

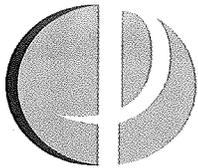
***Corporation for the Development of the Arts,
Science and Film Industry of Puerto Rico***
**(A Component Unit of the Commonwealth of Puerto
Rico)**

*Basic Financial Statements and Required Supplementary
Information as of and for the Year Ended June 30, 2013 and
Independent Auditors' Report*

***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, and Required Supplementary Information
As of and for the Year Ended June 30, 2013 and Independent Auditors' Report*

Table of Contents

	<u>Page</u>
Independent Auditors' Report	1
Management's Discussion and Analysis	3
Basic Financial Statements	
Government-Wide Financial Statements:	
Statement of Net Position	7
Statement of Activities and Changes in Net Position	8
Fund Financial Statements:	
Balance Sheet	9
Statement of Revenue, Expenditures and Changes in Fund Balance	10
Reconciliation of the Statement of Revenue, Expenditures, and Changes in Fund Balances to the Statement of Activities	11
Statement of Revenue and Expenditures – Budget and Actual	12
Notes to Financial Statements	13



PARISSI P.S.C.
Certified Public Accountants, Tax & Business Advisors

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 financial statements of the governmental activities and each mayor fund of the 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, 2013, and the related notes to the financial statements, which collectively comprise the Corporation'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.

Auditor's Responsibility

Our responsibility is to express an opinion 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. 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 auditor's 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 auditor considers 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Corporation for the Development of the Arts, Science and Film Industry of Puerto Rico, as of June 30, 2013, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis information on pages 3-6 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

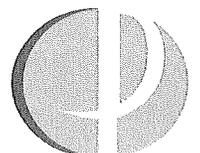
As discussed in Note 9 to the financial statements, in March 2011, the Corporation transferred \$1,000,000 of funds restricted under Act 121 to be used for activities not allowed under such Act. As of the date of this report, the Corporation has not obtained a waiver from the Legislature of Puerto Rico and, therefore such funds may need to be returned to the Commonwealth. Our opinion is not modified with respect to that matter.


Parissi, PSC



February 7, 2014
San Juan, Puerto Rico

Stamp No. E88586 was affixed
to the original of this report
License No. 88 Exp. December 1, 2014.



***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
June 30, 2013

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, 2013. 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, 2013 and the results of operations. As of June 30, 2013, the Corporation's net position increased by \$1,562,203.
- The Corporation's total assets increased by \$1,384,698 and total liabilities decreased by \$177,505 over the course of the current fiscal year.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial statements consist of two parts – management's discussion and analysis (this section) and the basic financial statements. The basic financial statements include two kinds of statements that present different views of the Corporation:

- The first two statements are government-wide financial statements that provide information about the Corporation's overall financial position and results of operations. These statements, which are presented on an accrual basis of accounting, consist of the statement of net position and the statement of activities and changes in net position.
- The remaining statements are fund financial statements of the Corporation's major and non-major governmental funds, for which activities are funded primarily from Commonwealth appropriations and for which the Corporation follows a modified accrual basis of accounting.
- The basic financial statements also include the notes to financial statements section that explains some of the information in the government-wide and fund financial statements, and provides more detailed data.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The government-wide financial statements report information about the Corporation as a whole using accounting methods similar to those used by private sector companies. The statement of net position includes all of the Corporation's assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities and changes in net position regardless of when the cash is received or paid.

***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
June 30, 2013

FUND FINANCIAL STATEMENTS

The fund financial statements provide more detailed information about the Corporation's most significant funds and not the Corporation as a whole. The Corporation has one kind of fund:

Governmental Funds – Governmental funds are used to account for essentially the same functions as governmental activities in the government-wide financial statements. Governmental funds financial statements focus on current inflows and outflows of expendable resources, as well as on balances of expendable resources available at the end of the fiscal year. This information may be useful in evaluating the Corporation's current financing requirements. The Corporation maintains three individual governmental funds.

NET POSITION

To begin our analysis, the condensed Statements of Net Position as of June 30, 2013 and 2012 are presented below:

	June 30,		Change	
	2013	2012	In dollars	Percentage
Current and other assets - total assets	\$ 14,140,367	12,755,669	1,384,698	10.86%
Current liabilities	523,441	630,896	(107,455)	-17.03%
Long-term liabilities	162,408	232,458	(70,050)	-30.13%
Total liabilities	685,849	863,354	(177,505)	-20.56%
Net position:				
Restricted for film industry development activities	14,707,355	12,200,860	2,506,495	20.54%
Deficit	(1,252,837)	(308,545)	(944,292)	306.05%
Total net position	\$ 13,454,518	11,892,315	1,562,203	13.14%

Financial Analysis of the Corporation

For the fiscal year 2013, total assets increased in cash from the governmental appropriations for \$2 million net by a decrease in account receivables for \$367 thousand and a decrease in due to Commonwealth's Treasury Department for \$217 thousand. The increase in cash is reflected in the restricted for firm industry development activities net position.

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***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
June 30, 2013

The condensed Statement of Activities and Changes in Net Position for the years ended June 30, 2013 and 2012 are presented below:

	<u>Year Ended June 30,</u>		<u>Change</u>	
	<u>2013</u>	<u>2012</u>	<u>In dollars</u>	<u>Percentage</u>
Revenue:				
Program revenue:				
Legislative appropriations	\$ 358,537	463,000	(104,463)	-22.56%
Government appropriations	3,240,000	3,240,000	—	0.00%
Charges for service	468,002	322,976	145,026	44.90%
General revenue:				
Other revenue	16,140	6,324	9,816	155.22%
Total revenues	<u>4,082,679</u>	<u>4,032,300</u>	<u>50,379</u>	<u>1.25%</u>
Expenses:				
General and administrative	367,222	514,927	(147,705)	-28.68%
Film industry promotion	<u>2,153,254</u>	<u>5,391,172</u>	<u>(3,237,918)</u>	<u>-60.06%</u>
Total expenses	<u>2,520,476</u>	<u>5,906,099</u>	<u>(3,385,623)</u>	<u>-57.32%</u>
Change in Net Position	1,562,203	(1,873,799)	3,436,002	-183.37%
Net position, beginning of the year	<u>11,892,315</u>	<u>13,766,114</u>	<u>(1,873,799)</u>	<u>-13.61%</u>
Net position, end of the year	<u>\$ 13,454,518</u>	<u>11,892,315</u>	<u>1,562,203</u>	<u>13.14%</u>

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 position as of June 30, 2013 amounted to \$13,454,518. Revenue of the Corporation includes legislative appropriations, charges for services which consist of a 1% application fee of the Puerto Rico production expenditures of film projects applying for tax benefits under Act No. 27 and government appropriations related to the collections from the sale and use tax.

For fiscal year 2013, total revenues of the Corporation increased by \$50,379. This increase is mainly due to the effect of an increase in license fee income of approximately \$145,026, due to the increase in film projects, an increase in other revenue of approximately \$9,816 and a decrease in Commonwealth's appropriations to the General Fund of approximately \$104,463. The Corporation's total expenses during the year ended June 30, 2013 decreased by \$3,385,623 when compared with the year ended June 30, 2012. The decrease in the film industry promotion expenses was mainly due to charges to bad debt expense for \$3.3 million in fiscal year 2012.

***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

June 30, 2013

During the year, the Corporation lent approximately \$845,000 to film producers to invest in the production of movies and development of the film industry in Puerto Rico through the various programs of the Puerto Rico Film Fund.

The Corporation has entered into contracts with producers and distributors of films for the purchase of film rights amounting to \$86,886. During the years ended June 30, 2013 and 2012, the Corporation fully reserved the investment in film rights to its net realizable value. Also, during the year ended June 30, 2013, there was a charge to note receivables amounting to approximately \$1 million, presented within film industry promotion expenses in the statement of activities and in the statements of revenues, expenditures and changes in fund balances.

ADMINISTRATIVE FUND BUDGETARY HIGHLIGHTS

During the fiscal year ended June 30, 2013, there was no amendment to the administrative fund original budget. A total variance of (\$183,198) was noted between budget and actual figures.

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, Science and Film Industry of Puerto Rico, PO Box 362350, San Juan, Puerto Rico, 00936-2350.

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**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 Position

June 30, 2013

	Governmental Activities
Assets	
Cash	\$ 915,487
Cash with fiscal agent	11,172,349
Accounts receivable	31,000
Notes receivable, net	563,543
Due from Commonwealth's Treasury Department	593,487
Investment in equity interest	864,501
Total assets	<u>14,140,367</u>
Liabilities and Net Position	
Accounts payable and accrued liabilities	200,403
Due to Puerto Rico Industrial Development Company	323,038
Compensated absences and sick leave obligations	162,408
Total liabilities	<u>685,849</u>
Net Position:	
Restricted for film industry development activities	14,707,355
Deficit	<u>(1,252,837)</u>
Total net position	<u>\$ 13,454,518</u>

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 Position

Year Ended June 30, 2013

	Expenses	Program Revenue		Net (Expense)
		Charges for Services	Operating Grants and Contributions	Revenue and Changes in Net Assets
				Governmental Activities
Functions/Programs				
Governmental Activities:				
General and administrative	\$ 367,222	—	358,537	(8,685)
Film industry promotion	2,153,254	468,002	3,240,000	1,554,748
Total governmental activities	<u>2,520,476</u>	<u>468,002</u>	<u>3,598,537</u>	<u>1,546,063</u>
General Revenue:				
Other revenue				<u>16,140</u>
Total general revenue				16,140
Change in Net Position				1,562,203
Net position - beginning of year				<u>11,892,315</u>
Net position - end of year				<u>\$ 13,454,518</u>

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, 2013

	General	Film Industry Development Funds		Total Governmental Funds
		Act 121	Act 27	
Assets				
Cash	\$ —	913,620	1,867	915,487
Cash with fiscal agent	—	10,257,140	915,209	11,172,349
Due from Commonwealth's Treasury Department	—	565,000	28,486	593,486
Due from Department of Economic Development and Commerce	—	—	31,000	31,000
Due from other funds	—	1,667,763	—	1,667,763
Total assets	\$ —	13,403,523	976,562	14,380,085
Liabilities and Fund Balance				
Accounts payable and accrued liabilities	\$ 26,613	124,211	49,578	200,402
Due to Puerto Rico Industrial Development Company	323,038	—	—	323,038
Due to other funds	365,303	—	1,302,460	1,667,763
Total liabilities	714,954	124,211	1,352,038	2,191,203
Fund balances (deficit):				
Restricted for film industry development activities	—	9,285,770	—	9,285,770
Committed	—	3,993,542	—	3,993,542
Unassigned	(714,954)	—	(375,476)	(1,090,430)
Total fund balances (deficit)	(714,954)	13,279,312	(375,476)	12,188,882
Total liabilities and fund balances	\$ —	13,403,523	976,562	

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

Accrued compensated absences are not due and payable in the current period and, therefore, are not reported in the funds	(162,408)
Notes receivable, net are not current financial resources and, therefore, are not reported in the funds	563,543
Investment in equity interest are not current financial resources and therefore are not reported in the funds	864,501
Net position of governmental activities	\$ 13,454,518

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, 2013

	<u>General</u>	<u>Film Industry Development Funds</u>		<u>Total Governmental Funds</u>
		<u>Act 121</u>	<u>Act 27</u>	
Revenue:				
Legislative appropriations	\$ 358,537	—	—	358,537
Government appropriations	—	3,240,000	—	3,240,000
Charges for services	—	—	468,002	468,002
Other revenue	—	16,102	38	16,140
Total revenues	<u>358,537</u>	<u>3,256,102</u>	<u>468,040</u>	<u>4,082,679</u>
Expenditures:				
Current:				
General and administrative	437,272	—	—	437,272
Film industry promotion	—	1,178,988	534,970	1,713,958
Total expenditures	<u>437,272</u>	<u>1,178,988</u>	<u>534,970</u>	<u>2,151,230</u>
Excess (deficiency) of revenue over (under) expenditures	(78,735)	2,077,114	(66,930)	1,931,449
Fund balance (deficit) at beginning of year	<u>(636,219)</u>	<u>11,202,198</u>	<u>(308,546)</u>	<u>10,257,433</u>
Fund balance (deficit) at end of the year	<u><u>\$ (714,954)</u></u>	<u><u>13,279,312</u></u>	<u><u>(375,476)</u></u>	<u><u>12,188,882</u></u>

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 Balance to the
Statement of Activities – Governmental Funds
Year Ended June 30, 2013*

Amounts recorded for governmental activities in the statement of activities and changes in net position are different because:

Net change in fund balances - total governmental funds \$ 1,931,449

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 decrease in accrued compensated absences. 70,050

Increase in note receivable and investment in equity reported in the statement of net position are not current financial resources and therefore are reported as expenditures in the governmental funds. This amount is the increase in note receivable and investment in equity net of the allowances. (439,296)

Change in net position of governmental activities \$ 1,562,203

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 – General Fund

(Budgetary Basis)

Year Ended June 30, 2013

	<u>Original Budget</u>	<u>Amended Budget</u>	<u>Actual</u>	<u>Variance with Amended Budget</u>
Revenue:				
Legislative appropriations	\$ 463,000	463,000	358,537	(104,463)
Expenditures:				
General and administrative	<u>358,537</u>	<u>358,537</u>	<u>437,272</u>	<u>(78,735)</u>
Excess of revenues over expenditures	<u>\$ 104,463</u>	<u>104,463</u>	<u>(78,735)</u>	<u>(183,198)</u>

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)

Notes to the Basic Financial Statements

June 30, 2013

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 Act Number 121 of August 17, 2001, for the development of the arts and the film industry in Puerto Rico. On March 4, 2011, the Governor of Puerto Rico House of Representatives approved a new Act 27 to replace Act 362 of 1999. This new Act improved the incentives framework available under Act 362.

a. *Government-Wide and Fund Financial Statements*

Government-Wide Financial Statements – The Statement of Net Position, Statement of Activities and Changes in Net Position report information on all activities of the Corporation. All interfund activity has been removed from these statements. Governmental activities generally are financed through intergovernmental revenue, charges for services and other non-exchange revenue. Following is a description of the Corporation's government-wide financial statements:

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

- **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 preceding category. 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 and Changes in Net Position 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 include 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. 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.

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

(A Component Unit of the Commonwealth of Puerto Rico)

Notes to the Basic Financial Statements

June 30, 2013

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.

b. Basis of 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, 2013, has been reported only in the government-wide financial statements.

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.
- **Puerto Rico Film Fund – Act 121** – Is used to account for the proceeds of specific

***Corporation for the Development of the Arts, Science
and Film Industry of Puerto Rico***
(A Component Unit of the Commonwealth of Puerto Rico)
Notes to the Basic Financial Statements
June 30, 2013

revenue sources that are legally restricted to expenditures for activities dedicated to the promotion of the Puerto Rico film industry, specifically excluding administrative expenditures of the Corporation.

- **Film Industry Development Fund – Act 27** – Is used to account for the proceeds of specific revenue sources that can be used to promote, administer and implement Act 27 and for the development of the local film industry in Puerto Rico and/or pay for any administrative or operational expenses of the Corporation.

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 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 and expenditures– 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 3 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 – Restrictions of Fund Balance

Restrictions of fund balance represent portions of fund balances that are legally segregated for a specific future use or are not appropriable for expenditure. The Corporation classifies and report amounts in the appropriate fund balance classification by applying their accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to have been spent. These restrictions of fund balance may include, but not limited to, the following purposes:

- *Film industry development activities* – Represent the fund balance available for future expenditures directed towards promoting the Puerto Rico film industry.

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

(A Component Unit of the Commonwealth of Puerto Rico)

Notes to the Basic Financial Statements

June 30, 2013

Restricted amounts refer to funds from the Puerto Rico Film Fund, which are legally restricted to expenditures for activities dedicated to the promotion of the Puerto Rico film industry, specifically excluding administrative expenditures of the Corporation.

Committed amounts refer to funds from the Puerto Rico Film Fund that have been approved for film project financings or other programs through a decision of the Board of Directors of the Corporation.

Such commitment requires the issuance of a resolution. Those committed amounts cannot be used for any other purpose unless the Corporation removes or changes the specified use by taking the same type of action it employed to previously commit those amounts. If a modification or a cancellation needs to be made to any amount previously committed, an explanatory memorandum needs to be prepared accompanying the amended ordinance or resolution.

Amounts that are constrained by the Corporation's intent to be used for specific purposes, but are not committed, are reported as assigned fund balance. Specifically, the assigned fund balance refers to 15% of the yearly budget of the Puerto Rico Film Fund for the corresponding fiscal year, which may be used for activities dedicated to the promotion of the Puerto Rico film industry, excluding the financing of film projects, as set forth in the regulation of the Puerto Rico Film Fund.

The Corporation reduces restricted amounts, committed amounts, assigned amounts and unassigned amounts at different times depending on the nature of the particular expenditure in question.

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.

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

(A Component Unit of the Commonwealth of Puerto Rico)

Notes to the Basic Financial Statements

June 30, 2013

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, 2013.

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 provided 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 included the valuation of film rights and notes receivable. Actual results could differ from those estimates.

k. Future Adoptions of Accounting Pronouncements

The following new accounting standards were adopted by the Corporation effective July 1, 2012:

- In June 2011, the GASB issued GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Concepts Statement No. 4, *Elements of Financial Statements*, introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. Previous financial reporting standards do not include guidance for reporting these financial statement elements, which are distinct from assets and

***Corporation for the Development of the Arts, Science
and Film Industry of Puerto Rico***
(A Component Unit of the Commonwealth of Puerto Rico)
Notes to the Basic Financial Statements
June 30, 2013

liabilities. There was no impact on the Corporation's financial statement as a result of the implementation of GASB Statement No. 63, except for the changes in the name of the financial statements.

The GASB has issued the following accounting pronouncements that have effective date after June 30, 2013:

- In March 2012 the GASB issued Statement No. 65, *Items Previously as Assets and Liabilities*. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2012.
- In March 2012 the GASB issued Statement No. 66, *Technical Corrections 2012 an amendment of GASB Statements No. 10 and No. 62*. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2012.
- In January 2013, the GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*. The requirements of this Statement are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013.
- In April 2013, the GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. The provisions of this Statement are effective for reporting periods beginning after June 15, 2013.

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

1. Adoption of GASB No. 51

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 of 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. FUNDS DEFICIT AND MANAGEMENT PLAN

As of June 30, 2013, the general fund has a deficit of \$714,954. Such deficit is mainly due to the restatement adjustment in fiscal years 2012 and 2011 related to the cash held by the fiscal agent that the Corporation did not adjust in their accounting records when it was withdrawn by the Treasury Department, its fiscal agent, after the Corporation failed to use such funds at the end of the fiscal year.

***Corporation for the Development of the Arts, Science
and Film Industry of Puerto Rico***
(A Component Unit of the Commonwealth of Puerto Rico)
Notes to the Basic Financial Statements
June 30, 2013

Effective July 1, 2013 the amount of \$104,463 was withdrawn by the Treasury Department after the Corporation failed to use such funds at the end of the fiscal year.

As of June 30, 2013, the Film Industry Development Fund – Act 27 also has a deficit of \$375,476. The deficit is mainly due to excess of expenditures over revenues such as salaries, traveling and miscellaneous expenses.

Management plans for reducing the deficit of the general fund and the Film Industry Development Fund-Act 27 are among other things, to request additional capital resources. Management's plan is to obtain such resources for the Corporation by requesting an increase in the general budget sufficient to meet its minimal operating expenses and seeking equity and/or debt financing. Also, management plans consist of the implementation of various cost-reduction measures. However management cannot provide any assurances that the Corporation will be successful in accomplishing any of its plans.

The ability of the Corporation to cover the deficits are dependent upon its ability to successfully accomplish the plans described in the preceding paragraph and eventually secure other sources of financing and attain profitable operations.

3. 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 excess of revenue over expenditures for the year then ended June 30, 2013, is presented as follow:

Excess of revenue over expenditures - budgetary basis	\$ (78,735)
Plus current year encumbrances which represent budgetary expenditures	26,000
Less current year expenditures against prior year encumbrances	<u>(26,000)</u>
Excess of revenue over expenditures - GAAP basis	\$ <u>(78,735)</u>

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

(A Component Unit of the Commonwealth of Puerto Rico)

Notes to the Basic Financial Statements

June 30, 2013

4. DEPOSITS

The carrying amount and corresponding bank balances of the Corporation at June 30, 2013 amounted to \$12,087,836. This balance is deposited at the Commonwealth's Treasury Department cash and investment pool accounts, which are at the Government Development Bank (GDB), Economic Development bank (EDB) and a commercial bank in the amount of \$10,992,948, \$179,401 and \$915,487, 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 Commonwealths' Treasury Department and EDB , are exempt from compliance with the collateral equipment of the Commonwealth's banking regulations, therefore, these deposits are considered not insured and collateralized.

Interest Rate Risk

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

5. INVESTMENT IN FILM RIGHTS

The Corporation offers eligible film projects financing through the Puerto Rico Film Fund. Such financing is provided, in part, through 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*. Under such agreements the Corporation has the right to license, exploit, reproduce, distribute, subdistribute, 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 licenses 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, 2013, the Corporation recorded a reserve

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

(A Component Unit of the Commonwealth of Puerto Rico)

Notes to the Basic Financial Statements

June 30, 2013

provision to write-down the investment in film rights made during that year amounting to \$86,886 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, 2013.

6. INVESTMENT IN EQUITY INTEREST

The Corporation offers eligible film projects financing through the Puerto Rico Film Fund. Such financing is provided, in part, through investment in equity interests. Such investments have consisted of preferred units owned by the Corporation from the following three Puerto Rico limited liabilities companies engaged in film projects:

Film Producers	Preferred Units	Purchase Price	Amount Purchase	Project
El Acantilado Holding, LLC				
Class A preferred membership interest	1,000,000	\$ 1,000,000	\$ 1,000,000	El Acantilado
The Caller Production, LLC				
Class B preferred units	1,000,000	1,000,000	1,000,000	The Caller
Isla Film Productions, LLC				
Class A membership interest	1,140	1,140,000	798,003	America
200 Cartas Films, LLC				
Class B membership interest	800	800,000	724,499	200 Cartas
Rid 79, LLC				
Class A membership interest	800	800,000	800,000	Riding 79
			4,322,502	
Reserve			(3,458,001)	
Investment in equity interest			\$ 864,501	

The reserve is an amount that management believes will be adequate to absorb possible losses on investment in equity interest that may become unrecoverable.

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

(A Component Unit of the Commonwealth of Puerto Rico)

Notes to the Basic Financial Statements

June 30, 2013

7. NOTES RECEIVABLE

Notes receivable as of June 30, 2013 were as follow:

Note receivables	\$ 9,331,190
Allowance for doubtful account	<u>(8,767,647)</u>
Notes receivable net	<u>\$ 563,543</u>

As of June 30, 2013, notes receivable consists of receivables from film producers. Such amount is non-interest bearing, and an expected settlement date has not being determined.

8. 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 office space in which they are located. The amount due to PRIDCO as of June 30, 2013 amounts to \$323,038.

9. INTERFUND BALANCES

Inter-fund balances as of June 30, 2013 are comprised of amounts due to and from the film industry development funds and the general fund, as shown below:

	General Fund	Film Industry Development Funds		Total
		Act 121	Act 27	
General Fund	\$ —	133,816	231,487	365,303
Act 121	(133,816)	—	(1,533,947)	(1,667,763)
Act 27	<u>(231,487)</u>	<u>1,533,947</u>	<u>—</u>	<u>1,302,460</u>
	<u>\$ (365,303)</u>	<u>1,667,763</u>	<u>(1,302,460)</u>	<u>—</u>

The transactions resulting in the balances shown in the table above are mainly due to payments made by the Act 121 fund on behalf of the general fund and the Act 27 fund as a result of cash shortage in such funds. The general fund inter-fund payable to Act 121 and Act 27 funds amounts to \$365,303 of which \$308,191 comes from previous years. The Act 27 fund inter-fund payable to Act 121 fund amounts to \$1,533,947 of which \$149,533 comes from previous years. Such transactions are non-interest bearing and do not have a formal repayment term. In March 2011, the Corporation transferred \$1,000,000 of funds restricted under Act 121 to be used for activities not allowed under such Act. As of the date of this report, the Corporation has not obtained a waiver from the Legislature of Puerto

***Corporation for the Development of the Arts, Science
and Film Industry of Puerto Rico***
(A Component Unit of the Commonwealth of Puerto Rico)
Notes to the Basic Financial Statements
June 30, 2013

Rico and, therefore such funds may need to be returned to the Commonwealth. Our opinion is not modified with respect to that matter.

10. PENSION PLAN

Employees of the Corporation participate in the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (System). The System is a defined-benefit cost-sharing multi-employer plan sponsored by the Commonwealth 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 case 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 non-occupational disability up to a maximum benefit of 50 percent of the average compensation. However, for non-occupational 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

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

(A Component Unit of the Commonwealth of Puerto Rico)

Notes to the Basic Financial Statements

June 30, 2013

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. Commencing on July 1, 2011, the Corporation is required to contribute 10.275% with annual increases of 1% from July 1, 2012 through June 30, 2016.

The Corporation recognize pension expenditures/expense equal to the employer's contractually required contributions and a liability for unpaid contributions.

Defined Contribution Hybrid Program

On April 4, 2013, the Legislature enacted Act 3 which amended Act 447 and Act 305 to establish, among other things, a defined contribution hybrid program (the Hybrid Program) to be administered by the Retirement System. All regular employees hired for the first time on or after July 1, 2013, and former employees who participated in the defined benefit pension plan and the defined contribution plan, and were rehired on or after July 1, 2013, become members of the Hybrid Program as a

***Corporation for the Development of the Arts, Science
and Film Industry of Puerto Rico***
(A Component Unit of the Commonwealth of Puerto Rico)
Notes to the Basic Financial Statements
June 30, 2013

condition to their employment. In addition, employees who at June 30, 2013, were participants of previous plans will become part of the Defined Contribution Hybrid Program.

Participants in the defined benefit pension plan who as of June 3, 2013, were entitled to retire and receive some type of pension, may retire on any later date and will receive the annuity corresponding to their retirement plan, as well as the annuity accrued under the Hybrid Program. Participants who as of June 30, 2013, have not reach the age of 58 and completed 10 years of service or have not reached the age of 55 and completed 25 years of service can retire depending on the new age limits defined by the Hybrid Program and will receive the annuity corresponding to their retirement plan, as well as the annuity accrued under the Hybrid Program.

Participants in the defined contribution plan who as of June 30, 2013 were entitled to retire because they were 60 years of age may retire on any later date and will receive the annuity corresponding their retirement plan, as well as the annuity accrued under the Hybrid Program. Participants in the Hybrid Program who as of June 30, 2013, has not reached the age of 60 can retire depending on the new age limits defined by the Hybrid Program and will receive the annuity corresponding to their retirement plan, as well as the annuity accrued under the Hybrid Program.

Act 3 requires employees to contribute ten percent (10%) of their monthly gross salary to the Hybrid Program. Employee contributions are credited to individual accounts established under the Hybrid Program. In addition a mandatory contribution equal to or less than point twenty five percent (.25%) is required for the purchase of disability insurance.

The Corporation's contractually required contributions for the years ended June 30, 2013, 2012 and 2011 amounted to approximately \$15,123, \$21,500 and \$17,300, respectively, which represent 100% of the required contributions for such years.

11. 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 one year. Appropriations received during June 30, 2013 amounted to \$358,537.

12. GOVERNMENTAL APPROPRIATIONS

On March 8, 2007, the Governor of the Commonwealth signed Act No. 23, that amended the section 2706 of the Puerto Rico Internal Code (the Code), in which Treasury Department assign \$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 supersedes 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 \$2,675,000

***Corporation for the Development of the Arts, Science
and Film Industry of Puerto Rico***
(A Component Unit of the Commonwealth of Puerto Rico)
Notes to the Basic Financial Statements
June 30, 2013

from the Sales and Use Tax during the fiscal year ended June 30, 2013, while \$540,000 remained receivable at June 30, 2013.

13. CHARGES FOR SERVICES

The Corporation receives the equivalent of a one (1%) percent application fee of the Puerto Rico production expenditures of film projects applying for tax benefits under Act. No.27. During the year ended June 30, 2013 the Corporation received \$468,002 from these arrangements.

14. 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.

15. SUBSEQUENT EVENTS

The Corporation evaluated subsequent events through February 7, 2014, the date on which the financial statements were available to be issued. There were no material subsequent events that would require further disclosure.

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