | 341,622 |
| Other income | — | 17,223 | — | 17,223 |
| Total revenue | 561,000 | 3,257,223 | 341,622 | 4,159,845 |
| Expenditures: | | | | |
| Current: | | | | |
| General and administrative | 581,631 | — | — | 581,631 |
| Film industry promotion | — | 2,243,945 | 359,120 | 2,603,065 |
| Total expenditures | 581,631 | 2,243,945 | 359,120 | 3,184,696 |
| Excess (deficiency) of revenue over expenditures | (20,631) | 1,013,278 | (17,498) | 975,149 |
| Net change in fund balances | (20,631) | 1,013,278 | (17,498) | 975,149 |
| Fund balance, beginning of year | 767,749 | 12,385,099 | 131,884 | 13,284,732 |
| Fund balance, end of year | $ 747,118 | 13,398,377 | 114,386 | 14,259,881 |

See accompanying notes to basic financial statements.

**CORPORATION FOR THE DEVELOPMENT OF THE ARTS, SCIENCE AND FILM INDUSTRY OF PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

Reconciliation of the Statement of Revenue, Expenditures, and Changes in Fund Balances to the Statement of Activities – Governmental Funds

Year ended June 30, 2010

| | | |
|---|---|---|
| Amounts reported for governmental activities in the statement of activities are different because: | | |
| Net change in fund balances – total governmental funds | $ | 975,149 |
| Some expenses or liability reductions reported in the statement of activities do not require the use or receipt of current financial resources and therefore are not reported as expenditures or revenues in the governmental funds. This is the amount of net increase in accrued compensated absences. | | (17,298) |
| Change in net assets of governmental activities | $ | 957,851 |

See accompanying notes to basic financial statements.

**CORPORATION FOR THE DEVELOPMENT OF THE ARTS, SCIENCE AND FILM INDUSTRY OF PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Revenue and Expenditures – Budget and Actual – Budgetary Basis – General Fund

Year ended June 30, 2010

| | | Original budget | Amended budget | Actual | Variance with amended budget |
|---|---|---|---|---|---|
| Revenue: | | | | | |
| Legislative appropriations | $ | 561,000 | 561,000 | 561,000 | — |
| Total revenue | | 561,000 | 561,000 | 561,000 | — |
| Expenditures: | | | | | |
| Current: | | | | | |
| General and administrative | | 561,000 | 561,000 | 603,665 | (42,665) |
| Total expenditures | | 561,000 | 561,000 | 603,665 | (42,665) |
| Deficiency of revenue over expenditures | $ | — | — | (42,665) | (42,665) |

See accompanying notes to basic financial statements.

## 1. Reporting Entity and Summary of Significant Accounting Policies

The Corporation for the Development of the Arts, Science and Film Industry of Puerto Rico (the Corporation) is a component unit of the Commonwealth of Puerto Rico (the Commonwealth), created by Law Number 121 of August 17, 2001, for the development of the arts and the film industry in Puerto Rico.

### a) Government-Wide and Fund Financial Statements

**Government-Wide Financial Statements** - The statement of net assets and statement of activities report information on all non-fiduciary activities of the Corporation. All interfund activity has been removed from these statements. Governmental activities generally are financed through taxes, intergovernmental revenue, and other non-exchange revenue. Following is a description of the Corporation's government-wide financial statements:

The Statement of Net Assets presents the reporting entities' assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- **Invested in capital assets** - consists of capital assets, net of accumulated depreciation.

- **Restricted net assets** - result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.

- **Unrestricted net assets** - consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources which are imposed by management, but can be removed or modified.

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

**Fund Financial Statements –** separate financial statements are provided for governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements, with non-major funds being combined into a single column.

When both restricted and unrestricted resources are available for use, generally it is the Corporation's policy to use restricted resources first, then unrestricted resources as they are needed. Major individual governmental funds are reported as separate columns in the fund financial statements.

## b) Measurement Focus, Basis of Accounting and Financial Statement Presentation

The accompanying basic financial statements have been prepared in conformity with the accounting principles generally accepted in the United States of America (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

***Government-Wide Financial Statements*** — The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

***Governmental Fund Financial Statements*** — The Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as they are both measurable and available. Revenue is 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 Corporation considers revenue to be available if they are collected within 90 days of the end of the current fiscal year end. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include:

- Employees' vested annual leave is recorded as expenditure when utilized. The amount of accumulated annual leave unpaid at June 30, 2010, has been reported only in the government-wide financial statements.
- Executory purchase orders and contracts are recorded as a reservation of fund balance.

## c) Fund Accounting

The financial activities of the Corporation are recorded in individual funds, each of which is deemed to be a separate accounting entity. The Corporation uses fund accounting to report on its financial position and results of operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts. The financial activities of the Corporation that are reported in the accompanying financial statements have been classified into the following major governmental funds:

- ***General Fund*** — This fund accounts for all financial resources except those required to be accounted for in another fund.

- ***Film Industry Development Fund*** — Is used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for activities dedicated to promote the film industry in Puerto Rico.

### d) Budgeting and Budgetary Control

The Corporation's budget is adopted in accordance with a statutory basis of accounting which is not in accordance with Generally Accepted Accounting Principles (GAAP). Revenue is generally recognized when cash is received. However, revenue receivable from reimbursements is recognized when related expenditures are incurred. Expenditures are generally recorded when they are encumbered (i.e. executed but unperformed contracts or purchase orders) or otherwise processed for payment. Unencumbered amounts lapse at the end of the subsequent fiscal year.

Under the statutory basis of accounting, the Corporation uses encumbrance accounting to record the full amount of purchase orders, contracts and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds encumbrance accounting is a significant aspect of budgetary control.

The statement of revenue, expenditures and change in fund balance — budget and actual —general fund — budgetary basis presents the information for which there is an annual legally adopted budget, as required by GAAP. Budget revenue represents official estimates while expenditures represent amounts originally adopted and amended. Actual amounts are presented in the budgetary basis. See note 2 for a reconciliation of the statement of revenue and expenditures — budget and actual — general fund — budgetary basis with the statement of revenue, expenditures and changes in fund balance, for the general fund – GAAP basis.

### e) Governmental Funds — Reservations of Fund Balance

The governmental fund financial statements present reservations of fund balance for portions that are legally segregated for a specific future use or are not appropriated for expenditure. The Corporation has the following reservations of fund balance:

- ***Encumbrances*** — Represents future expenditures under purchase orders and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.

- ***Film industry development activities*** — Represent the amount reserved for future expenditures directed towards promoting the film industry in Puerto Rico.

### f) Notes Receivable

Notes receivable are valued at the outstanding principal balance less an allowance for uncollectable amounts. The Corporation provides for losses through an allowance for doubtful accounts to the extent revenues from film productions are insufficient to cover the notes' outstanding balance.

### g) Interfund transactions

Interfund activities consist of advances between funds, which are presented as amounts due to and due from other funds. However, those transfers and related amounts receivables and payable are

considered internal balances and activities that have been eliminated in the government-wide financial statements.

### h) Compensated Absences

The employees of the Corporation are granted 30 days of vacation and 18 days of sick leave annually. Vacation and sick leave may be accumulated up to a maximum of 60 and 90 days, respectively. In the event of employee resignation, an employee is reimbursed for accumulated vacation and sick days up to the maximum allowed. The governmental fund financial statements record expenditures when employees are paid for leave. The government-wide financial statements present the cost of accumulated vacation leave as a liability as of June 30, 2010.

### i) Risk Management

The Corporation pays 10% of the commercial insurance purchased by the Puerto Rico Industrial Development Company (another Component Unit of the Commonwealth ) to cover for casualty, theft, tort claims, and other losses through the Commonwealth's Treasury Department (the Treasury Department) negotiated under a blanket agreement and then charged to the Corporation. The current insurance policies have not been canceled or terminated. There have been no settlements of insurance claims exceeding coverage under such policies in any of the past three years. Worker's compensation insurance coverage is provided by the State Insurance Fund Corporation, a component unit of the Commonwealth, which provides compensation to both public and private employees.

### j) Use of Estimates

Management of the Corporation has made certain estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with accounting principles generally accepted in the United States of America. Significant items subject to such estimates and assumptions include the valuation of film rights and notes receivable. Actual results could differ from those estimates.

### k) Future Adoptions of Accounting Pronouncements

The GASB has issued the following accounting standards that have an effective date after June 30, 2010:

- GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions.* This Statement establishes criteria for classifying fund balances into specifically defined classifications and clarifies definitions for governmental fund types. This statement is effective for fiscal periods beginning after June 15, 2010.

The impact of these pronouncements on the Corporation's basic financial statements has not yet been determined, but is not expected to be significant.

### l) Adoption of GASB No. 51

Effective July 1, 2007, the Corporation adopted GASB Statement No. 51, *Accounting and Financial Reporting by for Intangible Assets.* Statement 51 requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. The requirements of this statement reduce the inconsistencies that have developed in accounting and financial reporting of intangible assets. The provisions of this statement apply to all intangible assets except for the following:

a. Items acquired primarily for the purposes of obtaining income or profit, rather than for use in operation.
b. Assets resulting from capital lease transactions reported by lessees.
c. Goodwill created through the combination with another entity.

The Corporation evaluated the impact of this statement and determined that the distribution film rights acquired during the past years fall into one of the exceptions of the statement (items acquired primarily for the purposes of obtaining income or profit) and therefore the film rights should be classified as an investment instead of intangible asset. Prior to, the adoption of this Statement, film rights were classified and presented in the statement of net assets as intangible assets which were long term in nature, therefore, not presented in the balance sheet in the governmental funds. The outlays to acquire film rights were previously reported as expenditures in the governmental funds.

## 2. Budgetary Basis and Budgetary Control

The Corporation prepares an annual operating budget for all governmental funds. Subsequent changes to the budget must be approved by the Corporation's Board. The following schedule presents comparisons of the general fund legally adopted budget with actual data on a budgetary basis. Since accounting principles applied for purposes of developing data on a budgetary basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of timing and entity difference in the deficiency of revenue over expenditures for the year then ended June 30, 2010, is presented as follows:

| | | |
|---|---|---|
| Deficiency of revenue over expenditures – budgetary basis | $ | (42,665) |
| Plus current year encumbrances which represent budgetary expenditures | | 27,542 |
| Less current year expenditures against prior year encumbrances | | (5,508) |
| Excess of revenue over expenditures – GAAP basis | $ | (20,631) |

## 3. Deposits

The carrying amount and corresponding bank balances of the Corporation at June 30, 2010 amounted to $12,406,598. This balance is deposited at the Commonwealth's Treasury Department cash and investment pool accounts, Economic Development Bank (EDB) and a commercial bank in the amount of $9,062,729, $2,090,290 and $1,253,579, respectively.

### *Custodial Credit Risk*

Custodial credit risk for deposits is the risk that in the event of bank failure, the Corporation may not be able to recover deposits that are in the possession of an outside party. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized in excess of federal depository insurance. All securities pledged as collateral are held by the banks in the Commonwealth's name. Cash deposited at the Commonwealth's Treasury Department and EDB, are exempt from compliance with the collateral requirement of the Commonwealth's banking regulations, therefore these deposits are considered not insured or collateralized.

### *Interest Rate Risk*

The Corporation mitigates the interest rate risk by investing in instruments with maturities of three months or less.

## 4. Notes Receivable

Notes receivable as of June 30, 2010 were as follows:

| | | |
|---|---|---|
| Note receivables | $ | 9,408,205 |
| Allowance for doubtful account | | (7,506,563) |
| Notes receivable, net | $ | 1,901,642 |

## 5. Due to Puerto Rico Industrial Development Company

The Corporation receives clerical services from the Puerto Rico Industrial Development Corporation (PRIDCO), such as messenger and internal postal service. The Corporation also pays rent to PRIDCO for the building in which they are located. The amount due to PRIDCO as of June 30, 2010 amounts to $164,569.

## 6. Pension Plan

Employees of the Corporation participate in the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (the System). The System is a defined-benefit cost-sharing multi-employer plan sponsored by the Commonwealth of Puerto Rico under the terms of Act No. 447 of 1951, as amended. Participation is mandatory for regular employees. The System issues a publicly available financial report that includes its financial statements and required supplementary information,

which can be obtained from the Systems' Administrator, Retirement System Administration, PO Box 42003, San Juan, P.R. 00940.

Members who have attained at least 55 years of age and have completed at least 30 years of creditable service or members who have attained at least 58 years of age and have completed at least 10 years of creditable service are entitled to a life-term annual benefit, payable on a monthly basis.

The amount of the annuity shall be 1.5 percent of the average highest compensation in any of three years of credited service multiplied by the number of years of creditable service up to 20 years, plus 2 percent of the average compensation multiplied by the number of years of creditable service in excess of 20 years. In no ease will the annuity be less than $300 per month.

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive up to a maximum of 65 percent of the average highest compensation in any three years of credited service or if they have attained 55 years of age will receive up to a maximum of 75 percent of the average compensation. Disability retirement benefits are available to members for occupational and nonoccupational disability up to a maximum benefit of 50 percent of the average compensation. However, for nonoccupational disability, a member must have at least 10 years of creditable service.

Act No. 1 of 1990 made certain amendments applicable to new participants joining the System effective April 1, 1990. These changes consist principally of the establishment of contributions at 8.275 percent of their monthly gross salary, an increase in the retirement age to 65, a decrease in the annuity benefit to 1.5 percent of the average compensation for all years of creditable service, a decrease in the maximum disability and death benefits annuities from 50 percent to 40 percent of average compensation, and the elimination of the Merit Annuity for participants who have completed 30 years of creditable service.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the System, was enacted with the purpose of establishing a new pension program (System 2000), which became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999, may elect either to stay in the defined-benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000, will only be allowed to become members of System 2000.

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 the System, together with those of the current defined-benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275 percent of the employees' salary up to a maximum of 10 percent) 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 a rate equal to 75 percent of the return of the System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The employees' contributions (9.275 percent of the employees' salary) will be used to fund the current plan.

System 2000 reduces the retirement age from 65 years to 60 years for those employees who joined the current plan on or after April 1, 1990.

**Funding Policy**

Contribution requirements are established by law and are as follows:

| | |
|---|---|
| Commonwealth | 9.275% of gross salary |
| Employees: | |
| Hired on or before March 31, 1990 | 5.775% of gross salary up to $6,600 |
| | 8.275% of gross salary over $6,600 |
| Hired on or after April 1, 1990 | 8.275% of gross salary |

The Corporation is required to contribute 9.275 percent of its employees' gross salaries.

The Corporation follows the provisions of the GASB No. 27, *Accounting for Pensions by State and Local Governmental Employers*, which requires employers that participate in cost-sharing multi-employer defined-benefit pension plans to recognize pension expenditures/expense equal to the employer's contractually required contributions and a liability for unpaid contributions. The Corporation's contractually required contributions for the years ended June 30, 2010, 2009 and 2008 amounted to approximately $21,000 $26,500 and $28,450, respectively, which represent 100% of the required contributions for such years.

## 8. Legislative Appropriations

The Corporation received appropriations from the Commonwealth to be used solely to carry out the general operating purposes of the Corporation and for promotion, advertising and other activities related to the films and arts industry in Puerto Rico, which are accounted for in the general fund. All legislative appropriations lapse after three years. Appropriations received during June 30, 2010 amounted to $561,000.

## 9. Collections from the Sale and Use Tax

On March 8, 2007, the Governor of the Commonwealth signed Act No. 23, that amended the section 2706 of the Puerto Rico Internal Revenue Code (the Code), in which the Treasury Department assigns $270,000 on a monthly basis to the Corporation from the funds collected from the sales and use tax, to replace the funds received from the former Act No. 121 of August 17, 2001 (section 2082 of the Code). Act No. 23 superseded the Act No. 121 in which the Corporation received fifty percent (50%) of the tax collected from public spectacles by the Treasury Department. The Corporation received $2,970,000 from the Sales and Use Tax during the fiscal year ended June 30, 2010, while $270,000 remained receivable at June 30, 2010.

## 10. Charges for services

Pursuant to Act No. 121 of August 17, 2001, the Corporation receives the equivalent of one (1) percent of the budget of any film project proposed by film entities described under Article 5 of Act No. 362 of December 24, 1999, as amended, in exchange for a license to produce a film project. During the year ended June 30, 2010 the Corporation received $341,622 from these arrangements.

## 11. Contingencies

The Corporation is subject to various litigations, claims and assessments arising in the normal course of its operations. Management believes that the ultimate resolution of these matters, either individually or in the aggregate, will not have a material adverse effect in the Corporation's financial position or results of operations.

## 12. Investment in film rights

The Corporation enters into the acquisition of distribution film rights, mainly in international markets, which are treated as investments pursuant to GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets.* The Corporation has the right to license, exploit, reproduce, distribute, sub-distribute, broadcast, perform, exhibit, market, advertise and publicize the picture in the territory for non-commercial and commercial broadcast in any form, method or means of delivery including terrestrial, cable, satellite or whatsoever other means of delivery broadcast or exhibition now known or later, on such terms and conditions that the Corporation or its licensees may elect in the exercise of its sole discretion. The producer will have the right to buy back these rights for the same amount paid by the Corporation before the picture is completed and delivered or if thereafter, before the Corporation makes the first sale of the picture. After film exploitation on international markets, the Corporation will first recoup the cost of the film rights and if it enters into a profit position, then the Corporation will share the revenue equally with the producer on a 50%-50% basis. Investments in film rights are carried at the lower of cost or net realizable value. The Corporation has estimated the fair value of the investment by determining the present value of estimated expected future cash flows. Due to the lack of cash flows from these film rights, the Corporation has provided a reserve to write down the investment to its net realizable value. During the year ended June 30, 2010 the Corporation recorded a reserve provision to write-down the investment in film rights made during that year amounting to $61,123 which is included within film industry promotion expenditures/expenses in the statement of revenues, expenditures and changes in fund balances/ statement of activities for the year ended June 30, 2010.

## 13. Subsequent events

During January 2011, the Commonwealth's Puerto Rico House of Representatives approved a new Law to replace Law 362 of 1999. This Law is in the process of being reviewed and approved by the Governor. This new Law will improve the incentives available under Law 362 for the purpose of increasing the production of film projects in Puerto Rico by expanding the definition projects entitled for the tax incentives.