

***Special Incentives Fund***  
***(A Fund of the Commonwealth of Puerto Rico)***

*Basic Financial Statements as of and for the Year  
Ended June 30, 2010 and Independent Auditors' Report*

***Special Incentives Fund***

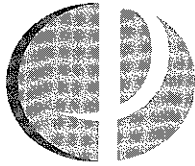
*(A Fund of the Commonwealth of Puerto Rico)*

*Basic Financial Statements as of and for the Year Ended June 30, 2010  
and Independent Auditors' Report*

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**Table of Contents**

	<b>Page</b>
Independent Auditors' Report	1
Management's Discussion and Analysis	2
Basic Financial Statements:	
Statement of Net Assets and Governmental Fund Balance Sheet	6
Statement of Activities and Governmental Fund Revenues, Expenditures and Change in Net Assets	7
Notes to Basic Financial Statements	8



**PARISSI P.S.C.**

Certified Public Accountants, Tax & Business Advisors

## Independent Auditors' Report

To the Board of Directors of the  
Puerto Rico Industrial Development Company  
San Juan, Puerto Rico

We have audited the accompanying basic financial statements of the Special Incentives Fund (the Fund), a fund of the Commonwealth of Puerto Rico, as of and for the year ended June 30, 2010 as listed in the table of contents. These financial statements are the responsibility of the Fund's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

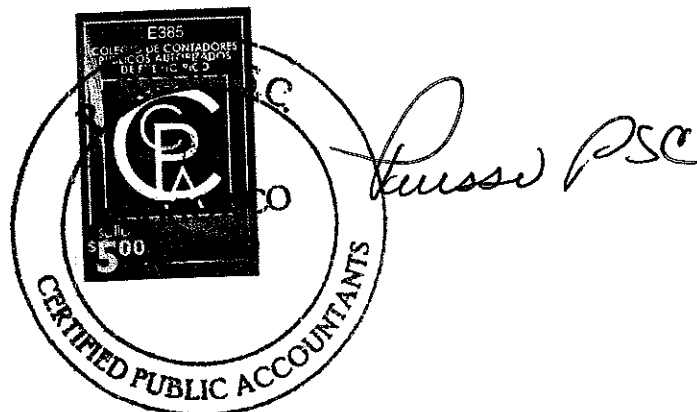
As discussed in Note 1, the financial statements present only the Special Incentives Fund, a fund of the Commonwealth of Puerto Rico, and do not purport to, and do not, present fairly the financial position of the Commonwealth of Puerto Rico as of June 30, 2010, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the government activities for the Special Incentives Fund as of June 30, 2010, and the changes in financial position of those activities for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 2 through 5 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

February 15, 2011

Stamp No. E385 was affixed  
to the original of this report.  
License No. 88 Exp. December 1, 2011



***Special Incentives Fund***  
*(A Fund of the Commonwealth of Puerto Rico)*  
*Management's Discussion and Analysis*  
*Year Ended June 30, 2010*

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Following is an overview and analysis of the financial activities of the Special Incentives Fund (the Fund) for the fiscal years ended June 30, 2010 and 2009.

**Overview of the Financial Statements**

This discussion and analysis is designed to assist the reader in focusing on the significant financial issues and activities and to identify any significant changes in financial position. It is intended to serve as an introduction to the Fund's financial statements, which are comprised of the basic financial statements and the notes to the basic financial statement. We encourage readers to consider the information presented here in conjunction with the financial statements taken as a whole.

**Government Wide Highlights**

The Statement of Net Assets and Governmental Fund Balance Sheet present information on all of the Fund's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Fund is improving or deteriorating. Net assets increase when revenues exceed expenses. Increases to assets without a corresponding increase to liabilities, result in increased net assets, which also indicates an improved financial position.

The Statement of Activities and Governmental Fund Revenues, Expenditures, and Changes in Net Assets present information showing how the Fund's net assets are reported as soon the underlying event occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

**Fund Highlights**

The Fund's financial statements provide more detailed information about the Fund's most current financial resources. Funds are accounting devices that the Fund uses to keep track of specific sources of funding and spending for particular purposes.

The Fund's basic service is included in a governmental fund, which is used to account for essentially the same functions reported as governmental activities in the government-wide statements. However, unlike the government-wide statements, the governmental fund is prepared using the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under this approach, the financial statements focus on near-term inflows and outflows of external resources, as well as on balances of expendable resources available at year end. Consequently, the governmental fund statements provide a detailed short-term view that helps the reader determine whether there are more or fewer financial resources that can be spent in the near future to finance the Fund's programs. Because this information does encompass the additional long-term focus of the government-wide statements, there are no differences between the government-wide and fund statements.

The governmental fund statements focus on only one major fund. The Fund's major fund is the general fund which accounts for the main operating activities of the Fund.

The notes to the basic financial statements provide additional information that is essential to the full understanding of the data provided in the basic financial statements.

**Special Incentives Fund**  
*(A Fund of the Commonwealth of Puerto Rico)*  
*Management's Discussion and Analysis*  
*Year Ended June 30, 2010*

**FINANCIAL ANALYSIS OF THE FUND AS A WHOLE**

The balance sheet and the statement of revenue, expenditures, and changes in net assets present the net assets of and the changes in them. Net assets—the difference between assets and liabilities—is one way to measure financial health or financial position. Increases or decreases in net assets are one indicator of whether its financial health is improving or deteriorating. However, one will need to consider other non-financial factors such as changes in economic conditions and new or changed government legislation.

Net assets – The condensed net asset information is presented as follows (in thousands):

	2010	2009	Change	
			In dollars	Percentage
Current assets	\$ 28,987	36,125	(7,138)	-19.8%
Noncurrent assets	256	3,100	(2,844)	-91.7%
Total assets	<u>29,243</u>	<u>39,225</u>	<u>(9,982)</u>	<u>-25.4%</u>
Liabilities	11,293	11,379	(86)	-0.8%
Net assets				
Restricted	1,854	3,100	(1,246)	-40.2%
Unrestricted	16,096	24,746	(8,650)	-35.0%
Total net assets	<u>17,950</u>	<u>27,846</u>	<u>(9,896)</u>	<u>-35.5%</u>
Total liabilities and net assets	\$ <u>29,243</u>	<u>39,225</u>	<u>(9,982)</u>	<u>-25.4%</u>

**Analysis of Net Assets at June 30, 2010 and 2009**

The Special Incentives Fund (the Fund)(*Fondo de Incentivos Especiales*) is a fund of the Commonwealth of Puerto Rico and it is administered by the Puerto Rico Industrial Development Company (PRIDCO) which is a component unit of the Commonwealth of Puerto Rico. The Fund was created to promote Puerto Rico's economic development through economic incentives awarded to private enterprises.

Total net assets for 2010 decreased by approximately \$9.9 million (-35.5%) mostly as a result of incentives awarded amounting to \$10.8 million.

Current assets consist mainly of certificates of deposit and accounts receivables from incentives repayments of approximately \$28.5 million and \$466 thousand, respectively. Other non-current assets are composed of amount due from PRIDCO of approximately \$256 thousand.

Liabilities remained comparable with prior year balance and decreased by \$86 thousand. Liabilities include amounts due to PRIDCO, the Special Fund for Economic Development (SFED) and to the Rums of Puerto Rico Fund of \$6.4 million, \$3.5 million and \$900 thousand, respectively, mostly for operating purposes.

Restricted net assets consist of the amount withheld as per an incentives agreement which was subject to be reimbursed following compliance with agreement requirements. Decrease of approximately \$1.2

**Special Incentives Fund**  
*(A Fund of the Commonwealth of Puerto Rico)*  
*Management's Discussion and Analysis*  
*Year Ended June 30, 2010*

million corresponds to a partial payment made by the Fund to a grantee in accordance with contract provisions during the year ended June 30, 2010.

The condensed changes in net assets information is presented below (in thousands):

	2010	2009	Change	
			In dollars	Percentage
Operating revenue - intergovernmental	\$ —	5,000	(5,000)	-100.00%
Non-operating revenue:				
Investment recovery	523	—	523	100.00%
Interest income	247	550	(303)	-55.09%
Other	200	3	197	6566.67%
Total revenue	<u>970</u>	<u>5,553</u>	<u>(4,583)</u>	<u>-82.53%</u>
Operating expenses:				
Incentives	6,108	9,766	(3,658)	-37.46%
Capital contributions to PRIDCO	4,735	7,850	(3,115)	-39.68%
Administrative	23	238	(215)	-90.34%
Total expenses	<u>10,866</u>	<u>17,854</u>	<u>(6,988)</u>	<u>-39.14%</u>
Excess of expenses over revenues before transfers and capital contributions	<u>(9,896)</u>	<u>(12,301)</u>	<u>2,405</u>	<u>-19.55%</u>
Transfer in from SFED	—	10,000	(10,000)	-100.00%
Change in net assets	<u>(9,896)</u>	<u>(2,301)</u>	<u>(7,595)</u>	<u>330.07%</u>
Net assets, beginning of year	<u>27,846</u>	<u>30,147</u>	<u>(2,301)</u>	<u>-7.63%</u>
Net assets, end of year	<u>\$ 17,950</u>	<u>27,846</u>	<u>(9,896)</u>	<u>-35.54%</u>

**Analysis of Changes in Net Assets for the Year Ended June 30, 2010 and 2009**

During the year ended June 30, 2010, the Fund did not receive monies from the Commonwealth of Puerto Rico. However, the Fund disbursed industrial incentives amounting to approximately \$6 million, a decrease of approximately \$3.7 million, or 37.5%, during the year ended June 30, 2010.

Incentives disbursed during the year ended June 30, 2009 decreased by approximately \$3.7 million as there were approximately 4 incentives contracts granted by importance which exceeded \$1 million each while there was only one granted during the year ended June 30, 2010. In addition, there were additional incentives granted in the amount of \$4.7 million which were considered capital contributions as they were granted for infrastructure pertaining to PRIDCO.

In addition, the Fund incurred in operational expenses which amounted to approximately \$23 thousand as management elected not to charge administrative fees during the year ended June 30, 2010.

## ***Special Incentives Fund***

*(A Fund of the Commonwealth of Puerto Rico)*

*Management's Discussion and Analysis*

*Year Ended June 30, 2010*

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### **GOVERNMENTAL FUND**

The focus of the Incentive Fund's governmental fund is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Fund's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a Fund's net resources available at the end of a fiscal year.

For the fiscal year ended June 30, 2010, the governmental fund reported ending fund balances of approximately \$17.9 million, a net decrease of \$9.9 million. Total fund balance of \$17.9 million is reserved for commitments or to indicate that is not available for new spending.

### **REQUEST FOR INFORMATION**

This financial report is designed to provide a general overview of the Fund's finances for all those interested parties. Questions concerning any of the information provided in this report or request for additional financial information should be addressed to the Executive Director's Office, Puerto Rico Industrial Development Company, PO Box 362350, San Juan, and Puerto Rico 00936-2350.

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## ***Special Incentives Fund***

*(A Fund of the Commonwealth of Puerto Rico)*

*Statement of Net Assets and Governmental Fund Balance Sheet*

*June 30, 2010*

	<u>General Fund (in thousands)</u>	<u>Adjustments (in thousands)</u>	<u>Statement of Net Assets (in thousands)</u>
<b>Assets</b>			
Current assets:			
Cash and cash equivalents in governmental banks	\$ 21,416	—	21,416
Cash and cash equivalents in commercial banks	110	—	110
Investments	6,995	—	6,995
Accounts receivable repayments, net of allowance for uncollectible amount of \$967,000	466	—	466
	<u>28,987</u>	<u>—</u>	<u>28,987</u>
Noncurrent assets:			
Due from PRIDCO	256	—	256
Total noncurrent assets	<u>256</u>	<u>—</u>	<u>256</u>
Total assets	<u>29,243</u>	<u>—</u>	<u>29,243</u>
<b>Liabilities and Fund Balances/Net Assets</b>			
Current liabilities:			
Accounts payable	470	—	470
Due to PRIDCO	6,423	—	6,423
Due to the Special Fund for Economic Development	3,500	—	3,500
Due to Rums of Puerto Rico Fund	900	—	900
Total liabilities	<u>11,293</u>	<u>—</u>	<u>11,293</u>
Fund balances/Net assets			
Fund balances:			
Reserved	17,950	(17,950)	—
Total fund balances	<u>17,950</u>	<u>(17,950)</u>	<u>—</u>
Total liabilities and fund balances	<u>\$ 29,243</u>		
Net assets:			
Restricted		1,854	1,854
Unrestricted		16,096	16,096
Total net assets		<u>17,950</u>	<u>17,950</u>

See notes to the basic financial statements.



**Special Incentives Fund***(A Fund of the Commonwealth of Puerto Rico)**Statement of Activities and Governmental Fund Revenue, Expenditures and Change in Net Assets  
Year Ended June 30, 2010*

	General Fund (in thousands)	Adjustments (in thousands)	Statement of Activities (in thousands)
Expenditures/expenses:			
Incentives—operations	\$ 6,108	—	6,108
Administrative	23	—	23
Total expenditures/expenses	<u>6,131</u>	<u>—</u>	<u>6,131</u>
General revenue:			
Investment earnings	247	—	247
Incentives recovery	523	—	523
Miscellaneous	200	—	200
Total general revenue	<u>970</u>	<u>—</u>	<u>970</u>
Excess of expenses over revenue before capital contributions and transfer in	<u>(5,161)</u>	<u>—</u>	<u>(5,161)</u>
Capital contribution to PRIDCO	<u>(4,735)</u>	<u>—</u>	<u>(4,735)</u>
Change in net assets	<u>(9,896)</u>	<u>—</u>	<u>(9,896)</u>
Fund balance/net assets:			
Beginning of the year	<u>27,846</u>	<u>—</u>	<u>27,846</u>
End of the year	<u>\$ 17,950</u>	<u>—</u>	<u>17,950</u>

See notes to the basic financial statements.

## ***Special Incentives Fund***

*(A Fund of the Commonwealth of Puerto Rico)*

*Notes to Basic Financial Statements*

*Year Ended June 30, 2010*

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### **1. REPORTING ENTITY**

The Special Incentives Fund (the Fund), was created through Law No. 381 of May 8, 1951, and is a fund of the Commonwealth of Puerto Rico. It is administered by the Puerto Rico Industrial Development Company (PRIDCO) which is a component unit of the Commonwealth of Puerto Rico.

The Fund was created to enhance the Puerto Rico's economic development through economic incentive grants granted to private enterprises. The different types of incentives are described as follows:

- a. ***Quality control*** – granted to conserve, modify and develop the quality of products made in Puerto Rico.
- b. ***Clothing and furniture industries*** – granted to Puerto Rican companies, operating in Puerto Rico, dedicated to the sale of finished goods and manufacture of furniture and clothing.
- c. ***Special incentives*** – consist of grant to compensate for certain costs incurred to establish or expand a company's unit.
- d. ***Importance of the project*** – consists of grant to companies for extraordinary importance projects for the economy of Puerto Rico, as defined by PRIDCO's board.
- e. ***Infrastructure*** – grants to finance projects in certain municipalities which lack of basic facilities to establish an operating manufacturing organization.
- f. ***Location*** – incentives granted by location and the number of persons to be employed.
- g. ***Enhancement*** – special grants for improving grantee's operations in order to avoid stoppage of their activities. The grants can be spent for management, finance, production, marketing and research.
- h. ***Development of the Puerto Rican craftsmanship*** – to help artisans in acquiring materials, tools, equipment and any other goods for the crafts production.
- i. ***Training of manufacturing personnel*** – to develop industrial skills to the management, supervisors and to train manufacturing personnel in its respective jobs.
- j. ***Marketing*** – consist of grant for industrials business advertising and promotion. The promotion includes: booth rent, brochures and graphics designs among others.

The source of funding, each year, is provided by funds transfers from the Commonwealth through the approval of Legislative Resolutions.

***Special Incentives Fund***  
*(A Fund of the Commonwealth of Puerto Rico)*  
*Notes to Basic Financial Statements*  
*Year Ended June 30, 2010*

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**2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accompanying basic financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, as applicable to governmental entities. The following is a summary of significant accounting policies:

***(a) Government Wide and fund financial statements***

The government-wide financial statements report information on all of the activities of the Fund as a whole. The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are specifically associated with a function, which is to provide industrial incentives or grants. Program revenues include (1) nonexchange revenue (legislative appropriations) and (2) interest income from investments.

The fund financial statements provide information about the governmental fund, which is the only fund category.

The statement of net assets presents the Fund's assets and liabilities, with the difference reported as net assets. Net assets are reported in two 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.

***(b) Measurement focus, basis of accounting, and financial statements presentation***

Basis of accounting refers to when the Fund recognizes revenue and expenditures/expenses and the related assets and liabilities and reports them in the financial statements. The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Industrial incentives are recognized as expenditures as soon as all eligibility requirements imposed by the provider have been met.

The governmental fund follows the modified accrual basis of accounting. Under this basis of accounting, revenues are recorded in the accounting period in which they become susceptible to accrual, that is, when they become both measurable and available. Available is defined as expected to be collected within the current period or soon enough thereafter to be used to pay liabilities of the current period. For this purpose, the Fund considers revenue to be available if they are collected within 60 days of the end of the current year-end. Expenditures and related liabilities are generally recorded in the accounting period in which the liability is incurred.

## ***Special Incentives Fund***

*(A Fund of the Commonwealth of Puerto Rico)*

*Notes to Basic Financial Statements*

*Year Ended June 30, 2010*

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In applying the “susceptible to accrual” concept to intergovernmental revenues (incentive grants) pursuant to the Governmental Accounting Standards Board (GASB) Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (the Fund may act as either provider or recipient), the provider should recognize liabilities and expenses and the recipient should recognize receivables and revenue when the applicable eligibility requirements including time requirements, are met. Resources transmitted before the eligibility requirements are met should, under most circumstances, be reported as advances by the provider and deferred revenue by the recipient.

### ***(c) Use of estimates***

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America require the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results may differ from those estimates.

### ***(d) Allowance for uncollectible accounts***

The Fund provides an allowance for possible uncollectible amounts based on an analysis of receivables deemed to be uncollectible. The Fund writes off the balances of those receivables determined by management to be uncollectible.

### ***(e) Reservations of fund balance – governmental funds***

The governmental fund financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditures or (2) legally segregated for a specific future use.

## **3. DUE FROM/(TO)**

Amounts due from PRIDCO represent advances made for short term investments. Amounts due to PRIDCO of approximately \$6.4 million are mainly composed of operating advances and administrative expenditures. Amounts due from PRIDCO of \$256 thousand correspond to certain investments in certificates of deposits.

Prior to June 30, 2004, the Fund received monies from a line of credit established with the Government Development Bank for Puerto Rico (GDB) through an agreement between the bank and PRIDCO, the Fund’s administrator. Therefore, the outstanding balance of the line of credit was recorded in PRIDCO’s books and amounted to approximately \$45 million as of June 30, 2010. Repayments for these notes are to be provided by the Commonwealth through legislative appropriations.

Amounts due to the Special Fund for Economic Development (SFED) and Rums of Puerto Rico Fund, which are funds of the Commonwealth administered by PRIDCO, represent operating advances received of approximately \$3.5 million and \$900 thousand, respectively.

***Special Incentives Fund***  
*(A Fund of the Commonwealth of Puerto Rico)*  
*Notes to Basic Financial Statements*  
*Year Ended June 30, 2010*

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**4. CASH EQUIVALENTS AND RESTRICTED CASH**

As of June 30, 2010, approximately \$21.4 million of the Fund's bank balance was exposed to custodial credit risk, since this amount represents deposits at Government Development Bank for Puerto Rico (GDB) and Economic Development Bank of Puerto Rico (EDB), component units of the Commonwealth that are exempt from collateralization requirements. Custodial credit risk is the risk that, in an event of a bank failure, the Fund's deposits might not be recovered. The Commonwealth requires that public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. Deposits at the GDB and EDB are uninsured and uncollateralized, as these entities, which are component units of the Commonwealth, are exempt from compliance with the collateralization requirement.

Pursuant to the Investment Guidelines for the Commonwealth adopted by GDB, the Fund may invest in obligations of the Commonwealth, obligations of the United States, certificates of deposit, commercial paper and banker's acceptance.

Restricted cash consists of \$1.8 million deposited with a fiscal agent for the payment of a grantee's interest payment obligations, in accordance to industrial development contract clauses which expires on June 30, 2010. Accordingly, the balance is presented as a reservation of fund balance since this balance is not available to as current financial resource, and as restricted net asset in the Statement of Net Asset, as its use is restricted as per respective incentive contract.

**5. INVESTMENTS**

Investment held at June 30, 2010 consisted of the following:

	<u>Date</u>		<u>Face</u>
	<u>Settlement</u>	<u>Maturity</u>	<u>Amount</u>
Certificate of deposit held at EDB	2/25/2010	8/26/2010	6,995

Deposits maintained in EDB are exempt from the collateral requirement established by the Commonwealth and thus represent a custodial credit risk because in the event of EDB's failure, the Commonwealth may not be able to recover the deposits.

**6. COMMITMENTS**

The Fund has entered into various contracts with private enterprises for economic incentive grants to help these enterprises to override any difficulties encountered in the course of operations. The Fund records the liability for these contracts when the applicable eligibility requirements including time requirements, are met. The non-granted portion of these contracts amounted to approximately \$16.1 million and has been presented as a reservation of fund balance as of June 30, 2010.

**7. SUBSEQUENT EVENTS**

On September 22, 2010 the Board of Directors of PRIDCO canceled approximately \$2.8 million of commitments as they concluded that grantees did not comply with the respective requirements.