

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

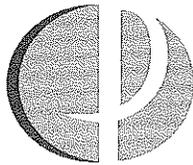
Basic Financial Statements as of and for the Year
Ended June 30, 2009 and Independent Auditors' Report

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

*Basic Financial Statements as of and for the Year Ended June 30, 2009
and Independent Auditors' Report*

Table of Contents

	Page
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, 2009 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.

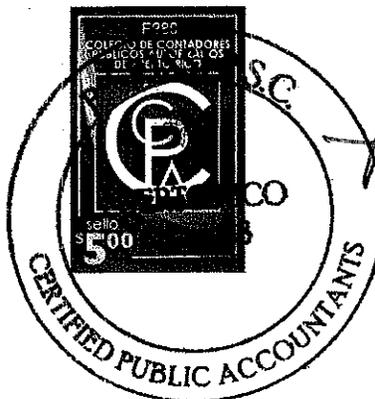
As discussed in Note 1, the financial statements present only the Special Incentives Fund, a fund of the Commonwealth of Puerto Rico, and do not purport to, and do not, present fairly the financial position of the Commonwealth of Puerto Rico as of June 30, 2009, and the changes in its financial position 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, 2009, 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. E386 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, 2009

Following is an overview and analysis of the financial activities of the Special Incentives Fund (the Fund) for the fiscal years ended June 30, 2009 and 2008.

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, 2009

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):

	2009	2008	Change	
			In dollars	Percentage
Current assets	\$ 36,125	37,510	(1,385)	-3.7%
Noncurrent assets	3,356	3,203	153	4.8%
Total assets	<u>39,481</u>	<u>40,713</u>	<u>(1,232)</u>	<u>-3.0%</u>
Liabilities	<u>11,635</u>	<u>10,566</u>	<u>1,069</u>	<u>10.1%</u>
Net assets:				
Restricted	3,100	3,100	—	0.0%
Unrestricted	<u>24,746</u>	<u>27,047</u>	<u>(2,301)</u>	<u>-8.5%</u>
Total net assets	<u>27,846</u>	<u>30,147</u>	<u>(2,301)</u>	<u>-7.6%</u>
Total liabilities and net assets	<u>\$ 39,481</u>	<u>40,713</u>	<u>(1,232)</u>	<u>-3.0%</u>

Analysis of Net Assets at June 30, 2009 and 2008

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 2009 decreased by approximately \$2.3 million (-7.6%) mostly as a result of an increase of approximately \$2.7 million of incentives disbursed.

Current assets consist mainly of certificates of deposit of approximately \$36.1 million, a decrease of \$1.3 million, or 3.7%. Other non-current assets are composed of \$3.1 million of restricted cash held with a trustee as established by an industrial incentive contract requirement.

Liabilities increased by \$813 thousand, or 7.7%, mostly due to an increase in accounts payable of approximately \$636 thousand. Liabilities also include amounts due to PRIDCO, the Special Fund for Economic Development and to the Rums of Puerto Rico Fund of \$6.6 million, \$3.5 million and \$900 thousand, respectively, mostly for operating purposes.

Special Incentives Fund
(A Fund of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis
Year Ended June 30, 2009

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

	2009	As Restated 2008	Change	
			In dollars	Percentage
Operating revenue - intergovernmental	\$ 5,000	10,000	(5,000)	-50.0%
Non-operating revenue:				
Interest income	550	635	(85)	-13.4%
Other	3	50	(47)	-94.0%
Total revenue	<u>5,553</u>	<u>10,685</u>	<u>(5,132)</u>	<u>-48.0%</u>
Operating expenses:				
Incentives	9,766	7,036	2,730	38.8%
Capital contributions to PRIDCO	7,850	1,998	5,852	293%
Administrative	238	459	(221)	-48.1%
Total expenses	<u>17,854</u>	<u>9,493</u>	<u>8,361</u>	<u>88.1%</u>
Excess (deficiencies) of revenues over expenses before transfers and capital contributions	<u>(12,301)</u>	<u>1,192</u>	<u>(13,493)</u>	<u>-1132%</u>
Contributions from PRIIF	—	23,513	(23,513)	-100%
Transfer in SFED	<u>10,000</u>	<u>—</u>	<u>10,000</u>	<u>100%</u>
Change in net assets	<u>(2,301)</u>	<u>24,705</u>	<u>2,359</u>	<u>-10%</u>
Net assets, beginning of year	<u>30,147</u>	<u>5,442</u>	<u>24,705</u>	<u>454.0%</u>
Net assets, end of year	<u>\$ 27,846</u>	<u>30,147</u>	<u>(2,301)</u>	<u>-7.6%</u>

Analysis of Changes in Net Assets for the Year Ended June 30, 2009 and 2008

During the year ended June 30, 2009, the Fund received \$5 million granted by the Commonwealth and disbursed industrial incentives amounting to approximately \$9.7 million, an increase of approximately \$2.7 million, or 38.8%, which is mainly due to the fact that national elections were held during November 2008. In addition, the Fund made capital contributions of approximately \$7.9 million as incentive awards made to companies which lease properties of PRIDCO. Therefore, the Board of Directors of PRIDCO approved a transfer from the Special Fund for Economic Development of \$10 million with the purpose of funding pending incentives commitments.

Incentives disbursed during the year increased by approximately \$2.7 million mostly due to increases in special and importance incentives of \$2 million and \$900 thousand, respectively.

Special Incentives Fund
(A Fund of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis
Year Ended June 30, 2009

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, 2009, the governmental fund reported ending fund balances of approximately \$27.8 million, a net decrease of \$2.3 million mostly due a net effect of contributions received of \$10 million and the excess of expenses over revenues of \$12.3 million. Of total combined fund balances, \$7.3 million constitutes unreserved fund balance of general fund, because the remainder of fund balances, \$20.5 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, 2009*

	General Fund (in thousands)	Adjustments (in thousands)	Statement of Net Assets (in thousands)
Assets			
Current assets:			
Cash and cash equivalents in governmental banks	\$ 3,119	—	3,119
Cash and cash equivalents in commercial banks	18,959	—	18,959
Investments	14,047	—	14,047
Total current assets	<u>36,125</u>	<u>—</u>	<u>36,125</u>
Noncurrent assets:			
Due from PRIDCO	256	—	256
Restricted cash	3,100	—	3,100
Total noncurrent assets	<u>3,356</u>	<u>—</u>	<u>3,356</u>
Total assets	<u><u>39,481</u></u>	<u><u>—</u></u>	<u><u>39,481</u></u>
Liabilities and Fund Balances/Net Assets			
Current liabilities:			
Accounts payable	636	—	636
Due to PRIDCO	6,599	—	6,599
Due to the Special Fund for Economic Development	3,500	—	3,500
Due to Rums of Puerto Rico Fund	900	—	900
Total liabilities	<u>11,635</u>	<u>—</u>	<u>11,635</u>
Fund balances/Net assets			
Fund balances:			
Reserved	20,486	(20,486)	—
Unreserved	7,360	(7,360)	—
Total fund balances	<u>27,846</u>	<u>(27,846)</u>	<u>—</u>
Total liabilities and fund balances	<u>\$ 39,481</u>	<u>—</u>	<u>—</u>
Net assets:			
Restricted	—	3,100	3,100
Unrestricted	—	24,746	24,746
Total net assets	<u>—</u>	<u>\$ 27,846</u>	<u>27,846</u>

See notes to 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, 2009

	General Fund (in thousands)	Adjustments (in thousands)	Statement of Activities (in thousands)
Expenditures/expenses:			
Incentives—operations	\$ 9,766	—	9,766
Administrative	238	—	238
Total expenditures/expenses	<u>10,004</u>	<u>—</u>	<u>10,004</u>
General revenues:			
Intergovernmental	5,000	—	5,000
Investment earnings	550	—	550
Other	3	—	3
Total general revenues	<u>5,553</u>	<u>—</u>	<u>5,553</u>
Excess of expenses over revenues before capital contributions and transfer in	<u>(4,451)</u>	<u>—</u>	<u>(4,451)</u>
Capital contribution to PRIDCO	(7,850)	—	(7,850)
Contribution from SFED	10,000	—	10,000
Change in net assets	<u>(2,301)</u>	<u>—</u>	<u>(2,301)</u>
Fund balance/net assets:			
Beginning of the year	<u>30,147</u>	<u>—</u>	<u>30,147</u>
End of the year	<u>\$ 27,846</u>	<u>—</u>	<u>27,846</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, 2009

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 (the Commonwealth). It is administered by the Puerto Rico Industrial Development Company (PRIDCO) which is a component unit of the Commonwealth.

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, 2009

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, 2009

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) 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 \$6.6 million are mainly composed of operating advances and administrative expenditures \$256 thousand due from PRIDCO in relation to certain investments in certificates of deposits.

Amount 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 \$43 million as of June 30, 2009. 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. The SFED also transferred \$10 million to the Fund in order to cover pending incentives commitments.

The Fund made capital contributions to PRIDCO amounting to approximately \$7.9 million during the year ended June 30, 2009.

Special Incentives Fund

(A Fund of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

Year Ended June 30, 2009

4. CASH EQUIVALENTS AND RESTRICTED CASH

As of June 30, 2009, approximately \$3.1 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 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 \$3.1 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

Investments held at June 30, 2009 consisted of the following:

	<u>Date</u>	<u>Face</u>	
	<u>Settlement</u>	<u>Maturity</u>	<u>Amount</u>
Certificate of deposit held at GDB	4/16/2009	8/20/2009	14,047

Deposits maintained in GDB are exempt from the collateral requirement established by the Commonwealth and thus represent a custodial credit risk because in the event of GDB'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 \$20.5 million and has been presented as a reservation of fund balance as of June 30, 2009.

Special Incentives Fund

(A Fund of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

Year Ended June 30, 2009

7. SUBSEQUENT EVENTS

On November 3, 2009, the Board of Directors of PRIDCO amended the incentives agreement with Ramallo Bros. Printing (the Company) in order to award the Company approximately \$1.2 million for the creation and sustenance of employee positions for the first 5 years. Subsequently, the Fund will perform the same assessment for the next 5 years and determine the amount of the award. The remainder of the restricted cash of \$3.1 million would be withheld by PRIDCO. On December 22, 2009, the Fund paid the Company approximately \$1.2 million in accordance with the amendment.

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