



Kevane

Grant Thornton

Financial Statements and Report of
Independent Certified Public Accountants

Puerto Rico Aqueduct and Sewer Authority

(A Component Unit of the Commonwealth of Puerto Rico)

June 30, 2015 and 2014

Puerto Rico Aqueduct and Sewer Authority (A Component Unit of the Commonwealth of Puerto Rico)

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Report of Independent Certified Public Accountants

To the Board of Directors of
Puerto Rico Aqueduct and Sewer Authority:

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Report on the Financial Statements

We have audited the accompanying financial statements of **Puerto Rico Aqueduct and Sewer Authority** (a component unit of the Commonwealth of Puerto Rico) (“the Authority”), which comprise the balance sheet as of June 30, 2015, and the related statements of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements.

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, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of 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 Authority’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 Authority’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.



Basis for Qualified Opinion

As described in Note 1 to the basic financial statements, the Authority has not implemented the requirements of Statement No. 68 of the Governmental Accounting Standard Board, *Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27* and Statement No. 71, *Pension Transition for contributions Made subsequent to the Measurement Date, an amendment of GASB Statement No. 68*, because the final audited pension information from the Employee Retirement System of the Government of the Commonwealth of Puerto Rico is not readily available. Therefore the Authority has not recorded its proportionate share of net pension obligation, deferred inflow of resources and deferred outflow of resources related to pension cost, and the Authority has not recognized the effect of current period changes in net pension obligation, deferred outflow of resources and deferred inflow of resources as these relate to pension costs for the year ended June 30, 2015.

Accounting principles generally accepted in the United States of America require that pension related liability, deferred outflow of resources, deferred inflow of resources, as applicable, be recognized in accordance with parameters established by Statements No. 68 and No. 71, as well as the effect of current period changes of the aforementioned amounts that must be recognized in pension expense during the current period. Preliminary unaudited estimates made by the Employee Retirement System of the Commonwealth of Puerto Rico indicates a possible additional liability arising from the adoption of this statement of approximately \$1,500 million. Most of the impact affects beginning net position; however, it will also require adjustment to the deferred outflow and inflow of resources, and pension expense.

In addition, the accompanying notes to the basic financial statements do not disclose the pension cost information required by Statement No. 68. In our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.

Qualified Opinion

In our opinion, except for the effects of the matter described above in the Basis for Qualified Opinion and Note Disclosure regarding pension paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of **Puerto Rico Aqueduct and Sewer Authority** as of June 30, 2015 and the respective changes in financial position, and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter Regarding Going Concern

The accompanying financial statements have been prepared assuming that the Authority will continue as a going concern. As discussed in Note 15 to the financial statements, the Authority's significant recurring losses, working capital deficiencies, credit downgrades, large non-discretionary capital expenditure requirement, and lack of market access raise substantial doubt about its ability to continue as a going concern. Management's plans in regards to these matters are also described in Note 15 to the financial statements. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 through 25 and the schedule of funding progress on page 81 be presented to supplement the financial statement. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the 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 inquires of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquires, the financial statements, and other knowledge we obtained during our audit of the 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.

GASB 68 Required Supplementary Information

The Authority did not include the Schedule of the Authority's Proportionate Share of the Net Pension Liability, and the Schedule of Authority's Contributions to the Employees' Pension Plan, information that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements because the final audited pension information from the Employee Retirement System of the Government of the Commonwealth of Puerto Rico is not readily available. Such missing information, although not a part of the basic financial statements, is required to be an essential part of the financial reporting by the Governmental Accounting Standards Board who considers it an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that comprise the Authority's basic financial statements. The supplemental schedule of financial results and debt coverage calculation per the 2012 amended and restated master agreement of trust ("schedule") on page 82 is presented as additional information and is not a required part of the basic financial statements. The schedule is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements and certain additional procedures, including comparing and reconciling financial statements or to the basic financial statements themselves, and other additional procedures in accordance with the auditing standards generally accepted in the United States. In our opinion, the schedule is fairly stated, in all material respects, in relation to the basic financial statements as a whole.



Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated July 22, 2016, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

Prior Period Financial Statements

The financial statements of **Puerto Rico Aqueduct and Sewer Authority** as of June 30, 2014, were audited by other auditors whose report dated March 31, 2015 expressed an unmodified opinion on these statements.

San Juan, Puerto Rico
July 22, 2016.

Kevane Grant Thornton LLP



Puerto Rico Aqueduct and Sewer Authority

(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis

Years Ended June 30, 2015 and 2014

As management of Puerto Rico Aqueduct and Sewer Authority (“the Authority”), we offer readers of the Authority’s annual financial report our discussion and analysis of the Authority’s financial performance during the fiscal years ended on June 30, 2015, 2014 and 2013. Please read it in conjunction with the Authority’s financial statements, which follow this section. Numbers included are rounded to facilitate the readers’ analysis.

Going Concern

GASB Statement No. 56 requires management to evaluate whether there is a substantial doubt about a government’s ability to continue as going concern for twelve months beyond the financial statements date. Information that may indicate substantial doubt as to government’s ability to continue as a going concern includes a government’s inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of governmental operations, restructuring debt, submission to the oversight of a separate financial assistance authority or financial review board, or similar actions.

The discussion in Note 15 to the financial statements provides information regarding the Authority’s financial risks and uncertainties, including liquidity risk, which is the risk of not having sufficient liquid financial resources to meet obligations when they come due. The severity of the risks and uncertainties facing the Authority together with other factors further described in Note 15 to the financial statements and summarized below, have led to conclude that there is substantial doubt as to the ability of the Authority to continue as a going concern.

The Authority is currently experiencing cash flows and financing difficulties. Net position for the years ended June 30, 2015 and 2014 decreased by \$86.1 million and \$41.0 million, respectively. In addition, the Authority working capital deficiencies as of June 30, 2015 and 2014 amounted to \$471 million and \$369 million, respectively. However, the Authority’s restricted cash includes a portion for the payment of current debt of approximately \$250.9 million and \$171.4 million for 2015 and 2014, respectively. In addition, the Authority has not made the quarterly interest and principal payments of the term note payable with the Government Development Bank for Puerto Rico (“GDB”), since December 2015. As of the date of the issuance of the financial statements, the term note has not been declared in default by GDB.

Historically, the Authority’s Construction Improvement Program (“CIP”) has been funded with external financings. As a result of recent setbacks in its attempt to access to the bond market for the issuance of revenue bonds to cover the cost of construction projects included in its CIP, the Authority had been unable to pay certain outstanding contractor obligations and had to suspend or cancel certain ongoing CIP projects. As of June 30, 2015, unpaid CIP contractor obligations were approximately \$150 million, excluding interest and penalties.

On June 30, 2016 the Authority with the acknowledgment and support of the United States Environmental Protection Agency (“EPA”), executed a Forbearance Agreement (the “Forbearance Agreement”) with the Puerto Rico Department of Health (DOH), administrator of the Drinking Water State Revolving Fund Programs, the Commonwealth’s Environmental Quality Board (EQB), administrator of the Clean Water State Revolving Fund Programs (CW-SRF), and the Puerto Rico Infrastructure Financing Authority (“PRIFA”), a public corporation and instrumentality of the Commonwealth, as operating agent for the for the SRFs, authorized to assist the DOH and the EQB in the administration, financial and accounting activities of the SRFs. Under the Forbearance Agreement, the payments due on July 1, 2016 under the SRF Loans are deferred, for a period of six (6) months, which may be extended for an additional six (6) months if certain conditions are met. During the forbearance period, the parties are expected to negotiate new terms and conditions to the SRF Loans under a restructuring of such loans and a revision of underlying agreements.

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Unaudited Management's Discussion and Analysis

Years Ended June 30, 2015 and 2014

The Authority also requested that USDA Rural Development Program provide a short-term forbearance period, which includes deferral of the payment due on July 1, 2016, during which it would refrain from exercising its rights and remedies under the RD Bond documents or grants or loan agreements. To this effect, the Authority and USDA Rural Development Program executed a forbearance document, effective as of June 30, 2016 and granted a three (3) month forbearance period, through September 30, 2016, in order to provide for additional time to examine all options available to correct the Authority's deficiencies and restore loan repayment. For more information refer to Note 15.

Implementation of New Accounting Standard for Pensions

As disclosed in Note 1 to the basic financial statements, the Authority was not able to implement the requirements of Statement No. 68 of the Governmental Accounting Standard Board, Accounting and Financial Reporting for Pensions, (GASB 68). The inability to implement the requirements of GASB 68 is because the Employee Retirement System of the Commonwealth of Puerto Rico (ERS), a pension trust fund of the Commonwealth, has not provided the final audited information. Therefore, the Authority has not recorded its proportionate share of net pension obligation, deferred inflow of resources and deferred outflow of resources related to pension cost, and the Authority has not recognized the effect of current period changes in net pension obligation, deferred outflow of resources and deferred inflow of resources as these relate to pension costs for the year ended June 30, 2015.

Puerto Rico Aqueduct and Sewer Authority

(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis

Years Ended June 30, 2015 and 2014

June 30, 2015 and 2014 Financial Highlights

- The Authority's net position decreased by \$86.1 million to \$2,292.9 million, or 3.6%, which represents a decrease of \$45.1 million when compared to the 2014 decrease in net position of \$41.0 million. The decrease was primarily the net result of a decrease in operating revenues of \$72.9 million, a decrease of total operating expenses, including depreciation and amortization of \$45.2 million, an increase in net non-operating expenses of \$17.5 million, and an increase in capital contributions of \$0.2 million.
- Operating revenues decreased by \$72.9 million to \$1,054.5 million, or 6.5%, mainly due to a reduction of water consumption and a decrease in the numbers of clients served. In addition, the decrease in operating revenues reflects the impact of the implementation of Act 66-2014, which adjusted government rates to the ones in place prior to the latest rate increase and a reduction in billed consumption required for certain governmental clients.
- Operating expenses, including depreciation and amortization, decreased by \$45.2 million to \$939.4 million, or 4.6%, primarily as a result of a decrease in payroll and payroll related expenses of \$26.3, a decrease in other operating expense of \$24.1 million, a decrease in electricity expense of \$18.5 million, a decrease in repairs and maintenance expense of \$5.9 million, netted by an increase in depreciation expense of \$15.7 million, an increase in cost of assets disposition of \$11.0 million, and increase in professional services and materials and replacement expenses of \$2.6 million and \$3.6 million, respectively.
- Non-operating expenses increased by \$17.5 million, or 8.3% to a net expense of \$227.3 million, primarily as a result of an increase of \$20.4 million in interest expense, net of amortization of bond premium and discount, and deferred refunding losses, a decrease of \$1.0 million in other income and an increase of \$4.0 million from commonwealth contributions for interest payments on bonds.

Capital contributions increased by \$0.2 million, or 0.8% to \$26.1 million, primarily as a result of an increase of \$4.3 million in contributions and grants received from the Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Fund, a decrease of \$3.7 million in the USDA Rural Development contributions and a decrease in other contributions of \$0.4 million.

- Total assets and deferred outflows decreased by \$58.5 million to \$8,209.8 million or 0.7%, as result of a decrease in current assets of \$70.0 million, a decrease in restricted assets of \$17.2 million, a decrease of \$4.0 million in deferred outflow of resources on loss from debt refunding and, an increase in Authority's capital assets net of depreciation and amortization of \$32.6 million. Total liabilities increased by \$27.5 million to \$5,916.9 million or 0.5%, primarily as a result of an increase of \$140.4 million in accounts payable and a decrease of \$94.3 million in long-term debt, a decrease of \$16.7 million in accrued liabilities and a decrease of \$2.8 million in accrued interest.

Puerto Rico Aqueduct and Sewer Authority

(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis

Years Ended June 30, 2015 and 2014

June 30, 2014 and 2013 Financial Highlights

- The Authority's net position decreased by \$41.0 million to \$2,378.9 million, or 1.7%, which represents an increase of \$430.1 million when compared to the 2013 decrease in net position of \$471.1 million, as restated. The increase was primarily the net result of an increase in operating revenues of \$391.7 million, a decrease of total operating expenses, including depreciation and amortization of \$55.4 million, an increase in net non-operating expenses of \$22.8 million, and an increase in capital contributions of \$5.7 million.
- Operating revenues increased by \$391.7 million to \$1,127.4 million, or 53.2%, mainly due to the impact of the implementation of a new rate structure on July 15, 2013.

Operating expenses, including depreciation and amortization, decreased by \$55.4 million to \$984.6 million, or 5.3%, primarily as a result of a decrease in the cost of assets disposition of \$85.3 million, a decrease in electricity expenses of \$42.4 million, a decrease in Superaqueduct service contract expense of \$1.7 million and netted by an increase other operating expense of \$34.5 million, an increase in payroll and related expenses of \$19.5 million, an increase in depreciation and amortization expense of \$14.1 million, and an increase in material and replacements expense of \$5.3 million.

- Non-operating expenses increased by \$22.8 million to a net expense of \$209.7 million, primarily as a result of an increase of \$18.7 million in interest expense, net of amortization of bond premium and discount, and deferred refunding losses, a decrease of \$3.0 million in interest income, and a decrease of \$1.1 million in other income.
- Capital contributions increased by \$5.7 million to \$25.9 million, primarily as a result of an increase of \$1.8 million for both, the Rural Development contributions and grants received from the Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Fund, and an increase in other contributions of \$2.4 million.
- Total assets and deferred outflows increased by \$118.7 million to \$8,268.3 million or 1.4%, primarily due to an increase in current assets of \$39.8 million, a decrease in restricted assets of \$22.8 million, an increase in Authority's capital assets net of depreciation and amortization of \$105.4 million and a decrease of \$3.7 million in deferred outflow of resources on debt refunding loss as result of the adoption of the GASB 65. Total liabilities increased by \$159.7 million to \$5,889.3 million or 2.7%, primarily as a result of an increase of \$190.6 million in long-term debt, an increase of \$35.7 million in accrued liabilities, an increase of \$3.0 million in accrued interest, and a decrease in lines of credit of \$81.5 million.

Puerto Rico Aqueduct and Sewer Authority

(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis

Years Ended June 30, 2015 and 2014

Overview of the Financial Statements

This annual report includes the unaudited management's discussion and analysis report, the report of independent certified public accountants, the basic financial statements and the required supplementary information of the Authority. The basic financial statements include notes that explain in more detail the information contained in the basic financial statements.

Required Financial Statements

The financial statements report the financial position and operations of the Puerto Rico Aqueduct and Sewer Authority and its balance sheet as of and for the year ended June 30, 2015, which include a Balance Sheet, Statement of Revenues, Expenses and Changes in Net Position, Statement of Cash Flows and the notes to financial statements.

Financial Analysis of the Authority

The balance sheets and the statement of revenues, expenses, and changes in net position, reports the net position of the Authority and the changes therein. The Authority's net position – the difference between assets and liabilities – can be used to measure its financial health or financial position. Increases or decreases in the Authority's net position are one indicator of whether its financial health is improving or deteriorating. However, other nonfinancial factors need to be considered such as changes in economic conditions and new or changed government regulations.

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis
Years Ended June 30, 2015 and 2014

Analysis of Financial Results

The following table provides a summary of the Authority's net position as of June 30 of the years indicated (in thousands):

	June 30,		Change
	2015	2014	
Current and other assets	\$ 675,783	\$ 762,957	\$ (87,174)
Capital assets, net	7,502,348	7,469,758	32,590
Deferred outflows	31,638	35,598	(3,960)
Total assets and deferred outflows	8,209,769	8,268,313	(58,544)
Long-term debt outstanding	5,213,297	5,312,311	(99,014)
Other liabilities	703,568	577,023	126,545
Total liabilities	5,916,865	5,889,334	27,531
Net position:			
Investment in capital assets, net	2,638,506	2,525,360	113,146
Restricted	27,777	27,050	727
Unrestricted deficit	(373,379)	(173,431)	(199,948)
Total net position	\$ 2,292,904	\$ 2,378,979	\$ (86,075)

	June 30,		Change
	2014	2013 <i>(As restated)</i>	
Current and other assets	\$ 762,957	\$ 745,912	\$ 17,045
Capital assets, net	7,469,758	7,364,353	105,405
Deferred outflows	35,598	39,343	(3,745)
Total assets and deferred outflows	8,268,313	8,149,608	118,705
Long-term debt outstanding	5,312,311	5,121,646	190,665
Other liabilities	577,023	607,937	(30,914)
Total liabilities	5,889,334	5,729,583	159,751
Net position:			
Investment in capital assets, net	2,525,360	2,689,467	(164,107)
Restricted	27,050	82,760	(55,710)
Unrestricted deficit	(173,431)	(352,202)	178,771
Total net position	\$ 2,378,979	\$ 2,420,025	\$ (41,046)

Puerto Rico Aqueduct and Sewer Authority

(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis

Years Ended June 30, 2015 and 2014

Net Position

June 30, 2015 and 2014

The Authority's net position as of June 30, 2015 was approximately \$2,292.9 million. This is a decrease of \$86.1 million from the net position as of June 30, 2014 of \$2,378.9 million.

Total assets and deferred outflows decreased by \$58.5 million during the fiscal year ended June 30, 2015.

Current and other assets decreased by \$87.2 million, mainly due to the effect of a decrease of \$32.3 million in cash and cash equivalents, a decrease of \$21.7 million in accounts receivable, a decrease of \$13.1 million in accounts receivables from Commonwealth, a decrease in restricted cash and cash equivalents of \$17.2 million and a decrease of \$1.5 million in material and supplies inventory.

Restricted cash, unrestricted cash and cash equivalents as of June 30, 2015, decreased by \$49.5 million when compared with June 30, 2014. The decrease is primarily due to the usage of funds for debt service payments.

Capital assets increased by \$32.6 million due to net current year additions of \$332.1 million offset by current year depreciation and amortization of \$274.5 million and cost of assets disposition of \$22.2 million.

Deferred outflows of resources decreased by 4.0 million as a result of the amortization of the period of losses resulting from debt refunding.

Total liabilities increased by \$27.5 million to \$5,916.9 million, or 0.5%. Total current liabilities increased by \$32.1 million mainly as a result of the net effect of an increase of \$140.4 million in accounts payable caused by cash flow adjustments in order to cover payments agreed of \$110 million on the \$200 million credit agreement among the Authority, Oriental Bank and Banco Popular de Puerto Rico (for more details, please refer to Notes Payable on the Debt Administration section of this Management's Discussion and Analysis and Note 11 to the financial statements), as a result there was a decrease of \$89.1 million in the current portion of long term debt. In addition, the Authority had a decrease of \$16.7 million in accrued liabilities, and a decrease in accrued interest of \$2.8 million.

Total non-current liabilities decreased by \$4.5 million, primarily as a result of the net effect of a decrease of \$63.0 million of the noncurrent portion on bond payables as a result of payments of principal on outstanding bonds, a decrease in lines of credit due to the reclassification to current portion of the outstanding balance of \$7.4 million in the \$70 million lines of credit with the Government Development Bank for Puerto Rico (GDB), net of an increase of \$64.5 million on outstanding balance of the Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund. In addition, during fiscal year 2015, the Authority entered into a credit agreement of \$7.5 million with Popular Auto, LLC, which proceeds were used to finance fleet acquisitions under the capital improvements program. Also, compensated absence and postemployment benefits increased by \$3.9 million, and customers' deposits increased by \$ 1.5 million.

Puerto Rico Aqueduct and Sewer Authority

(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis

Years Ended June 30, 2015 and 2014

Net Position - (continued)

June 30, 2014 and 2013

The Authority's net position as of June 30, 2014 was approximately \$2,378.9 million. This is a decrease of \$41.0 million from the restated net position as of June 30, 2013 of \$2,420 million.

Total assets and deferred outflows increased by \$118.7 million during the fiscal year ended June 30, 2014.

Current and other assets increased by \$17.0 million, primarily a net effect of an increase in accounts receivable of \$85.9 million, an increase of \$4.9 million in material and supplies inventory, a decrease of \$56.5 million in cash and cash equivalents, a decrease in accounts receivables from Commonwealth of \$17.0 million and a \$3.7 million decrease in deferred outflows of resources.

Restricted cash and unrestricted cash and cash equivalents as of June 30, 2014, decreased by \$56.5 million when compared with June 30, 2013. The decrease is primarily due to usage of 2013 surplus funds for debt service payments.

Capital assets increased by \$105.4 million due to net current year additions of \$375.0 million offset by current year depreciation and amortization including cost of assets disposition of \$269.9 million.

Deferred outflows of resources decreased by 3.7 million as a result of the amortization of the period of losses resulting from debt refunding.

Total liabilities increased by \$159.7 million to \$5,889.3 million, or 2.7%. Total current liabilities increased by \$129.1 million mainly as a result of the net effect of an increase in the current portion of long term debt of \$163.6 million as a result of the issuance of \$200 million note payable with commercial banks, an increase in accrued liabilities of \$35.7 million, an increase in accrued interest of \$3 million and a decrease of \$73.6 million in account payable.

Total non-current liabilities increased by \$30.7 million, primarily as a result of the net effect of an increase of \$77.6 million of the noncurrent portion in notes payables which includes the outstanding balance of \$72.3 million of the \$150 million line of credit with GDB that was refinanced into an interim loan note payable agreement, the balance outstanding of \$8.2 million in the \$70 million lines of credit with the GDB and the proceeds and payments of the Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund, an increase in compensated absence and postemployment benefits of \$3.3 million, the decrease of \$53.1 million on bonds payable as a result of the payments of principal on outstanding bonds, the payment of \$31 million on 2012 Series B bonds reclassified to current portion, and the implementation of the GASB 65 for the earliest comparative period presented, which requires, the deferred losses from refunding debt to be presented as a deferred outflow of resources instead of a reduction of the outstanding principal balance of long-term debt.

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis
Years Ended June 30, 2015 and 2014

Capital Assets

Capital assets as of June 30, 2015 and 2014 were as follows (in thousands):

	June 30,		Change
	2015	2014	
Capital assets being depreciated	\$ 10,432,316	\$ 10,302,793	\$ 129,523
Accumulated depreciation and amortization	(3,799,439)	(3,555,042)	(244,397)
	6,632,877	6,747,751	(114,874)
Land and other nondepreciable assets	74,100	72,996	1,104
Construction in progress	795,371	649,011	146,360
Capital assets, net	<u>\$ 7,502,348</u>	<u>\$ 7,469,758</u>	<u>\$ 32,590</u>

	June 30,		Change
	2014	2013 <i>(As restated)</i>	
Capital assets being depreciated	\$ 10,302,793	\$ 9,773,405	\$ 529,388
Accumulated depreciation and amortization	(3,555,042)	(3,302,411)	(252,631)
	6,747,751	6,470,994	276,757
Land and other nondepreciable assets	72,996	71,188	1,808
Construction in progress	649,011	822,171	(173,160)
Capital assets, net	<u>\$ 7,469,758</u>	<u>\$ 7,364,353</u>	<u>\$ 105,405</u>

June 30, 2015 and 2014

The net increase of \$32.6 million in capital assets includes additions of \$332.6 million, reduced by \$274.6 million in depreciation and amortization and \$22.2 million in cost of assets disposition. The \$332.6 million in capital investment is broken down as follows:

- \$299.5 million in the Authority's capital improvement program;
- \$33.1 million in renewal and replacement projects;

The Authority has approximately \$795.4 million in construction in progress as of June 30, 2015, and has construction commitments of approximately \$90.7 million.

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis
Years Ended June 30, 2015 and 2014

Capital Assets - (continued)

June 30, 2014 and 2013

The net increase of \$105.4 million in capital assets, as restated, includes additions of \$375.8 million, reduced by \$258.8 million in depreciation and amortization and \$11.1 million in cost of assets disposition. The \$375.8 million in capital investment is broken down as follows:

- \$326.6 million in the Authority's capital improvement program;
- \$48.4 million in renewal and replacement projects;

The Authority had approximately \$649.0 million in construction in progress as of June 30, 2014, and had construction commitments of approximately \$124.2 million.

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis
Years Ended June 30, 2015 and 2014

Debt Administration

Long-term debt for the years ended June 30, 2015 and 2014 was as follows (in thousands):

	June 30,		Change
	2015	2014	
Bonds payable:			
2011 Series A PFC Commonwealth Appropriation Bonds	\$ 90,099	\$ 90,099	\$ -
2011 Series B PFC Commonwealth Appropriation Bonds	102,183	102,183	-
2011 Series B PFC Commonwealth Appropriation Bonds (Superaqueduct)	162,700	162,700	-
2012 Series A PFC Commonwealth Appropriation Bonds	56,247	56,247	-
Revenue Bonds:			
2008 Series A Serial Bonds	54,410	67,960	(13,550)
2008 Series A Convertible Capital Appreciation Bonds	155,975	155,975	-
2008 Series A Term Bonds	1,095,125	1,095,125	-
2008 Series B Serial Bonds	22,445	22,445	-
2008 Series A and B Revenue Refunding Term Bonds	284,755	284,755	-
2012 Series A Serial Bonds	418,455	418,455	-
2012 Series A Term Bonds	1,381,995	1,381,995	-
2012 Series B Serial Bonds	157,095	188,130	(31,035)
2012 Series B Term Bonds	107,115	107,115	-
Rural Development Serial Bonds	388,333	397,000	(8,667)
Plus premium on bonds refunding	26,306	26,817	(511)
Less: bond discounts	(16,038)	(16,217)	179
Total bonds	<u>\$ 4,487,200</u>	<u>\$ 4,540,784</u>	<u>\$ (53,584)</u>

(Continued)

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis
Years Ended June 30, 2015 and 2014

Debt Administration - (continued)

	June 30,		Change
	2015	2014	
Bonds payable	\$ 4,487,200	\$ 4,540,784	\$ (53,584)
Notes payable:			
Water Pollution Control and Drinking Water			
Treatment Revolving Funds Loans	555,391	490,915	64,476
Notes with commercial banks	96,553	200,000	(103,447)
Notes with GDB	66,764	72,363	(5,599)
Total notes payable	718,708	763,278	(44,570)
Lines of credit	7,389	8,249	(860)
Long-term debt outstanding	5,213,297	5,312,311	(99,014)
Other long term liabilities:			
Accrued compensated absences	40,543	41,707	(1,164)
Net OPEB obligation	36,561	32,312	4,249
Customer deposits	84,823	83,154	1,669
Total other liabilities	161,927	157,173	4,754
Total – long-term obligations	5,375,224	5,469,484	(94,260)
Current portion	227,768	317,503	(89,735)
Long-term obligations, less current portion	\$ 5,147,456	\$ 5,151,981	\$ (4,525)

The Authority's long-term debt increased by \$99.0 million from \$5,312.3 million as of June 30, 2014, to \$5,213.3 million as of June 30, 2015.

Bonds Payable

Bonds outstanding as of June 30, 2015 decreased by \$53.6 million, mainly from the payment of principal on 2012 Series B of \$31.0 million and on 2008 Series A Revenue Bonds of \$13.6 million, and the payment of \$8.7 million in principal on Rural Development Bonds. During fiscal year 2015, the Authority did not issue additional bond debt.

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis
Years Ended June 30, 2015 and 2014

Debt Administration - (continued)

June 30, 2015

Notes Payable

As authorized by the Authority's Governing Board's Resolution No. 2796 adopted on July 3, 2013, on October 24, 2013, the Authority entered into a credit agreement (the CIP Credit Agreement), as amended on February 26, 2014, with the Lenders party thereto and Oriental Bank and Banco Popular, financial institutions organized under the laws of the Commonwealth, pursuant to the terms of which the Lenders agreed to make certain advances to the Authority in the aggregate principal amount of up to \$350 million to be repaid on the earliest to occur of (a) March 31, 2015 or (b) three (3) days after the issuance by the Authority of its revenue bonds under the Master Agreement of Trust. This note had an outstanding balance of \$200 million as of June 30, 2014 and was designated by the Authority as Senior Indebtedness pursuant to the terms of the Master Agreement of Trust. On March 4, 2015, the Authority executed an amendment to the CIP Credit Agreement originally executed on October 24, 2013, by and among PRASA, Oriental Bank as Administrative Agent and Banco Popular de Puerto Rico (BPPR) as a Lender. With the execution of this amendment, the local commercial bank syndicate agreed to extend the maturity date on the credit facility granted under the CIP Credit Agreement through May 29, 2015. As a condition to such extension, PRASA agreed to make a principal payment in an aggregate amount of \$50 million. Concurrently with the execution of the amendment, the Authority paid the Lenders \$40 million, reducing the outstanding principal amount of the indebtedness to \$160 million, and agreed to make two additional \$5 million principal payments on April 1, 2015 and May 1, 2015, which were made on their due dates.

On May 29, 2015, the Authority entered into a Credit Agreement with Banco Popular (the "Banco Popular Credit Agreement") pursuant to which Banco Popular made a \$90 million term loan to the Authority for the purpose of refinancing the \$75 million due to such bank under the CIP Credit and providing an additional \$15 million of credit. The Authority applied the \$15 million of net proceeds from the Banco Popular Credit Agreement together with Operating Revenues collected during the month of May 2015, after making other required deposits to the Senior Bond Fund, to pay Oriental its \$75 million portion of the CIP Credit Agreement in full on May 29, 2015. The amounts due under the Banco Popular Credit Agreement are collateralized with an escrow of \$90 million of the Authority's funds that were on deposit in the Rate Stabilization Account of the Surplus Fund under the Master Trust Agreement and will be payable on the earlier of (i) August 31, 2015, (ii) upon the occurrence and continuation of an event of default under the Banco Popular Credit Agreement or (iii) the date of issuance of the 2015A Senior Bonds. The August 31, 2015 due date was extended to September 15, 2015, and on that date the Authority issued \$75 million of its 2015A Senior Bonds under the Master Trust Agreement, as supplemented by a Fifth Supplemental Agreement of Trust, dated as of September 15, 2015 setting the details of such bonds. The proceeds of the purchase of the 2015A Senior Bonds by Merrill Lynch, Pierce, Fenner & Smith Incorporated pursuant to a Bond Purchase Agreement, dated September 15, 2015 were used to repay part of the outstanding balance of a \$90 million term loan extended by Banco Popular under the Banco Popular Credit Agreement. The Banco Popular Credit Agreement balance was then reduced to \$15 million. Both financings were due on November 30, 2015 and on that date, they were extended until February 29, 2016, and fully paid.

Puerto Rico Aqueduct and Sewer Authority

(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis

Years Ended June 30, 2015 and 2014

Debt Administration - (continued)

June 30, 2015 (continued)

As authorized by the Board's Resolution No. 2844, adopted on April 23, 2014, on November 3, 2014, the Authority entered into a credit agreement with Popular Auto, LLC, a limited liability company organized and existing under the laws of the Commonwealth, pursuant to the term of which such institution agreed to make borrowings available to the Authority in the aggregate principal amount of \$7.5 million (the "Fleet Term Loan") to be repaid by November 2, 2017. The Fleet Term Loan was designated by the Authority as Senior Subordinate Indebtedness, Other System Indebtedness and a Refundable Principal Installment pursuant to the terms of the Master Trust Agreement. As of June 30, 2015, the outstanding balance of the Fleet Term Loan was \$6.6 million.

The Authority finances the cost of design and construction of certain capital improvements projects with notes from the Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund programs that bear interest at 2%. As of June 30, 2015, the Authority's loans outstanding under these programs amounted to approximately \$555.4 million, which are considered Commonwealth Guaranteed Indebtedness under the Master Agreement of Trust. These loans increased by \$64.5 million due to the net effect of drawings of \$91.2 million for payment of capital improvements projects and payments of principal outstanding of \$26.8 million.

On February 29, 2012, the Authority entered into a credit agreement with GDB. This agreement provides an available maximum amount of \$150 million for the purpose of assisting with the Authority's cash flows needs during the transition period after amending and restating the Master Agreement of Trust as a result of the issuance of 2012 Revenue Bonds Series A and B. On June 27, 2014, the Authority and GDB executed an Amended and Restated Loan Agreement reducing the line of credit to the outstanding balance as of that date of \$72.3 million and converting the interim loan to a term loan due and payable on March 31, 2019. The term loan has an amortization period of fifteen (15) years, which shall be payable in nineteen (19) quarterly payments, commencing on June 30, 2014, plus a final balloon payment (of such amount as may be the balance then outstanding) on the maturity date. As of June 30, 2015, the outstanding balance was \$66.8 million.

Lines of Credit

The existing \$70.0 million line of credit with GDB used to provide funding for the capital improvement program of the Authority had an outstanding balance as of June 30, 2015 of approximately \$7.4 million.

The \$180.0 million revolving line of credit with GDB for the purpose of financing the operating reserve, required by the Master Agreement of Trust securing its revenue bonds, had no outstanding balance as of June 30, 2015.

Detailed information regarding long-term debt activity is included in Notes 9 through 13 to the financial statements.

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis
Years Ended June 30, 2015 and 2014

Debt Administration - (continued)

June 30, 2014

Bonds Payable

Bonds outstanding as of June 30, 2014 decreased by \$21.2 million, mainly from the payment of principal on 2008 Series A and B Revenue Bonds of \$12.9 million, and the payment of \$8.0 million in principal on Rural Development Bonds. During fiscal year 2014, the Authority did not issued additional bond debt.

Notes Payable

As authorized by the Authority's Governing Board's Resolution No. 2796 adopted on July 3, 2013, on October 24, 2013, the Authority entered into a credit agreement (the Credit Agreement), as amended on February 26, 2014, with the Lenders party thereto and Oriental Bank, a financial institution organized under the laws of the Commonwealth as Administrative Agent for the Lenders, pursuant to the terms of which the Lenders agreed to make certain advances to the Authority in the aggregate principal amount of up to \$350 million to be repaid on the earliest to occur of (a) March 31, 2015 or (b) three (3) days after the issuance by the Authority of its revenue bonds under the Master Agreement of Trust. This note had an outstanding balance of \$200 million as of June 30, 2014 and was designated by the Authority as Senior Indebtedness pursuant to the terms of the Master Agreement of Trust. On March 4, 2015, the Authority executed an amendment to the Credit Agreement originally executed on October 24, 2013, by and among PRASA, Oriental Bank as Administrative Agent and Banco Popular de Puerto Rico (BPPR) as a Lender. With the execution of this amendment, the local commercial bank syndicate agreed to extend the maturity date on the credit facility granted under the Credit Agreement through May 29, 2015. As a condition to such extension, PRASA agreed to make a principal payment in an aggregate amount of \$50 million. Concurrently with the execution of the amendment, the Authority paid the Lenders \$40 million, reducing the outstanding principal amount of the indebtedness to \$160 million, and agreed to make two additional \$5 million principal payments on April 1, 2015 and May 1, 2015. The Authority does not currently have sufficient funds available to fully repay on May 29, 2015, the amount that will be outstanding on that date of \$150 million and is working on a bond issuance scheduled, to be closed prior to the note payable extended due date, to provide funds to cancel the outstanding balance at the date of the transaction, and to finance capital improvement projects. Management has alternative plans to repay the outstanding note payable balance by its due date if the bond issuance is not closed. However, there can be no assurance the projected bond issuance will be closed by the planned date and/or amount, or that management's alternative ways to repay the note or extend its due date will be achieved, such that a default on the note or other obligations that have cross default provisions will be avoided.

The Authority finances the cost of design and construction of certain capital improvements projects with notes from the Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund programs that bear interest at 2%. As of June 30, 2014, the Authority's loans outstanding under these programs amounted to approximately \$490.9 million. These loans increased by \$21.1 million due to the net effect of drawings of \$41.5 million for payment of capital improvements projects and payments of principal outstanding of \$20.4 million.

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis
Years Ended June 30, 2015 and 2014

Debt Administration - (continued)

June 30, 2014 - (continued)

Notes Payable - (continued)

On February 29, 2012, the Authority entered into a line of credit agreement with GDB. This agreement provides an available maximum amount of \$150 million for the purpose of assisting with the Authority's cash flows needs during the transition period after amending and restating the Master Agreement of Trust as a result of the issuance of 2012 Revenue Bonds Series A and B. On June 27, 2014, the Authority and GDB executed an Amended and Restated Loan Agreement reducing the line of credit to the outstanding balance as of that date of \$72.3 million and converting the interim loan to a term loan due and payable on March 31, 2019. The term loan has an amortization period of fifteen (15) years, which shall be payable in nineteen (19) quarterly payments, commencing on June 30, 2014, plus a final balloon payment (of such amount as may be the balance then outstanding) on the maturity date.

Lines of Credit

The existing \$70.0 million line of credit with GDB used to provide funding for the capital improvement program of the Authority had an outstanding balance as of June 30, 2014 of approximately \$8.2 million.

The \$180.0 million revolving line of credit with GDB for the purpose of financing the operating reserve, required by the Master Agreement of Trust securing its revenue bonds, had no outstanding balance as of June 30, 2014.

Detailed information regarding long-term debt activity is included in notes 9 through 13 to the financial statements.

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis
Years Ended June 30, 2015 and 2014

Summary of Revenues, Expenses, and Changes in Net Position

The following table provides a summary of the Authority's changes in net position for the years ended June 30, 2015 and June 30, 2014 (in thousands):

	June 30,		Change
	2015	2014	
Operating revenue:			
Revenues from water and sewer services, net	\$ 1,054,488	\$ 1,127,422	\$ (72,934)
Operating expenses:			
Payroll and payroll related expenses	265,339	291,639	(26,300)
Service contract – Superaqueduct	3,495	3,908	(413)
Professional and consulting services	34,994	32,371	2,623
Chemicals	27,107	28,659	(1,552)
Materials and replacements	21,723	18,085	3,638
Repairs and maintenance of capital assets	39,254	45,134	(5,880)
Electricity	148,267	166,720	(18,453)
Insurance	8,058	9,492	(1,434)
Other operating expenses	94,423	118,614	(24,191)
Operating expenses (excluding depreciation and amortization)	642,660	714,622	(71,962)
Depreciation and amortization	274,573	258,850	15,723
Cost of assets disposed of	22,179	11,143	11,036
Total operating expenses	939,412	984,615	(45,203)
Operating income	115,076	142,807	(27,731)
Nonoperating expenses, net	(227,255)	(209,759)	(17,496)
Loss before capital contributions	(112,179)	(66,952)	(45,227)
Capital contributions	26,104	25,906	198
Change in net position	(86,075)	(41,046)	(45,029)
Net position at beginning of year	2,378,979	2,420,025	(41,046)
Net position at end of year	\$ 2,292,904	\$ 2,378,979	\$ (86,075)

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis
Years Ended June 30, 2015 and 2014

Summary of Revenues, Expenses, and Changes in Net Position - (continued)

The following table provides a summary of the Authority's changes in net position for the years ended June 30, 2014 and 2013, as restated (in thousands):

	June 30,		Change
	2014	2013 <i>(As restated)</i>	
Operating revenue:			
Revenues from water and sewer services, net	\$ 1,127,422	\$ 735,693	\$ 391,729
Operating expenses:			
Payroll and payroll related expenses	291,639	272,092	19,547
Service contract – Superaqueduct	3,908	5,679	(1,771)
Professional and consulting services	32,371	31,575	796
Chemicals	28,659	28,872	(213)
Materials and replacements	18,085	12,731	5,354
Repairs and maintenance of capital assets	45,134	45,214	(80)
Electricity	166,720	209,168	(42,448)
Insurance	9,492	9,493	(1)
Other operating expenses	118,614	84,046	34,568
Operating expenses (excluding depreciation and amortization)	714,622	698,870	15,752
Depreciation and amortization	258,850	244,734	14,116
Cost of assets disposed of	11,143	96,508	(85,365)
Total operating expenses	984,615	1,040,112	(55,497)
Operating income (loss)	142,807	(304,419)	447,226
Nonoperating expenses, net	(209,759)	(186,907)	(22,852)
Loss before capital contributions	(66,952)	(491,326)	424,374
Capital contributions	25,906	20,135	5,771
Change in net position	(41,046)	(471,191)	430,145
Net position at beginning of year, <i>as restated</i>	2,420,025	2,891,216	(471,191)
Net position at end of year	\$ 2,378,979	\$ 2,420,025	\$ (41,046)

Puerto Rico Aqueduct and Sewer Authority

(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis

Years Ended June 30, 2015 and 2014

Summary of Revenues, Expenses, and Changes in Net Position - (continued)

June 30, 2015 and 2014

Net position decreased by \$86.1 million, from \$2,378.9 million in 2014 to \$2,292.9 million in 2015, due to the results of current year operations.

Major fluctuations that resulted in a decrease in net position of \$86.1 million when compared to 2014 operational results are broken down as follows (in thousands):

Decrease in operating revenues	\$	(72,934)
Decrease in operating expenses		45,203
Increase in nonoperating expenses, net		(17,496)
Decrease in capital contributions		198
Other changes		(41,046)
Net change	\$	<u>(86,075)</u>

Operating revenues decreased by \$72.9 million for fiscal year ended June 30, 2015 when compared to fiscal year ended June 30, 2014. The decrease is mainly due to a reduction on the water consumption billed, a decrease in the numbers of clients and the impact of the implementation of Act 66-2014, which adjusted government rates to the ones in place prior to the latest rate increase.

Operating expenses decreased by \$45.2 million primarily due to the net effect of the following:

- Decrease of \$26.3 million in payroll and payroll related expenses.
- Decrease of \$24.1 million in other operating expenses.
- Decrease of \$18.5 million in electricity expense.
- Decrease of \$5.9 million in repairs and maintenance expenses.
- Increase of \$15.7 million in depreciation and amortization expense.
- Increase of \$11.0 million in cost of assets disposition expense.
- Increase of \$3.6 million in materials and replacements expenses.

Non-operating expenses increased by \$17.5 million when compared to fiscal year 2014. This was mainly due to an increase of interest expenses as results of debt interest payments and the amortization of bond premium and discount, and deferred refunding losses by \$20.4 million.

Other income decrease by \$0.9 million and Commonwealth contributions for payments of interest on PFC Bonds increased by \$3.9 million.

Capital contributions increased by \$0.2 million, primarily as a result of an increase of \$4.3 million in contributions and grants received from the Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Fund, a decrease of \$3.7 million in the USDA Rural Development contributions and a decrease in other contributions of \$0.4 million.

Puerto Rico Aqueduct and Sewer Authority

(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis

Years Ended June 30, 2015 and 2014

Summary of Revenues, Expenses, and Changes in Net Position - (continued)

June 30, 2014 and 2013

Net position decreased by \$41.0 million, from \$2,420 million in 2013, as restated, to \$2,378.9 million in 2014, due to the results of current year operations.

Major fluctuations that resulted in a decrease in net position of \$41.0 million when compared to 2013 operational results, as restated, are broken down as follows (in thousands):

Increase in operating revenues	\$	391,729
Decrease in operating expenses		55,497
Increase in nonoperating revenues (expenses), net		(22,852)
Increase in capital contributions		5,771
Other changes		(471,191)
Net change	\$	<u>(41,046)</u>

Operating revenues increased by \$391.7 million for fiscal year ended June 30, 2014 when compared to fiscal year ended June 30, 2013. The increase is mainly due to the impact of the implementation of a new rate structure in July 15, 2013.

Operating expenses decreased by \$55.4 million primarily due to the net effect of the following:

- Decrease of \$85.3 million in cost of assets disposition.
- Decrease of \$42.4 million in electricity expenses.
- Decrease of \$1.7 million in service contract – Superaqueduct.
- Increase of \$34.5 million in other operating expenses.
- Increase of \$19.5 million in payroll and payroll related expenses.
- Increase of \$14.1 million in depreciation and amortization expense.
- Increase of \$5.3 million in materials and replacements expenses.

Non-operating expenses increased by \$22.8 million when compared with previous fiscal year. This is mainly due to the increased of the debt interest payments and the amortization of bond premium and discount, and deferred refunding losses by \$17.9 million. Interest income decreased by \$3.0 million, and other income decreased by \$1.1 million.

Capital contributions increased by \$5.7 million, primarily due to an increase of \$1.8 from both the Rural Development contributions and grants received from The Water Pollution Control Revolving Fund and Puerto Rico Safe Drinking Water Treatment Revolving Fund and, an increase in other contributions of \$2.4 million.

Puerto Rico Aqueduct and Sewer Authority

(An Component Unit of the Commonwealth of Puerto Rico)

Unaudited Management's Discussion and Analysis

Years Ended June 30, 2015 and 2014

Economic Factors, Ratings and Next Year's Budgets

The Puerto Rico Planning Board's reports on the performance of the Puerto Rico economy for fiscal year 2014 indicate that real gross domestic product increased by 1.1% over fiscal year 2013. At current prices, the gross national product for fiscal year 2014 was \$69.2 billion, an increase of 0.6% over fiscal year 2013. The projections for Puerto Rico's real gross national product are estimated at \$6.3 billion for fiscal year 2015, this represent a decrease of 0.9% over fiscal year 2014. At current prices, the gross national product is projected at \$70.1 billion and \$71.0 billion for fiscal years 2015 and 2016, respectively. This represent an increase of 0.5% for fiscal year 2015 and 0.8% in 2016. Real personal income in fiscal year 2014 decreased by 2.6% over fiscal year 2013, for a total of \$9.8 billion, the projections for fiscal year 2015 estimate it at \$9.5 billion and in fiscal year 2016 at \$9.3 billion a decline of 2.9% and 2.6%, respectively. Personal income per capita increased from \$17,755 in fiscal year 2013 to \$17,855 in fiscal year 2014.

According to the Household Survey, the civilian labor force employed in Puerto Rico during fiscal year 2015 averaged 1,138,000, a decrease of 2.1%, compared to the 2014 fiscal year; and the unemployment rate averaged 13%.

Even through the actual economic and fiscal situation in Puerto Rico, the Authority continues with the initiatives to reduce the operating expenses and reinforce the revenue optimization program to increase water and sewer revenues.

On May 2015, the Authority adopted a balanced operational budget for fiscal year 2016. In addition, the Authority's Capital Improvement Program for the fiscal year 2016 is estimated in approximately \$290.8 million.

The credit rating of the Commonwealth and most of its public entities (including the Authority) were recently downgraded. The Authority's Senior Revenue Bonds credit ratings, as of the date of the issuance of the financial statements are "Caa3" by Moody's Investor Services, "CC" by Standard and Poor's Ratings Services and "CC" by Fitch Ratings. As stated by the Rating Agencies, the recent downgrades of the Authority's obligations were a response to the proposed enactment, and subsequently, to the enactment, of the Recovery Act and to the reaction of the Governor's statement that the Commonwealth would need to restructure its debt.

Contacting the Authority's Financial Management

This financial report is designed to provide the Authority's customers and creditors and other interested persons with a general overview of its finances and to demonstrate the Authority's accountability for the funds it receives. If you have questions about this report, or need additional financial information, contact the Director of Finance at 604 Barbosa Avenue, Suite 406, San Juan, Puerto Rico 00917-4310 or (787) 620-3791.

Puerto Rico Aqueduct and Sewer Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Balance Sheets

June 30, 2015 and 2014

(In thousands)

	<u>2015</u>	<u>2014</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 35,686	\$ 67,982
Accounts receivable, net	222,471	244,182
Receivables from federal agencies	2,519	3,326
Receivables from Commonwealth	3,736	16,806
Materials and supplies inventory, net	28,733	30,215
Prepayments and other current assets	<u>4,909</u>	<u>5,483</u>
Total current assets	298,054	367,994
Restricted assets--		
Restricted cash and cash equivalents	377,729	394,963
Capital assets:		
Capital assets being depreciated	10,432,316	10,302,793
Accumulated depreciation and amortization	<u>(3,799,439)</u>	<u>(3,555,042)</u>
	6,632,877	6,747,751
Land and other nondepreciable assets	74,100	72,996
Construction in progress	<u>795,371</u>	<u>649,011</u>
Total capital assets, net	7,502,348	7,469,758
Deferred outflows of resources:		
Deferred loss resulting from debt refunding	31,638	35,598
Total assets and deferred outflows	<u>\$ 8,209,769</u>	<u>\$ 8,268,313</u>

(Continued)

Puerto Rico Aqueduct and Sewer Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Balance Sheets

June 30, 2015 and 2014

(In thousands)

	<u>2015</u>	<u>2014</u>
Liabilities and net position		
Current liabilities:		
Bonds payable	\$ 58,519	\$ 49,077
Notes payable	135,611	241,570
Lines of credit	7,389	-
Accounts payable	283,250	142,845
Accrued liabilities	135,800	152,475
Accrued interest	103,164	105,947
Unearned revenue	19,427	18,583
Customers' deposits	7,053	6,846
Compensated absences and postemployment benefits	19,196	20,010
Total current liabilities	<u>769,409</u>	<u>737,353</u>
Noncurrent liabilities:		
Bonds payable	4,428,681	4,491,707
Notes payable	583,097	521,708
Lines of credit	-	8,249
Customers' deposits	77,770	76,308
Compensated absences and postemployment benefits	57,908	54,009
Total noncurrent liabilities	<u>5,147,456</u>	<u>5,151,981</u>
Total liabilities	<u>5,916,865</u>	<u>5,889,334</u>
Net position:		
Net investment in capital assets	2,638,506	2,525,360
Restricted for environmental compliance, capital activity and other	27,777	27,050
Unrestricted deficit	<u>(373,379)</u>	<u>(173,431)</u>
Total net position	<u>2,292,904</u>	<u>2,378,979</u>
Total liabilities and net position	<u>\$ 8,209,769</u>	<u>\$ 8,268,313</u>

The accompanying notes are an integral part of these balance sheets.

Puerto Rico Aqueduct and Sewer Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2015 and 2014

(In thousands)

	<u>2015</u>	<u>2014</u>
Operating revenues:		
Water	\$ 737,321	\$ 755,937
Sewer	379,737	406,135
Bad debt expense	<u>(62,570)</u>	<u>(34,650)</u>
Total net operating revenues	1,054,488	1,127,422
Operating expenses:		
Payroll and payroll related	265,339	291,639
Service contract – Superaqueduct	3,495	3,908
Professional and consulting services	34,994	32,371
Chemicals	27,107	28,659
Materials and replacements	21,723	18,085
Repairs and maintenance of capital assets	39,254	45,134
Electricity	148,267	166,720
Insurance	8,058	9,492
Other operating expenses	<u>94,423</u>	<u>118,614</u>
Operating expenses (excluding depreciation and amortization)	642,660	714,622
Depreciation and amortization	274,573	258,850
Cost of assets disposition	<u>22,179</u>	<u>11,143</u>
Total operating expenses	<u>939,412</u>	<u>984,615</u>
Operating income	<u>115,076</u>	<u>142,807</u>
Nonoperating revenues (expenses):		
Interest expense, net of amortization of debt issuance cost, bond premium and discount, and deferred refunding loss	(244,545)	(224,162)
Commonwealth contributions for interest payments on bonds and notes	9,817	5,856
Interest income	4,435	4,467
Other income, net	<u>3,038</u>	<u>4,080</u>
Total non-operating expenses, net	<u>(227,255)</u>	<u>(209,759)</u>
Loss before capital contributions	<u>(112,179)</u>	<u>(66,952)</u>
Capital contributions:		
Federal grants and other contributions	26,054	25,906
Other Commonwealth contributions	<u>50</u>	<u>-</u>
Total capital contributions	<u>26,104</u>	<u>25,906</u>
Change in net position	(86,075)	(41,046)
Net position at beginning of year	<u>2,378,979</u>	<u>2,420,025</u>
Net position at end of year	<u>\$ 2,292,904</u>	<u>\$ 2,378,979</u>

Puerto Rico Aqueduct and Sewer Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Statements of Cash Flows
Years Ended June 30, 2015 and 2014

(In thousands)

	2015	2014
Cash flows from operating activities:		
Cash received from customers	\$ 1,078,416	\$ 1,042,411
Cash paid to suppliers	(244,206)	(443,552)
Cash paid to employees	(262,792)	(291,791)
Net cash provided by operating activities	571,418	307,068
Cash flows from noncapital financing activities:		
Payments of notes	(5,599)	-
Net cash from other income	3,038	4,080
Interest paid on notes and lines of credit	(4,550)	(4,342)
Net cash used in noncapital financing activities	(7,111)	(262)
Cash flows from capital and related financing activities:		
Additions to utility plant and other capital assets	(335,326)	(394,587)
Proceeds from capital contributions	26,401	26,265
Proceeds from issuance of notes payable	187,801	241,530
Proceeds from borrowings from lines of credit	94,696	56,601
Payments of bonds and notes	(280,023)	(41,329)
Payments of lines of credit	(95,556)	(65,824)
Interest paid on bonds, notes and lines of credit	(216,265)	(190,478)
Net cash used in capital and related financing activities	(618,272)	(367,822)
Cash flows from investing activities--		
Interest received on investments	4,435	4,467
Net change in cash and cash equivalents	(49,530)	(56,549)
Cash and cash equivalents at beginning of year	462,945	519,494
Cash and cash equivalents at end of year	\$ 413,415	\$ 462,945
For purposes of the statements of cash flows, cash and cash equivalents include:		
Unrestricted	\$ 35,686	\$ 67,982
Restricted	377,729	394,963
	\$ 413,415	\$ 462,945

(Continued)

Puerto Rico Aqueduct and Sewer Authority
(A Component Unit of the Commonwealth of Puerto Rico)

Statements of Cash Flows
Years Ended June 30, 2015 and 2014

(In thousands)

	<u>2015</u>	<u>2014</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 115,076	\$ 142,807
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	274,573	258,850
Cost of assets disposition	22,179	11,143
Bad debt expense	62,570	34,650
Change in assets and liabilities:		
Accounts receivable	(41,155)	(120,973)
Receivables from federal agencies	807	(624)
Materials and supplies inventory	1,482	(4,931)
Prepayments and other current assets	574	894
Accounts payable	146,390	(54,484)
Unearned revenue	844	405
Compensated absences and post employment benefit	3,085	2,648
Accrued liabilities	(16,676)	35,776
Customers' deposits	1,669	907
Total adjustments	<u>456,342</u>	<u>164,261</u>
Net cash provided by operating activities	<u>\$ 571,418</u>	<u>\$ 307,068</u>

Puerto Rico Aqueduct and Sewer Authority

(An Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2015 and 2014

1. Reporting Entity and Summary of Significant Accounting Policies

The Puerto Rico Aqueduct and Sewer Authority (PRASA or the Authority) is a component unit of the Commonwealth of Puerto Rico (the Commonwealth). The Authority was created in 1945 under Act No. 40 (the Act), as amended, and reenacted, for the purpose of owning, operating, and developing all of the public aqueduct and sewer systems in Puerto Rico. The Authority provides water and wastewater services to the Commonwealth, businesses, and residents of Puerto Rico. As a public corporation and an instrumentality of the Commonwealth, the Authority is exempt from the payment of income, property and municipal taxes. Under the terms of the Act, the Authority has broad powers, including, among others, to borrow money and issue revenue bonds for any of its corporate purposes. The Authority receives, in addition to the funds derived from operating its water and wastewater systems, grants from various agencies of the federal government of the United States of America and donations in kind or in cash from developers and various governmental agencies and instrumentalities of the Commonwealth.

Basis of Presentation – Blended Component Unit

The financial statements of the Authority as of June 30, 2015 and 2014, include the financial position and operations of PRASA Holdings, LLC. PRASA Holdings, LLC is a limited liability company incorporated under the laws of the State of Delaware on March 6, 2014. PRASA Holdings, LLC engages in lawful activities, for which limited liability companies may be organized under the Delaware Limited Company Act, subject to the limitations contained in PRASA's enabling act.

As part of the Authority's plan to collect additional revenues to supplement the Authority's Revenues, pursuant to Act No. 228, enacted on November 1, 2011, the Authority has created PRASA Holdings LLC, pursuant to Resolution No. 2826, a public new corporate entity, as a holding company for future investments. PRASA Holdings, LLC is authorized to do business in Puerto Rico. It is the parent company of Zumfiber, LLC, a limited liability company organized for investment purposes, which is also registered in the State of Delaware and is to engage in the development and operation of open access fiber optic infrastructure mainly through the water and wastewater System pipes in the San Juan Metropolitan area neighborhoods of Old San Juan, Condado and Isla Verde.

The optic fiber network will be comprised of a mix of infrastructure elements and will be capable of delivering ultra-high-speed data, video, and voice services providing each customer with access to a bandwidth of 100 Megabits to 1 Gigabyte per second.

The fiber optic infrastructure will be built using, to the extent possible, the Authority's existing assets. It will incorporate planned aesthetic and undisruptive enhancements to complement such assets and to preserve their current operations without interfering with the capacity of the pipelines and sewer services.

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements
June 30, 2015 and 2014

1. Reporting Entity and Summary of Significant Accounting Policies – (continued)

Basis of Presentation – Blended Component Unit – (continued)

The financial information as of June 30, 2015 and for the year then ended for PRASA Holdings, LLC, is as follows:

	<u>2015</u>
	<i>(In thousands)</i>
Balance sheet:	
Assets:	
Cash	\$ 138
Construction in progress	496
Total assets	<u>\$ 634</u>
Liabilities:	
Account payable	\$ 9
Total liabilities	<u>\$ 9</u>
Net position	<u>\$ 625</u>
Statement of revenues, expenditures and change in net position:	
Operating revenues	\$ -
Operating expenses	(125)
	<u>\$ (125)</u>

Summary of Significant Accounting Policies

The accounting and reporting policies of the Authority conform to the accounting rules prescribed by the Governmental Accounting Standards Board (“GASB”). The Authority follows GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* effective July 1, 2012. The Authority functions as an enterprise fund and maintains its accounting records on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles. The following describes the most significant accounting policies followed by the Authority.

Measurement Focus and Basis of Accounting

The Authority’s operations are accounted for on a flow of economic resources measurement focus, using the accrual basis of accounting. Under this method, all assets and liabilities associated with operations are included on the balance sheets, and revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Puerto Rico Aqueduct and Sewer Authority

(An Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2015 and 2014

1. Reporting Entity and Summary of Significant Accounting Policies – (continued)

Measurement Focus and Basis of Accounting– (continued)

Revenues are recorded when utility services are provided to customers. All customers are billed on a monthly basis. Revenues are presented net of estimated allowances for uncollectible accounts. The Authority recognizes revenue on unbilled utility services based on estimated consumption.

The Authority distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services in connection with the Authority's principal ongoing operations. The principal operating revenues of the Authority are charges to customers for water and sewer related sales and services. Operating expenses of the Authority include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Cash and Cash Equivalents

Cash equivalents include all highly liquid instruments with maturities of three months or less at the time of acquisition. If such instruments are included in restricted assets, they are considered cash equivalents for purposes of the statements of cash flows.

The Authority maintains some construction fund accounts related to past bond issuances invested in mutual funds. As of June 30, 2015 and 2014, the account balances amounted to approximately \$3.9 million and \$7.8 million, respectively. The accounts are held under the Puerto Rico Government Investment Trust Fund ("the Trust Fund"), a collective investment trust created by the Secretary of the Treasury of Puerto Rico as settler and the Government Development Bank of Puerto Rico as trustee. The Trust Fund seeks to maintain a constant net asset value per unit of \$1 through investment in high-grade short term money market instruments with a dollar-weighted average portfolio maturity of less than 60 days, including, but not limited to, obligations of the U.S. Government, the Puerto Rico Government, their respective agencies and instrumentalities, repurchase agreements with respect to obligations of the U.S. Government, certificates of deposit, time deposits, bank notes and banker's acceptances issued by the U.S. or Puerto Rico regulated banks, commercial paper and corporate obligations. The Authority can invest, reinvest or redeem units acquired at any time without charge or penalty.

The Trust Fund values its investments on the basis of amortized cost. Although the Trust Fund's policies are designed to help maintain a stable net asset value per unit of \$1.0, all money market instruments can change in value when interest rates or issuers' creditworthiness change, or if an issuer or guarantor of a security fails to pay interest or principal when due. As of June 30, 2015 and 2014, the net asset value per unit of the Trust Fund was \$1.0.

Funds set aside for construction, debt service payments or other specific purposes are classified as restricted assets since their use is limited for these purposes by the applicable agreements.

When both restricted and unrestricted resources are available for a specific use, it is the Authority's policy to use restricted resources first, then unrestricted resources as they are needed.

Puerto Rico Aqueduct and Sewer Authority

(An Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2015 and 2014

1. Reporting Entity and Summary of Significant Accounting Policies – (continued)

Receivables

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined based upon past collection experience and current economic conditions, among other factors.

Materials and Supplies Inventory

Materials and supplies inventory is stated at average cost, not to exceed market. Inventory is presented net of a reserve for obsolescence totaling approximately \$1.1 million and \$1.4 million as of June 30, 2015 and 2014, respectively.

Unamortized Premiums, Discounts and Deferred Refunding Losses

Debt premiums and discounts are deferred and amortized to expense over the life of the related debt using the effective interest method.

The excess of reacquisition costs over the carrying value of refunded long-term debt is deferred and amortized to expense using the effective interest method over the remaining term of the original debt, or the term of the new debt, whichever is shorter.

Bonds payable are reported net of applicable bond premium or discount. The unamortized debt issuance costs are classified as non-operating expenses and the deferred loss from debt refunding as deferred outflows of resources on the accompanying balance sheets.

Capital Assets

The Authority defines capital assets as tangible and intangible assets used in the Authority's operations with a useful life longer than a year, not held for sale and with an individual cost of over \$1,000 for technology hardware and software and over \$2,000 for all other capital assets.

Utility plant and other capital assets are carried at historical cost or estimated historical cost, which includes capitalized labor, materials, administrative costs, and interest on debt financed construction. Interest capitalized by the Authority for the years ended June 30, 2015 and 2014 amounted to approximately \$30.8 million and \$44.0 million, respectively.

Recurring maintenance and repair costs are charged to expense, whereas major repairs, improvements, and replacements are capitalized. When capital assets are disposed of, the cost and applicable accumulated depreciation are removed from the respective accounts, and the resulting gain or loss is recorded as a non-operating expense.

Puerto Rico Aqueduct and Sewer Authority

(An Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2015 and 2014

1. Reporting Entity and Summary of Significant Accounting Policies – (continued)

Capital Assets – (continued)

Depreciation and amortization expense is calculated using the straight-line method over the following useful lives:

Description	Useful Life
Wells and tanks	Fifty (50) years
Vehicles, computers and software, tools and laboratory equipment	Five (5) years
Furniture and fixtures, water meters, construction equipment	Ten (10) years
Water and sewer plants and pump station	Thirty (30) years
Buried infrastructure	Range from fifty (50) to Seventy (70) years
Dams	Seventy (70) years

Construction in progress represents the accumulated costs of various construction projects. If construction plans are abandoned, such costs are expensed.

Unearned Revenue

Unearned revenue arises from advances received from the Commonwealth and other governmental agencies in accordance with a consumption schedule for water and sewer services. Unearned revenue also arises from water and sewer services paid in advance by residential, commercial or industrial customers over periodic billings that are adjusted.

Accounting for Compensated Absences

Employees earn vacation and sick leave based on a prescribed formula. The amount of vacation and sick leave earned and not used by the Authority's employees is accrued as a liability, including payroll related costs, as the benefits are earned by the employees and if the employees' rights to receive compensation are attributable to services already rendered and it is probable that the Authority will compensate the employees for the benefits through paid time off or some other means, such as cash payments at termination or retirement.

The cost of compensated absences expected to be paid in the next twelve months is classified as a current liability while amounts expected to be paid after twelve months are classified as noncurrent liabilities.

Postemployment Health Benefits

The Authority provides certain healthcare benefits for retired employees. Substantially all of the Authority's employees may become eligible for these benefits if they meet the required years of service working for the Authority.

Puerto Rico Aqueduct and Sewer Authority

(An Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2015 and 2014

1. Reporting Entity and Summary of Significant Accounting Policies – (continued)

Postemployment Health Benefits – (continued)

The Authority has the obligation to contribute a maximum of \$125 monthly per retired employee for coverage under the medical plan. The Authority accounts for its postretirement healthcare benefits in accordance with GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*, as detailed in Note 18.

The total cost of healthcare benefits paid to retired employees amounted to approximately \$3.1 million and \$3.0 million for fiscal years 2015 and 2014, respectively.

Pension Benefits

As detailed in Note 17, the Authority's employees participate in the Employees Retirement System of the Government of Puerto Rico ("ERS"), a cost-sharing, multiple-employers defined benefit pension plan. The Authority recognizes annual pension expense equal to its required contribution to the Plan.

Net Position

Net position is reported in three categories:

- ▶ **Net Investment in Capital Assets** – These consist of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets. Debt pertaining to significant unspent debt proceeds is not included in the calculation of net investment in capital assets.
- ▶ **Restricted Net Position** – These result when constraints on the use of net assets are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation. At June 30, 2015 and 2014, the Authority had no assets restricted by enabling legislation.
- ▶ **Unrestricted Net Position** – These consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net position could be designated to indicate that management does not consider certain amounts to be available for general operations. Unrestricted net position often has constraints on resources that are imposed by management that can be removed or modified.

Use of Estimates

Management of the Authority has made a number of estimates and assumptions relating to the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements
June 30, 2015 and 2014

1. Reporting Entity and Summary of Significant Accounting Policies – (continued)

Future Adoption of Accounting Standards

GASB has issued the following accounting standards that the Authority has not yet adopted:

GASB Statement No.	Adoption required in fiscal year
72 Fair Value Measurement and Application	2016
73 Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain provisions of GASB Statements 67 and 68	2017
74 Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans	2017
75 Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions	2017
76 The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments	2017
77 Tax Abatement Disclosures	2017
78 Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans	2017
79 Certain External Investment Pools and Pool Participants	2017
80 Blending Requirements for Certain Component Units—an amendment of GASB Statement No. 14	2018
81 Irrevocable Split-Interest Agreements	2019
82 Pension Issues—an amendment of GASB Statements No. 67, No. 68, and No. 73	2017

Effects of New Pronouncements

The following GASB statements were effective for fiscal year 2015:

GASB No. 69, Government Combinations and Disposal of Government Operations. This statement had no impact on the Authority. Statement No.71, *Pension Transition for Contributions Made Subsequent to the Measurement Date, an Amendment of GASB Statement No.68.* Although applicable to the Authority this statement had no impact on the accompanying basic financial statements because GASB No. 68 was not implemented as further discussed below.

Puerto Rico Aqueduct and Sewer Authority

(An Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2015 and 2014

1. Reporting Entity and Summary of Significant Accounting Policies – (continued)

Effects of New Pronouncements – (continued)

GASB No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, was issued on June 2012. This Statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, and deferred inflows of resources, and expense. For defined benefit pensions, this Statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. In addition, Statement No.68 details the recognition and disclosure requirements for employers with liabilities (payables) to a defined benefit pension plan and for employers whose employees are provided with defined contribution pensions. It also requires the liability of employers and non-employer contributing entities to employees for defined benefit pensions (net pension liability) to be measured as the portion of the present value of projected benefit payments to be provided through the pension plan to current active and inactive employees that is attributed to those employees' past periods of service (total pension liability), less the amount of the pension plan's fiduciary net position. The Authority has not implemented the requirements of this standard due to the information to be provided by the Employee Retirement System of the Commonwealth of Puerto Rico to adopt this Statement is not readily available.

Commonwealth Appropriations

The Authority receives appropriations from the Commonwealth. Appropriations are classified as operating revenues, non-operating revenues and capital contributions as specified in Joint Resolutions approved by the Puerto Rico Legislature. Appropriations to pay for operating expenses are classified as operating revenues. Appropriations to pay for debt service are classified as non-operating revenues and appropriations for capital projects are classified as capital contributions.

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements
June 30, 2015 and 2014

2. Deposits

The carrying amount of deposits with financial institutions of the Authority consisted of the following (in thousands):

	June 30,			
	2015		2014	
	Carrying Amount	Bank Balance	Carrying Amount	Bank Balance
Unrestricted deposits in commercial banks in Puerto Rico	\$ 35,686	\$ 34,494	\$ 67,982	\$ 75,872
Restricted deposits in commercial banks in Puerto Rico	345,654	345,654	359,809	359,809
Restricted deposits in governmental banks:				
GDB	27,971	27,971	31,524	31,524
EDB	4,104	4,104	3,630	3,630
Total	<u>\$ 413,415</u>	<u>\$ 412,223</u>	<u>\$ 462,945</u>	<u>\$ 470,835</u>

Cash and cash equivalents consist of demand deposits, interest-bearing accounts, certificates of deposit, and mutual funds, as described in Note 1.

Custodial Credit Risks Related to Deposits

Pursuant to the laws of the Commonwealth, the Authority's cash is required to be held only in banks designated as depository institutions of public funds by the Commonwealth's Secretary of the Treasury. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico 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.

Custodial credit risk is the risk that, in the event of a bank failure, the Authority's deposits might not be recovered. Deposits maintained at Government Development Bank for Puerto Rico (GDB) and Economic Development Bank for Puerto Rico (EDB) are exempt from the collateral requirements established by the Commonwealth and thus represent a custodial credit risk that in the event of GDB's or EDB's failure, the Authority may not be able to recover these deposits. GDB and EDB are component units of the Commonwealth.

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements
June 30, 2015 and 2014

2. Deposits - (continued)

Custodial Credit Risks Related to Deposits – (continued)

The Authority was exposed to the following custodial credit risk arising from the balance of deposits maintained in governmental banks as follows (in thousands):

	June 30,	
	2015	2014
Uninsured and uncollateralized		
GDB	\$ 27,971	\$ 31,524
EDB	4,104	3,630
	<u>\$ 32,075</u>	<u>\$ 35,154</u>

GDB was declared to be in state of emergency with the signature of executive order EO-2016-010 (“the Executive Order”), in accordance with the emergency powers provided for in Act No. 21. The Executive Order implemented a regulatory framework governing GDB’s operations and liquidity, including establishing a new procedure with respect to governmental withdrawals, payments, and transfer request in respect to funds held on deposit at GDB. The procedures implemented by the Executive Order may result in restrictions on the ability of the Authority to withdraw the funds held on deposit at GDB, which could result in an adverse impact on the Authority’s financial condition, liquidity and results of operations.

3. Accounts Receivable

Accounts receivable are primarily for water and sewer services provided to residential, industrial, commercial and government customers, and consisted of the following (in thousands):

	June 30,	
	2015	2014
Water and sewer services:		
Residential, industrial, and commercial	\$ 645,370	\$ 594,327
Government agencies and municipalities	113,624	124,137
	<u>758,994</u>	<u>718,464</u>
Other receivables:		
Government agencies and municipalities	3,410	3,410
Private entities	29,817	29,192
	<u>33,227</u>	<u>32,602</u>
	<u>792,221</u>	<u>751,066</u>
Less: allowance for uncollectible accounts	<u>(569,750)</u>	<u>(506,884)</u>
Total	<u>\$ 222,471</u>	<u>\$ 244,182</u>

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements
June 30, 2015 and 2014

4. Other Receivables

Receivables from Federal Agencies

Receivables from federal agencies of approximately \$2.5 million and \$3.3 million as of June 30, 2015 and 2014, respectively, consisted primarily of amounts to be received from the U.S. Department of Homeland Security (USDHS) as reimbursement for expenses incurred by the Authority's disaster recovery activities.

Receivables from Commonwealth

Receivables from Commonwealth of approximately \$3.7 million and \$16.8 million as of June 30, 2015 and 2014, respectively, consist of prepaid interest by the Authority on the PFC 2011 Series B Bonds to be reimbursed by the Commonwealth and capitalized interest used by the Commonwealth to pay interest on bonds.

5. Materials and Supplies Inventory

As of June 30, 2015 and 2014, material and supplies inventory consisted of the basic materials needed for the operation and maintenance of the water and sewer system and for the replacement of water meters.

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements
June 30, 2015 and 2014

6. Capital Assets

Utility plant and other capital assets as of June 30, 2015 and 2014 and the changes therein for the years then ended are as follows (in thousands):

	June 30, 2015			Ending Balance
	Beginning Balance	Increases	Decreases	
Capital assets not being depreciated:				
Land	\$ 63,293	\$ 490	\$ -	\$ 63,783
Easement	9,703	614	-	10,317
Construction in progress	649,011	331,501	(185,141)	795,371
Total capital assets not being depreciated	<u>722,007</u>	<u>332,605</u>	<u>(185,141)</u>	<u>869,471</u>
Capital assets being depreciated:				
Infrastructure (water and sewer facilities)	9,147,388	99,754	(33,137)	9,214,005
Wells, tanks and meters	714,680	39,960	(17,848)	736,792
Buildings and improvements	97,768	3,531	-	101,299
Equipment, furniture, fixtures and vehicles	342,957	37,274	(11)	380,220
Total capital assets being depreciated	<u>10,302,793</u>	<u>180,519</u>	<u>(50,996)</u>	<u>10,432,316</u>
Less: accumulated depreciation and amortization:				
Infrastructure (water and sewer facilities)	(3,075,339)	(218,964)	17,161	(3,277,142)
Wells, tanks and meters	(203,652)	(26,332)	13,012	(216,972)
Buildings and improvements	(35,840)	(3,083)	-	(38,923)
Equipment, furniture, fixtures and vehicles	(240,211)	(26,194)	3	(266,402)
Total accumulated depreciation and amortization	<u>(3,555,042)</u>	<u>(274,573)</u>	<u>30,176</u>	<u>(3,799,439)</u>
Total capital assets being depreciated, net	<u>6,747,751</u>	<u>(94,054)</u>	<u>(20,820)</u>	<u>6,632,877</u>
Total capital assets, net	<u>\$ 7,469,758</u>	<u>\$ 238,551</u>	<u>\$ (205,961)</u>	<u>\$ 7,502,348</u>

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements
June 30, 2015 and 2014

6. Capital Assets - (continued)

	June 30, 2014			Ending Balance
	Beginning Balance	Increases	Decreases	
Capital assets not being depreciated:				
Land	\$ 61,983	\$ 1,310	\$ -	\$ 63,293
Easement	9,205	498	-	9,703
Construction in progress	822,171	373,176	(546,336)	649,011
Total capital assets not being depreciated	<u>893,359</u>	<u>374,984</u>	<u>(546,336)</u>	<u>722,007</u>
Capital assets being depreciated:				
Infrastructure (water and sewer facilities)	8,723,157	502,119	(77,888)	9,147,388
Wells, tanks and meters	683,598	34,431	(3,349)	714,680
Buildings and improvements	82,989	14,779	-	97,768
Equipment, furniture, fixtures and vehicles	283,661	59,296	-	342,957
Total capital assets being depreciated	<u>9,773,405</u>	<u>610,625</u>	<u>(81,237)</u>	<u>10,302,793</u>
Less: accumulated depreciation and amortization:				
Infrastructure (water and sewer facilities)	(2,866,449)	(212,759)	3,869	(3,075,339)
Wells, tanks and meters	(179,352)	(26,650)	2,350	(203,652)
Buildings and improvements	(33,563)	(2,277)	-	(35,840)
Equipment, furniture, fixtures and vehicles	(223,047)	(17,164)	-	(240,211)
Total accumulated depreciation and amortization	<u>(3,302,411)</u>	<u>(258,850)</u>	<u>6,219</u>	<u>(3,555,042)</u>
Total capital assets being depreciated, net	<u>6,470,994</u>	<u>351,775</u>	<u>(75,018)</u>	<u>6,747,751</u>
Total capital assets, net	<u>\$ 7,364,353</u>	<u>\$ 726,759</u>	<u>\$ (621,354)</u>	<u>\$ 7,469,758</u>

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements
June 30, 2015 and 2014

7. Restricted Assets

Restricted assets at June 30, 2015 and 2014 consisted of the following:

Construction Funds – Amounts in construction funds represent unspent bond proceeds, which will be used to pay the cost of construction of infrastructure projects. Construction funds are held by the Authority and deposited in GDB and in Banco Popular de Puerto Rico (Trustee Agent).

Capital Activity Funds – Amounts in capital activity funds represent amounts deposited as a result of agreements between Commonwealth agencies and municipalities for construction of infrastructure projects, fines and penalties assessed by EPA that will be used for construction of infrastructure projects to provide water and sewer services and to comply with environmental regulations.

Debt Service Funds – Amounts in debt service funds represent amounts deposited for the payment of principal and interest on bonds and notes. They also include deposits required by the Master Agreement of Trust.

Restricted assets by category consist of (in thousands):

	<u>June 30,</u>	
	<u>2015</u>	<u>2014</u>
Construction funds	\$ 12,428	\$ 65,776
Capital activity funds	19,641	20,991
Debt service funds	345,660	308,196
	<u>\$ 377,729</u>	<u>\$ 394,963</u>

8. Accrued Liabilities

Accrued liabilities consisted of the following (in thousands):

	<u>June 30,</u>	
	<u>2015</u>	<u>2014</u>
Payroll and related accruals	\$ 33,543	\$ 39,382
Legal, labor related and environmental contingencies	77,739	81,158
Contract retentions	24,518	31,935
	<u>\$ 135,800</u>	<u>\$ 152,475</u>

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Notes to Financial Statements
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9. Long-Term Liabilities

Long-term debt activity for the years ended June 30, 2015 and 2014 was as follows (in thousands):

	June 30, 2015					
	Beginning Balance	Additions/ Amortization	Reductions	Ending Balance	Due Within One Year	Due Thereafter
Bonds payable:						
2011 Series A PFC Commonwealth Appropriation Bonds	\$ 90,099	\$ -	\$ -	\$ 90,099	\$ -	\$ 90,099
2011 Series B PFC Commonwealth Appropriation Bonds	102,183	-	-	102,183	-	102,183
2011 Series B PFC Commonwealth Appropriation Bonds (Superaqueduc	162,700	-	-	162,700	-	162,700
2012 Series A PFC Commonwealth Appropriation Bonds	56,247	-	-	56,247	7,316	48,931
2008 Series A Revenue Bonds	1,319,060	-	(13,550)	1,305,510	14,230	1,291,280
2008 Series B Revenue Bonds	22,445	-	-	22,445	-	22,445
2008 Series A Revenue Refunding Bonds	159,055	-	-	159,055	-	159,055
2008 Series B Revenue Refunding Bonds	125,700	-	-	125,700	-	125,700
2012 Series A Revenue Bonds	1,800,450	-	-	1,800,450	32,075	1,768,375
2012 Series B Revenue Bonds	295,245	-	(31,035)	264,210	-	264,210
Rural Development Serial Bonds	397,000	-	(8,667)	388,333	4,548	383,785
Sub total bonds	<u>4,530,184</u>	<u>-</u>	<u>(53,252)</u>	<u>4,476,932</u>	<u>58,169</u>	<u>4,418,763</u>
Add: bond premium	26,817	-	(511)	26,306	540	25,766
Less: bond discount	(16,217)	-	179	(16,038)	(190)	(15,848)
Total bonds	<u>4,540,784</u>	<u>-</u>	<u>(53,584)</u>	<u>4,487,200</u>	<u>58,519</u>	<u>4,428,681</u>
Notes payable:						
Water Pollution Control and Safe Drinking Water Treatment						
Revolving Funds Loans	490,915	91,248	(26,772)	555,391	38,351	517,040
Notes with commercial banks	200,000	97,496	(200,943)	96,553	92,405	4,148
Notes with GDB	72,363	-	(5,599)	66,764	4,855	61,909
Total notes	<u>763,278</u>	<u>188,744</u>	<u>(233,314)</u>	<u>718,708</u>	<u>135,611</u>	<u>583,097</u>
Lines of credit	8,249	94,696	(95,556)	7,389	7,389	-
Other long-term liabilities:						
Accrued compensated absences	41,689	12,977	(14,142)	40,524	12,105	28,419
Net OPEB obligation	32,330	7,091	(2,841)	36,580	7,091	29,489
Customers' deposits	83,154	10,787	(9,118)	84,823	7,053	77,770
Total other liabilities	<u>157,173</u>	<u>30,855</u>	<u>(26,101)</u>	<u>161,927</u>	<u>26,249</u>	<u>135,678</u>
Total – long-term obligations	<u>\$ 5,469,484</u>	<u>\$ 314,295</u>	<u>\$ (408,555)</u>	<u>\$ 5,375,224</u>	<u>\$ 227,768</u>	<u>\$ 5,147,456</u>

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Notes to Financial Statements
June 30, 2015 and 2014

9. Long-Term Liabilities - (continued)

	June 30, 2014					
	Beginning Balance	Additions/ Amortization	Reductions	Ending Balance	Due Within One Year	Due Thereafter
Bonds payable:						
2011 Series A PFC Commonwealth Appropriation Bonds	\$ 90,099	\$ -	\$ -	\$ 90,099	\$ -	\$ 90,099
2011 Series B PFC Commonwealth Appropriation Bonds	102,183	-	-	102,183	-	102,183
2011 Series B PFC Commonwealth Appropriation Bonds (Superaqueduc)	162,700	-	-	162,700	-	162,700
2012 Series A PFC Commonwealth Appropriation Bonds	56,247	-	-	56,247	-	56,247
2008 Series A Revenue Bonds	1,331,965	-	(12,905)	1,319,060	13,550	1,305,510
2008 Series B Revenue Bonds	22,445	-	-	22,445	-	22,445
2008 Series A Revenue Refunding Bonds	159,055	-	-	159,055	-	159,055
2008 Series B Revenue Refunding Bonds	125,700	-	-	125,700	-	125,700
2012 Series A Revenue Bonds	1,800,450	-	-	1,800,450	-	1,800,450
2012 Series B Revenue Bonds	295,245	-	-	295,245	31,035	264,210
Rural Development Serial Bonds	405,064	-	(8,064)	397,000	4,159	392,841
Sub total bonds	4,551,153	-	(20,969)	4,530,184	48,744	4,481,440
Add: bond premium	27,302	-	(485)	26,817	512	26,305
Less: bond discount	(16,386)	-	169	(16,217)	(179)	(16,038)
Total bonds	4,562,069	-	(21,285)	4,540,784	49,077	4,491,707
Notes payable:						
Water Pollution Control and Safe Drinking Water Treatment						
Revolving Funds Loans	469,743	41,530	(20,358)	490,915	35,501	455,414
Notes with GDB	-	72,363	-	72,363	6,069	66,294
Notes with commercial banks	-	200,000	-	200,000	200,000	-
Total notes	469,743	313,893	(20,358)	763,278	241,570	521,708
Lines of credit	89,835	56,601	(138,187)	8,249	-	8,249
Other long-term liabilities:						
Accrued compensated absences	43,136	15,436	(16,883)	41,689	12,918	28,771
Net OPEB obligation	28,141	7,091	(2,902)	32,330	7,092	25,238
Early retirement obligation	93	-	(93)	-	-	-
Customers' deposits	82,247	10,110	(9,203)	83,154	6,846	76,308
Total other liabilities	153,617	32,637	(29,081)	157,173	26,856	130,317
Total – long-term obligations	\$ 5,275,264	\$ 403,131	\$ (208,911)	\$ 5,469,484	\$ 317,503	\$ 5,151,981

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10. Bonds Payable

Bonds payable consisted of the following (in thousands):

	June 30,	
	2015	2014
PFC Commonwealth Appropriation Bonds:		
Series 2011:		
Series A, 6.50%, due in semiannual interest payments through August 1, 2028 and annual principal installments from August 1, 2027 to 2028	\$ 90,099	\$ 90,099
Series B, 5.50% - 6.00% due in semiannual interest payments through August 1, 2031 and annual principal installments from August 1, 2024 to 2031	102,183	102,183
Series B - Superaqueduct, 5.50% - 6.00% due in semiannual interest payments through August 1, 2031 and annual principal installments from August 1, 2024 to 2031	162,700	162,700
Series 2012:		
Series A, 3.10% - 5.35%, due in monthly interest payments through August 1, 2031 and annual principal installments from August 1, 2015 to 2031	56,247	56,247
Revenue Refunding Bonds:		
Series 2008:		
Series A and B, Term Bonds, 5.80% – 6.10%, due in monthly interest payments through July 1, 2034 and annual principal payments from July 1, 2021 to 2034	284,755	284,755
Revenue bonds:		
Series 2008:		
Series A, Serial Bonds, 5.00%, due in semiannual interest payments through July 1, 2025 and annual principal payments from July 1, 2012 to July 1, 2025	54,410	67,960
Series A, Convertible Capital Appreciation Bonds, 6.125%, due in semiannual interest payments from January 1, 2012 through July 1, 2024 and annual principal payments from July 1, 2017 to 2024	155,975	155,975

(Continued)

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Notes to Financial Statements
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10. Bonds Payable - (continued)

	June 30,	
	2015	2014
Series A, Term Bonds, 5.00% - 6.00%, due in semiannual interest payments through July 1, 2027 and annual principal payments from July 1, 2026 to 2047	1,095,125	1,095,125
Series B, Serial Bonds, 6.15% due in monthly interest interest payments through July 1, 2038 and one principal payment on July 1, 2038	22,445	22,445
Series 2012:		
Series A, Serial Bonds, 4.00% - 5.55%, due in semiannual interest payments through July 1, 2030 and annual principal payments from July 1, 2015 to July 1, 2030	418,455	418,455
Series A, Term Bonds, 5.00% - 6.00%, due in semiannual interest payments through July 1, 2047 and annual principal payments from July 1, 2033 to July 1, 2047	1,381,995	1,381,995
Series B, Serial Bonds, 3.35% - 5.00%, due in semiannual interest payments through July 1, 2023 and annual principal payments from July 1, 2014 to July 1, 2023	157,095	188,130
Series B, Term Bonds, 5.35%, due in semiannual interest payments through July 1, 2027 and one principal payment on July 1, 2027	107,115	107,115
Rural development serial bonds:		
Serial Bonds, 2.00% - 5.00%, due semiannually through July 1, 2050	388,333	397,000
Subtotal	<u>4,476,932</u>	<u>4,530,184</u>
Bond premium	26,306	26,817
Bond discount	<u>(16,038)</u>	<u>(16,217)</u>
Total	<u>\$ 4,487,200</u>	<u>\$ 4,540,784</u>

Act 164 PFC Bonds

The PFC Bonds are limited obligations of Public Financing Corporation payable solely from the proceeds of principal and interest on certain promissory notes. On December 17, 2001, Act No. 164 ("Act 164") of the Commonwealth authorized to issue to PFC by certain departments, agencies, instrumentalities, and public corporations (the "Authorized Debtors") of the Commonwealth, including the Authority, Notes which are payable solely from budgetary appropriations approved annually by the Legislature of Puerto Rico pursuant to certain legislations. The proceeds were used to restructure outstanding obligations with GDB.

Puerto Rico Aqueduct and Sewer Authority

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Notes to Financial Statements

June 30, 2015 and 2014

10. Bonds Payable - (continued)

Act 164 PFC Bonds - (continued)

The Appropriations Acts require the office of Management and Budget of the Commonwealth (“OMB”) to include the amounts required to pay debt service on the Notes in the proposed annual budget of the Commonwealth submitted by the Governor to the Legislature of Puerto Rico. However, the Legislature of Puerto Rico is not legally required to appropriate funds for such payments. The non-appropriations of funds for payments on the Notes resulted in a lack of proceeds available under the Notes to pay principal and interest due on the PFC Bonds. The Debt Service of the PFC is payable solely from the proceeds of the Notes, and the PFC Bonds are limited obligations of PFC and not of any Commonwealth entity.

As of June 30, 2007, the Authority’s share of the Act 164 PFC Bonds was approximately \$721.3 million.

On July 31, 2007, December 20, 2007 and June 26, 2008, the Puerto Rico Sales Tax Financing Corporation (known as COFINA), issued its Sales Tax Revenue Bonds Series 2007A and 2007B, Series 2007C and Series 2008A, respectively, to refinance certain of the Act 164 PFC Bonds outstanding and the corresponding notes issued by PFC by certain of the Commonwealth’s agencies and component units (including the Authority). The Series 2007A and B proceeds were deposited in escrow with The Bank of New York/Mellon as master escrow agent. As a result, approximately \$180.2 million of the Authority’s share of the Act 164 PFC Bonds were considered defeased. The proceeds of the Series 2007C Bonds were used, in part, to purchase and cancel approximately \$61.4 million of the Authority’s share of the Act 164 PFC Bonds. The proceeds of the Series 2008A Bonds were used to purchase and cancel approximately \$127.4 million of the Authority’s share of the Act 164 PFC Bonds. After the COFINA debt refunding, the balance was reduced to approximately \$369.0 million.

On August 18, 2011, December 8, 2011 and June 28, 2012, PFC issued 2011 Series A, 2011 Series B and 2012 Series A Refunding Bonds for the amount of \$242.4 million, \$437.6 million, and \$410.6 million, respectively for the purpose of refunding its outstanding bonds. The net proceeds from the refunding bonds, after payment of the cost of issuance and bond premium, were used to advance refund PFC’s previously issued bonds in order to obtain lower interest rates.

The Authority’s share of 2011 Series A, 2011 Series B and 2012 Series A PFC Refunding Bonds of approximately \$90.1 million, \$264.9 million and \$56.2 million, respectively, is included in the Authority’s balance sheets at June 30, 2015 and 2014.

On December 13, 2011 COFINA, issued its Sales Tax Revenue Bonds Series 2011C, to refinance certain of the Act 164 PFC bonds outstanding and the corresponding notes issued by PFC by certain of the Commonwealth’s agencies and component units, (including the Authority). As a result of this issuance, approximately \$121.5 million of the Authority’s share of the Act 164 PFC Bonds were considered defeased.

As of June 30, 2011, the Authority’s share of the Act 164 PFC Bonds was approximately \$341.6 million. As of June 30, 2012, after 2011 Series A and B, 2012 Series A PFC Refunding Bonds and COFINA 2011 Series C Refunding Bonds there was no outstanding balance of Act 164 PFC Bond.

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Notes to Financial Statements

June 30, 2015 and 2014

10. Bonds Payable - (continued)

2004 Series A PFC Refunding Bonds

On June 28, 2004, PFC restructured debt related to 2001 Series A and B Bonds. As a result of this refunding process, \$326.8 of 2004 Series A and B Bonds were issued and \$321.4 million from 2001 Series A Bonds were reduced. On December 8, 2011, PFC issued 2011 Series B Refunding Bond for the amount of \$437.6 million, for the purpose of refunding a portion of certain of its 2004 Series A outstanding bonds. The Authority's share of the 2011 Series B Refunding Bonds is approximately \$162.7 million.

On December 13, 2011, COFINA issued its 2011 Series C Sales Tax Revenue Bonds, to refinance certain of the 2004 Series A PFC bonds outstanding. As a result of this issuance, the outstanding balance of approximately \$195.1 million of the 2004 Series A PFC Bonds were considered defeased.

As of June 30, 2011, the Authority's share of the 2004 Series A PFC Bonds was approximately \$326.8 million. As of June 30, 2012, the total outstanding balance of \$326.8 million was in part refunded with 2011 Series B PFC Refunding Bonds and in part defeased with COFINA 2011 Series C Sales Tax Revenue Refunding Bonds, as a result there was no outstanding balance of 2004 Series A and B PFC Bonds.

2011 Series A and B and 2012 Series A PFC Refunding Bonds

On August 18, 2011, December 8, 2011 and June 28, 2012 PFC issued 2011 Series A, 2011 Series B and 2012 Series A Refunding Bonds for the amount of \$242.4 million, \$437.6 million, and \$410.6 million, respectively.

The net proceeds from the refunding bonds, after payment of the cost of issuance and bond premium, were used to advance refund a portion of PFC's previously issued bonds. The Authority's share on these previous bond issuances was removed from the balance sheets.

As of June 30, 2015, the Authority's share for the 2011 Series A, 2011 Series B, 2011 Series B Superaqueduct and 2012 Series A Refunding Bonds is approximately \$90.1 million, \$102.2 million, \$162.7 million and \$56.2 million, respectively.

Due to the non-appropriations of funds for the payments of the Notes in the Commonwealth of Puerto Rico's ("the Commonwealth") annual budget for fiscal year 2016, none of the payments on the Notes, nor corresponding payments on the PFC Bonds, that have come due and payable in fiscal year 2016 have been made in full. As publically disclosed by GDB and PFC following the approval of the Commonwealth's annual budget for fiscal year 2016, the non-appropriation of the necessary funds to make the payments on PFC Bonds reflects the reality of the Commonwealth's current liquidity situation and fiscal challenges, in combinations with the balance of the Commonwealth's obligations to its creditors and the equally important obligations to the citizens of Puerto Rico to ensure the provisions of essential services. The Commonwealth currently faces a severe fiscal and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession (which commenced in 2006), high unemployment, population decline, and high levels of debt and pension obligations. The risks and uncertainties facing the Commonwealth, together with other factors, have led the Commonwealth's management to conclude that there is substantial doubt as to their ability to continue as

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10. Bonds Payable – (continued)

2011 Series A and B and 2012 Series A PFC Refunding Bonds – (continued)

a going concern. As of the date hereof, GDB is unaware of any claims being asserted by holders of the PFC Bond or the PFC Bonds trustee under the governing agreements and/or the Notes in connection with the missed payments on the PFC Bonds obligations.

2008 Series A and B Revenue Bonds

On March 18, 2008, the Authority issued approximately \$1,338.6 million of 2008 Series A and B Revenue Bonds (the 2008 Revenue Bonds).

The 2008 Series A and B Revenue Bonds net proceeds were used to repay certain outstanding bond anticipation notes, accrued interest and principal amount of lines of credit and to finance a portion of the Authority's capital improvement program.

The net proceeds of the 2008 Series A Revenue Bonds consist of (1) \$93.2 million of serial bonds bearing interest at 5% per annum with maturity dates ranging from July 1, 2012 to July 1, 2025, (2) \$127.9 million of capital appreciation term bonds bearing interest at 6 1/8% per annum and with maturity date of July 1, 2024, and (3) \$1,095.1 million of term bonds bearing interest at rates ranging from 5% to 6% per annum with maturity dates ranging from July 1, 2028 to July 1, 2047. As of June 30, 2015 and 2014, the outstanding balance for the 2008 Revenue Bonds Series A was approximately \$1,305.5 million and \$1,319.1 million, respectively, which included approximately \$28.0 million of accreted value.

The 2008 Series B Revenue Bonds consist of \$22.4 million term bond bearing interest at 6.15% per annum with maturity date of July 1, 2038.

The 2008 Series A and B Revenue Bonds are considered senior debt. As of June 30, 2015 and 2014, the outstanding balance for the 2008 Revenue Bonds Series A was \$22.4 million respectively.

2008 Series A and B Revenue Refunding Bonds

On March 18, 2008, the Authority issued approximately \$284.8 million of Series A and B Revenue Refunding Bonds, (the 2008 Revenue Refunding Bonds), guaranteed by the Commonwealth to refund the Authority's outstanding Revenue Refunding Bonds, 1995 Series (guaranteed by the Commonwealth) in the amount of approximately \$262.8 million. The 2008 Revenue Refunding Bonds bear interest at rates ranging from 5.80% to 6.10% per annum with maturity dates ranging from July 1, 2021 to July 1, 2034. The 2008 Series A and B Revenue Refunding Bonds net proceeds of approximately \$279.5 million (after payment of approximately \$5.3 million in underwriters' discount, insurance, and other issuance costs) and other funds made available from sinking funds and investment accounts from the refunded bonds, were deposited in an irrevocable trust with an escrow agent to pay all future principal and interest payments of the 1995 Series Bonds to their respective dates of redemption or maturity. As a result, the 1995 Series Bonds are considered to be defeased and the liability for those bonds has been removed from the Authority's balance sheets.

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Notes to Financial Statements

June 30, 2015 and 2014

10. Bonds Payable – (continued)

2008 Series A and B Revenue Refunding Bonds – (continued)

The defeasance of the 1995 Series Bonds increased the Authority's total debt service payments over the next 25 years by approximately \$292.8 million and resulted in an economic loss (difference between the present values of the old and new debt service payments) of approximately \$12.7 million. The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of approximately \$35.9 million. This difference, reported in the accompanying financial statements as a deferred outflow of resources, is being charged to operations through the year 2019 using the effective interest method.

The 2008 Revenue Refunding Bonds are guaranteed by the Commonwealth and the Authority's net revenue, as defined in the corresponding trust indenture, is pledged toward the payment of debt service on these bonds. The 2008 Revenue Refunding Bonds are subordinated to all senior and senior subordinated debt. As of June 30, 2015 and 2014 the outstanding balance for the 2008 Series A and B refunding Bonds was \$284.8 million.

2012 Series A and B Revenue Bonds

On February 29, 2012, the Authority issued approximately \$2,095.7 million of Series A and B Revenue Bonds (the 2012 Revenue Bonds).

The 2012 Series A Revenue Bonds of approximately \$1,800.4 was issued to (1) repay certain lines of credit provided by Government Development Bank to the Authority as interim financing for a portion of its capital improvement program, (2) finance a portion of the Capital Improvement Program, (3) make a deposit to a Budgetary Reserve Fund, (4) pay capitalized interest on the 2012 Series A Revenue Bonds through July 1, 2013, and (4) pay the costs of issuance and underwriters discounts.

The 2012 Series A Revenue Bonds consist of (1) \$418.4 million of serial bonds bearing interest at rates ranging from 4.0% to 5.55% per annum with maturity dates ranging from July 1, 2015 to July 1, 2030, and (2) \$1,382.0 million of term bonds bearing interest at rates ranging from 5% to 6% per annum with maturity dates ranging from July 1, 2033 to July 1, 2047.

The 2012 Series B Revenue Bonds of approximately \$295.2 million was issued to (1) provide funds to repay a bond anticipation note issued by the Authority in the aggregate principal amount of \$241.0 million, the proceeds were used to repay certain of the Authority outstanding indebtedness, (2) provide funds to repay certain lines of credit provided by Government Development Bank to the Authority to finance operating expenses and as interim financing for a portion of its capital improvement program, (3) pay capitalized interest on Series B Bonds through July 1, 2013, and (4) pay the cost of issuance and underwriters discounts.

The 2012 Revenue Bonds Series B consist of (1) \$188.1 million of serial bonds bearing interest at rates ranging from 3.35% to 5.00% per annum with maturity dates ranging from July 1, 2014 to July 1, 2023, and (2) \$107.1 million of term bonds bearing interest at 5.35% per annum with maturity date of July 1, 2027.

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Notes to Financial Statements

June 30, 2015 and 2014

10. Bonds Payable – (continued)

2012 Series A and B Revenue Bonds – (continued)

In connection with the 2012 Revenue Bond issuance, on January 24, 2012, PRASA's Board of Directors authorized the execution of an amended and restated Master Agreement of Trust (2012 MAT) by and between PRASA and Banco Popular de Puerto Rico as Trustee. The 2012 MAT changed from a net revenue pledge to a gross revenue pledge for Senior, Senior Subordinated, and Subordinated lien levels and changed the rate covenant requirements as explained in Note 13.

The 2012 Revenue Bonds are considered senior debt. As of June 30 2015 and 2014, the outstanding balance for 2012 Series A and B was \$2,064.7 million and \$2,095.7 million, respectively.

Rural Development Serial Bonds

United States Department of Agriculture (USDA) Rural Development Program assists the Authority in the financing and construction of aqueduct and sewer facilities in rural areas by purchasing revenue bonds from the Authority, the proceeds of which are used by the Authority to finance such projects. GDB provides interim financing for these projects through short-term lines of credit.

As of June 30, 2015 and 2014, the USDA Rural Development Program Bonds consisted of twenty-six (26) separate series, issued from 1983 through 2013, bearing interest from 2.0% vs. 5.00% due in semiannual installments through 2050. The outstanding balance of the USDA Rural Development Program Serial Bonds as of June 30, 2015 and 2014 was approximately \$388.3 million and \$397.0 million, respectively.

The USDA Rural Development Program Serial Bonds are guaranteed by the Commonwealth, pursuant to Law No. 140 of 2000 as amended and the Authority's net revenue is pledged toward the payment of debt service on the USDA Rural Development Program Bonds.

The USDA Rural Development Program Bonds are subordinate to all senior and senior subordinated debt.

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10. Bonds Payable - (continued)

Debt Service Payments

Future principal and interest payments on all bonds payable outstanding at June 30, 2015 are as follows (in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Fiscal year:			
2016	\$ 58,169	\$ 231,233	\$ 289,402
2017	63,852	236,360	300,212
2018	66,487	233,331	299,818
2019	69,763	229,990	299,753
2020	72,711	226,459	299,170
2021-2025	347,265	864,052	1,211,317
2026-2030	939,304	1,110,141	2,049,445
2031-2035	837,459	662,278	1,499,737
2036-2040	786,777	446,258	1,233,035
2041-2045	818,415	213,646	1,032,061
2046-2050	407,101	35,339	442,440
2051-2055	9,629	462	10,091
	<u>4,476,932</u>	<u>\$ 4,489,549</u>	<u>\$ 8,966,481</u>
Total	4,476,932	\$ 4,489,549	\$ 8,966,481
Plus: unamortized premium	26,306		
Less: unamortized discount	<u>(16,038)</u>		
Bonds payable, net	<u>\$ 4,487,200</u>		

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11. Notes Payable

Notes payable consisted of the following (in thousands):

	<u>June 30,</u>	
	<u>2015</u>	<u>2014</u>
Puerto Rico Water Pollution Control Revolving Fund	\$ 384,881	\$ 331,931
Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund	170,510	158,984
Notes with commercial banks	96,553	200,000
Note with GDB	66,764	72,363
	<u>\$ 718,708</u>	<u>\$ 763,278</u>

Puerto Rico Water Pollution Control Revolving Fund and Safe Drinking Water Treatment Revolving Loans

The Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund (the Revolving Funds) were created by Act No. 44 of June 21, 1988 and Act No. 32 of July 7, 1997, respectively, of the Commonwealth. The Puerto Rico Water Pollution Control Revolving Fund is administered, pursuant to Act No. 44 and Act No. 9 of June 21, 1988 and June 18, 1970, respectively, as amended, by the Puerto Rico Environmental Quality Board (EQB). The Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund is administered, pursuant to Act No. 5 of July 21, 1977, as amended, by the Puerto Rico Department of Health (DOH).

Pursuant to these laws, EQB and DOH, on behalf of the Commonwealth, are authorized to enter into operating agreements and capitalization grant agreements with the U.S. Environmental Protection Agency (EPA). The Puerto Rico Infrastructure Financing Authority (PRIFA), a component unit of the Commonwealth, the Authority, and GDB entered into a memorandum of understanding under which each party has agreed to assume specific responsibilities in connection with the operations of the Revolving Funds.

The Authority has entered into revolving loan agreements with PRIFA to finance certain capital improvements to the system. As of June 30, 2015 and 2014, the Authority had outstanding approximately \$555.4 million and \$490.9 million, respectively, under these loan agreements.

The PRIFA loan agreements are evidenced by promissory notes, which bear interest at a 2% annual rate payable semiannually. Construction loans are required to be paid in full within 20 years of the project completion date. The Authority has pledged its net revenues on a basis subordinate in all respects to the Authority's bonds outstanding. If the Authority's pledged net revenues are not sufficient for the payment of principal and interest, the payments are guaranteed by the Commonwealth under the Act No. 45 of July 28, 1994, as amended, which obligates the Commonwealth to pay principal and interest on the notes.

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11. Notes Payable – (continued)

Notes with commercial banks

As authorized by the Authority's Governing Board's Resolution No. 2796 adopted on July 3, 2013, on October 24, 2013, the Authority entered into a credit agreement (the CIP Credit Agreement), as amended on February 26, 2014, with the Lenders party thereto and Oriental Bank and Banco Popular, financial institutions organized under the laws of the Commonwealth, pursuant to the terms of which the Lenders agreed to make certain advances to the Authority in the aggregate principal amount of up to \$350 million to be repaid on the earliest to occur of (a) March 31, 2015 or (b) three (3) days after the issuance by the Authority of its revenue bonds under the Master Agreement of Trust. This note had an outstanding balance of \$200 million as of June 30, 2014 and was designated by the Authority as Senior Indebtedness pursuant to the terms of the Master Agreement of Trust. On March 4, 2015, the Authority executed an amendment to the CIP Credit Agreement originally executed on October 24, 2013, by and among PRASA, Oriental Bank as Administrative Agent and Banco Popular de Puerto Rico (BPPR) as a Lender. With the execution of this amendment, the local commercial bank syndicate agreed to extend the maturity date on the credit facility granted under the CIP Credit Agreement through May 29, 2015. As a condition to such extension, PRASA agreed to make a principal payment in an aggregate amount of \$50 million. Concurrently with the execution of the amendment, the Authority paid the Lenders \$40 million, reducing the outstanding principal amount of the indebtedness to \$160 million, and agreed to make two additional \$5 million principal payments on April 1, 2015 and May 1, 2015, which were made on their due dates.

On May 29, 2015, the Authority entered into a Credit Agreement with Banco Popular (the "Banco Popular Credit Agreement") pursuant to which Banco Popular made a \$90 million term loan to the Authority for the purpose of refinancing the \$75 million due to such bank under the CIP Credit and providing an additional \$15 million of credit. The Authority applied the \$15 million of net proceeds from the Banco Popular Credit Agreement together with Operating Revenues collected during the month of May 2015, after making other required deposits to the Senior Bond Fund, to pay Oriental its \$75 million portion of the CIP Credit Agreement in full on May 29, 2015. The amounts due under the Banco Popular Credit Agreement are collateralized with an escrow of \$90 million of the Authority's funds that were on deposit in the Rate Stabilization Account of the Surplus Fund under the Master Trust Agreement and will be payable on the earlier of (i) August 31, 2015, (ii) upon the occurrence and continuation of an event of default under the Banco Popular Credit Agreement or (iii) the date of issuance of the 2015A Senior Bonds. The August 31, 2015 due date was extended to September 15, 2015, and on that date the Authority issued \$75 million of its 2015A Senior Bonds under the Master Trust Agreement, as supplemented by a Fifth Supplemental Agreement of Trust, dated as of September 15, 2015 setting the details of such bonds. The proceeds of the purchase of the 2015A Senior Bonds by Merrill Lynch, Pierce, Fenner & Smith Incorporated pursuant to a Bond Purchase Agreement, dated September 15, 2015 (the "Bond Purchase Agreement"), were used to repay part of the outstanding balance of a \$90 million term loan extended by Banco Popular under the Banco Popular Credit Agreement. The Banco Popular Credit Agreement balance was then reduced to \$15 million. Both financings were due on November 30, 2015 and on that date they were extended until February 29, 2016, which was paid upon maturity.

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11. Notes Payable – (continued)

Notes with commercial banks (continued)

As authorized by the Board’s Resolution No. 2844, adopted on April 23, 2014, on November 3, 2014, the Authority entered into a credit agreement with Popular Auto, LLC, a limited liability company organized and existing under the laws of the Commonwealth, pursuant to the term of which such institution agreed to make borrowings available to the Authority in the aggregate principal amount of \$7.5 million (the “Fleet Term Loan”) to be repaid by November 2, 2017. The Fleet Term Loan was designated by the Authority as Senior Subordinate Indebtedness, Other System Indebtedness and a Refundable Principal Installment pursuant to the terms of the Master Trust Agreement. As of June 30, 2015, the outstanding balance of the Fleet Term Loan was \$6.6 million.

Notes with GDB

On February 29, 2012, the Authority entered into a line of credit agreement with GDB. This agreement provides an available maximum amount of \$150 million for the purpose of assisting with the Authority’s cash flows needs during the transition period after amending and restating the Master Agreement of Trust as a result of the issuance of 2012 Revenue Bonds Series A and B. On June 27, 2014, the Authority and GDB executed an Amended and Restated Loan Agreement reducing the line of credit to the outstanding balance as of that date of \$72.3 million and converting the interim loan to a term loan due and payable on March 31, 2019. The term loan has an amortization period of fifteen (15) years, which shall be payable in nineteen (19) quarterly payments, commencing on June 30, 2014, plus a final balloon payment (of such amount as may be the balance then outstanding) on the maturity date.

The combined future aggregate amount of debt service for these loans as of June 30, 2015 was as follows (in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2016	\$ 135,611	\$ 18,341	\$ 153,952
2017	33,236	10,332	43,568
2018	30,564	9,394	39,958
2019	75,429	7,857	83,286
2020	23,669	5,096	28,765
2021-2025	116,817	18,453	135,270
2026-2030	88,716	6,947	95,663
2031-2035	31,495	1,420	32,915
	<u>535,537</u>	<u>\$ 77,840</u>	<u>\$ 613,377</u>
Interim construction loans:			
Puerto Rico Water Pollution Control			
Revolving Fund	152,831		
Puerto Rico Safe Drinking Water			
Treatment Revolving Loan Fund	30,340		
Total	<u>\$ 718,708</u>		

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12. Lines of Credit

On March 18, 2008, the Authority entered into a revolving line of credit agreement with GDB. This agreement provides the Authority with an available maximum amount of \$150.0 million to be used to satisfy the Operating Reserve Requirement pursuant to the Master Agreement of Trust dated as of March 1, 2008 between the Authority and the bond trustee related to the 2008 Revenue Bonds. On February 29, 2012, the maximum amount was increased to \$180.0 million. This line of credit is due on June 30, 2016. There was no outstanding balance as of June 30, 2015 and 2014.

On March 10, 2010, the Authority entered into a revolving line of credit agreement with GDB. This agreement provides the Authority with an available maximum amount of \$70.0 million to be used to provide funding for the capital improvement program of the Authority. The proceeds will be applied only to projects approved and to be funded by the State Revolving Funds pursuant to federal regulations under the Clean Water Act, the Safe Drinking Water Act, the American Recovery Act ("ARRA"), and the USDA Rural Development Bonds. The Authority will pay this interim financing with moneys received from State Revolving Funds, as reimbursements on payments done by the Authority for the projects. As of June 30, 2015 and 2014, the Authority had an outstanding balance of approximately \$7.4 million and \$8.2 million on this line of credit, respectively. The line of credit was due on January 31, 2016. See Note 22.

Future amounts required to pay principal balances at June 30, 2015 is \$7,389 million for the fiscal year ended June 30, 2016.

13. Financial Covenants

The amended and restated Master Agreement of Trust (the MAT) governing the Authority's Revenue Bonds contains, financial covenants requiring the maintenance of certain debt service coverage ratios.

As stated in the MAT, the Authority has covenanted to establish and collect rates, fees and charges so that it meets the following four independent requirements:

- Operating Revenues (as defined per the MAT) shall be at least equal to 250% of annual debt service with respect to Senior Indebtedness for the current fiscal year;
- Operating Revenues shall be at least equal to 200% of annual debt service with respect to Senior Indebtedness and Senior Subordinate Indebtedness for the current fiscal year;
- Operating Revenues shall be at least equal to 150% of annual debt service with respect to all Bonds and Other System Indebtedness for the current fiscal year; and
- Authority Revenues (as defined per the MAT), shall be sufficient to pay current expenses, annual debt service on its indebtedness and to fund other amounts that may be due under the MAT.

Indebtedness, as defined in the MAT, includes Commonwealth Guaranteed Indebtedness and Commonwealth Supported Obligations.

As of June 30, 2015 and 2014, the Authority was in compliance with the senior annual debt service coverage requirements.

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14. Capital Contributions

Capital contributions for the fiscal years ended June 30, 2015 and 2014 were as follows (in thousands):

	June 30,	
	2015	2014
Federal grants:		
USDA Rural Development Program	\$ 9,055	\$ 12,751
Federal Emergency Management Agency	7	879
US EPA Clean Water State Revolving Funds	8,211	3,871
Developer contributions	6,630	6,524
Contributions from governmental agencies and municipalities	537	432
Other contributions from Commonwealth	50	-
Other contributions	1,614	1,449
	<u>\$ 26,104</u>	<u>\$ 25,906</u>

15. Going Concern

The discussion in the following paragraphs regarding the Authority's financial and liquidity risks provides the necessary background and support for management's evaluation as to whether there is substantial doubt about the Authority's ability to continue as a going concern for 12 months beyond the date of the financial statements or for an extended period if there is currently known information that may raise substantial doubt shortly thereafter. GASB Statement No. 56, Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards, establishes that the continuation of a legally separate governmental entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. Information that may significantly contradict the going concern assumption would relate to a governmental entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of governmental operations, restructuring of debt, submission to the oversight of a separate fiscal assistance authority or financial review board, or similar actions. Indicators such as negative trends in operating losses and negative cash flows, possible financial difficulties such as nonpayment or default of debt and/or restructurings or noncompliance with capital or reserve requirements, and internal or external matters impacting the governmental entity's ability to meet its obligations as they become due, are factors that are considered in this evaluation. The Authority has had significant recurring losses, working capital deficiencies, credit downgrades, and large non-discretionary capital expenditure requirements as further discussed below. The Authority currently faces heightened liquidity and lack of market access and, as a result of the Authority's inability to obtain long-term financing, it has not been able to pay during the fiscal year 2015 certain contractor obligations related to its Capital Improvement Program. The Authority's ability to obtain long term financing for its Capital Improvement Plan is uncertain. The risks and uncertainties facing the Authority together with other factors further described below, have led management to conclude that there is substantial doubt as to the ability to continue as a going concern in accordance with GASB Statement No. 56.

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15. Going Concern – (continued)

The Authority is currently experiencing cash flows and financing difficulties. The Authority's net position for the years ended June 30, 2015 and 2014 decreased by \$86.1 million and \$41.0 million, respectively. The credit rating of the Commonwealth and most of its public entities (including the Authority) were recently downgraded. The Authority's Senior Revenue Bonds credit ratings, as of the date of the issuance of the financial statements are "Caa3" by Moody's Investor Services, "CC" by Standard and Poor's Ratings Services and "CC" by Fitch Ratings.

As of June 30, 2015, the Authority had an unrestricted net deficit of approximately \$373 million and long-term debt outstanding of \$5,213.3 million (which included revenue bonds payable of \$4,487.2 million, notes payable of \$718.7 million and lines of credit of \$7.4 million). The Authority's net position decreased by \$86.1 million during the year ended June 30, 2015, and had a working capital deficiency of \$471 million as of June 30, 2015. The Authority's working capital deficiencies as of June 30, 2015 and 2014 amounted to \$369 million and \$280 million, respectively. However, the Authority's restricted cash includes a portion for the payment of current debt of approximately \$250.9 million and \$171.4 million for 2015 and 2014, respectively.

On August 10, 2015, the Authority published a preliminary offering of \$750 million of its revenue bonds however; the Authority was unable to complete the transaction and is re-evaluating its financing options considering the current market conditions.

Historically, the Authority's Capital Improvement Program ("CIP") has been funded with external financings. As a result of recent setbacks in its attempt to access the bond market for the issuance of revenue bonds to cover the cost of construction projects included in its CIP, the Authority had been unable to pay certain outstanding contractor obligations and had to suspend or cancel certain ongoing CIP projects. As of June 30, 2015, unpaid CIP contractor obligations were approximately \$150 million, excluding interest and penalties.

On June 30, 2016, the Authority with the acknowledgment and support of the United States Environmental Protection Agency ("EPA"), executed a Forbearance Agreement (the "Forbearance Agreement") with the Puerto Rico Department of Health (DOH), administrator of the Drinking Water State Revolving Fund Programs, the Commonwealth's Environmental Quality Board (EQB), administrator of the Clean Water State Revolving Fund Programs (CW-SRF), and the Puerto Rico Infrastructure Financing Authority ("PRIFA"), a public corporation and instrumentality of the Commonwealth, as operating agent for the SRFs, authorized to assist the DOH and the EQB in the administration, financial and accounting activities of the SRFs. Under the Forbearance Agreement, the payments due on July 1, 2016 under the SRF Loans are deferred, for a period of six (6) months, which may be extended for an additional six (6) months if certain conditions are met.

During the forbearance period, the parties will negotiate new terms and conditions to the SRF Loans under a restructuring of such loans and a revision of underlying agreements.

The Authority also requested that the USDA Rural Development Program provides a short-term forbearance period, during which it would refrain from exercising its rights and remedies under the RD Bond documents, grants or loan agreements. To this effect, PRASA and USDA Rural Development Program executed a forbearance document, effective as of June 30, 2016 and granted a three (3) month forbearance period, through September 30, 2016, in order to provide for additional time to examine all options available to correct the Authority's deficiencies and restore loan repayments.

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June 30, 2015 and 2014

15. Going Concern – (continued)

In addition, the Authority has not made the quarterly interest and principal payments of the term note payable with the Government Development Bank (“GDB”), since December 2015. As of the date of the issuance of the financial statements the term note was not declared in default by GDB.

Among the alternatives evaluated by the Authority’s management, is the enactment by the Legislature of the Commonwealth of legislation which would create a new special purpose entity and governmental instrumentality that would be permitted to issue bonds payable from special charges imposed by such entity, the proceeds of which would be provided to the Authority to pay for approved expenses, including CIP costs.

On July 12, 2016, the Governor of Puerto Rico signed into law Act 68 of 2016 (“Act 68”), providing for the creation of a new public corporation, to be known as the Puerto Rico Aqueduct and Sewer Authority Revitalization Corporation (the “Corporation”), as a single purpose, bankruptcy remote entity. The Corporation is authorized to fix and collect securitization charges for the purpose of issuing bonds the proceeds of which may be used by the Authority for its Capital Improvement Program (“CIP”), refinancing of bond anticipation notes and the cancelation, defeasance and refinancing of its Bonds, among other approved financing costs. Act 68 limits the securitization charge which may be imposed by the Corporation to an amount equivalent to 20% of the Authority’s revenues and provides that the Corporation may issue up to a maximum of \$900 million in bonds for the purpose of financing the development of the Authority’s CIP. The difference between the \$900 million that may be used for the financing of the CIP and the maximum amount that can be financed with the 20% of Authority revenues may be used to retire, cancel (defease) or refinance Bonds of the Authority, subject to certain conditions.

If the Authority is not able to obtain financing as previously mentioned, the Authority will be forced to re-evaluate the financing structure for its capital improvement program and may be required under its debt agreement to implement reductions in its operating expenses and/or additional increases in its service rates.

16. Related Party Transactions

Operating revenues for services provided to the Commonwealth and its component units amounted to approximately \$104.1 million and \$119.2 million during the years ended June 30, 2015 and 2014, respectively. As of June 30, 2015 and 2014, the Authority’s government account receivable is \$113.3 million and \$123.8 million respectively, for which \$69 and \$53.5 million are reserved. Further, operating, administrative, and general expenses during the fiscal years ended June 30, 2015 and 2014 included approximately \$148.3 million and \$166.7 million, respectively, of charges from Puerto Rico Electric Power Authority (PREPA), a component unit of the Commonwealth.

As of June 30, 2015 and 2014, the Authority had approximately \$3.7 million and \$16.8 million, respectively, of receivables from the Commonwealth and its component units, which are reported as receivables from the Commonwealth in the accompanying balance sheets.

The Authority had approximately \$1.1 million and \$0.4 million of excess of collections over billings from the Commonwealth, recorded as unearned revenue in the accompanying balance sheets as of June 30, 2015 and 2014, respectively.

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16. Related Party Transactions – (continued)

As of June 30, 2015, the Commonwealth and its component units face significant uncertainties, including liquidity risks, which is the risk of not having sufficient liquid financial resources to meet their obligations when they become due. Because of these uncertainties, the amount due from Commonwealth and its component units may not be collected in the near future. This situation could result in an adverse impact on the Authority's financial condition, liquidity and results of operations.

Over the years, GDB, as fiscal agent and bank of the Commonwealth, had extended lines of credit and term loans to the Authority in order to finance capital improvement projects and operational needs. As of June 30, 2015 and 2014, the Authority had an outstanding balance of approximately \$74.2 million and \$80.5 million, respectively, under these credit facilities. In addition, the Authority has restricted deposits with the GDB and EDB as of June 30, 2015 and 2014 of \$32 million and \$35 million, respectively.

17. Pension Plan

The Employees Retirement System of the Commonwealth of Puerto Rico (ERS) is a multiple-employers, cost-sharing hybrid defined benefit and defined contribution pension plan sponsored by, and reported as a component unit of, the Commonwealth. All regular employees of the Authority become members of the ERS as a consequence of their employment.

The ERS provides retirement, death, and disability benefits pursuant to Act 447, approved on May 15, 1951, as amended, which became effective on January 1, 1952. Disability retirement benefits for occupational and non-occupational disabilities are available to members enrolled in the plan before January 1, 2000. Benefits vest after ten (10) years of plan participation.

For the employees who were hired before April 1, 1990, the amount of the annuity shall be one and one half percent (1.5%) of the average compensation of the highest thirty-six (36) months multiplied by the number of years of creditable service up to twenty (20) years, plus two percent (2%) of the average compensation of the highest thirty-six (36) months multiplied by the number of years of creditable service in excess of twenty (20) years. In no case shall the annuity be less than \$400 per month.

Participants who have completed at least thirty (30) years of creditable service are entitled to receive a Merit Annuity. Such participants who have not attained fifty-five (55) years of age will receive 65% of the average compensation or if they have attained fifty-five (55) years of age will receive 75% of the average compensation.

On February 16, 1990, by means of Act 1, an amendment to Act No 447 of May 15, 1951, which created the ERS, was enacted for the purpose of establishing a new age for retirement and method of computation to determine the annuity for the employees hired after April 1, 1990.

The amount of the annuity shall be one and one half percent (1.5%) of the average compensation of the last five (5) years multiplied by the number of years of creditable service. Participants will receive the annuity when attained the age of sixty-five (65) years old. In no case shall the annuity be less than \$400 per month.

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17. Pension Plan – (continued)

System 2000 is a defined contribution plan, also known as a cash balance plan. Under this new plan, there is a pool of pension assets, which are invested by the ERS, together with those of the current defined benefit plan. Benefits at retirement age are not guaranteed by the Commonwealth. The annuity is based on a formula that assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) is 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% of the return of the ERS' 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.

System 2000 reduced the retirement age from sixty-five (65) years to sixty (60) for those employees who joined the ERS on or after April 1, 1990. Disability pensions are not granted under System 2000.

On April 4, 2013, by means of Act 3, an amendment to Act No. 447 of May 15, 1951, which created the ERS, was enacted for the purpose of establishing a new pension program effective July 1, 2013 for all active participants. Under the Act 3, all active and new participants at July 1, 2013 under Act 447 and Act 1 will join a "hybrid" program, a combination of defined benefits and defined contribution program.

All active participants under Act 447 and Act 1 will preserve benefits accrued as of June 30, 2013. The annuity for these participants will be computed based on the average compensation multiplied by the credited years of service as of June 30, 2013 and contributions made to the new defined contribution program after June 30, 2013. For participants under System 2000, all contributions made before June 30, 2013 will be transferred to the new defined contribution program.

To qualify for an annuity under the new "Hybrid Program", participants have to meet two conditions: five years of credited service and \$10,000 or more in contributions made under this program. The annuity will be based on a distribution of all contributions made, divided by a factor of life expectancy of the participant at the age of retirement. In no case shall the annuity be less than \$500 per month.

Effective July 1, 2013, all participants will contribute a minimum of 10% with no maximum restriction of their gross monthly salary to the program. Commencing in fiscal year 2014, the Authority will pay a contribution of 12.275% of the employee's gross monthly salary and will increase 1% per year until fiscal year 2016 and 1.25% per year until fiscal year 2021. The Authority's contributions during fiscal year 2015 were of 13.275% of the employee's gross salary.

Disability retirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten years of service.

Commonwealth legislation requires that employees hired before April 1, 1990 contribute 5.775% of the first \$550 of their monthly gross salary and 9.275% of their gross monthly salary in excess of \$550. Employees hired after April 1, 1990 contribute 8.275% of their gross monthly salary.

No benefits are payable if participants receive a refund of their accumulated contributions.

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Notes to Financial Statements
June 30, 2015 and 2014

17. Pension Plan - (continued)

Under Act 447 the Authority's contributions during fiscal years ended June 30, 2015, 2014 and 2013 amounted to approximately \$8.7 million, \$8.5 million and \$9.3 million, respectively, which represented 100% of required contributions.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the ERS, was enacted for the purpose of establishing a new pension program (System 2000) for participants hired on or after January 1, 2000. Employees participating in the ERS as of December 31, 1999 had the option to stay in the defined benefit plan or transfer to System 2000.

The Authority contributions under System 2000 plan during the fiscal years ended June 30, 2015, 2014 and 2013, amounted to approximately \$8.9 million, \$8.2 million and \$7.1 million, respectively, which represented 100% of required contributions.

Under Act 3, the Authority contributions for the hybrid program during fiscal years ended on June 30, 2015 and 2014, amounted to approximately \$1.2 million and \$ 0.7 million, respectively.

The new pension program also established a new age for retirement as follows:

For participants who entered the program before April 1, 1990 Act 447:

<u>Age at June 30, 2013</u>	<u>Age under new program</u>
57 years or more	59 years
56 years	60 years
55 years or less	61 years

For participants who entered the program after April 1, 1990 through December 31, 1999 (Act 1):

<u>Age at June 30, 2013</u>	<u>Age under new program</u>
65 years or less	65 years

For participants who entered the program after January 1, 2000 through June 30, 2015 (System 2000):

<u>Age at June 30, 2013</u>	<u>Age under new program</u>
59 years	61 years
58 years	62 years
57 years	63 years
56 years	64 years
55 years or less	65 years

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17. Pension Plan - (continued)

For participants who entered into the program after July 1, 2013 (Act 3) the retirement age will be sixty-seven (67) years.

To improve the liquidity and solvency of the ERS, the Commonwealth enacted Act. No. 32 of June 25, 2013, which provides for incremental annual contributions from the Commonwealth's General Fund, public corporations and municipalities beginning on fiscal year 2013-2014 through fiscal year 2032-2033. The additional contribution is determined annually based on actuarial studies. The ERS determined the portion amount based on the Authority on the total employer contributions percentage for the current fiscal year. For the fiscal years ended June 30, 2015 and 2014, the Authority's additional benefits uniform contribution was \$4.8 and \$4.4 million, respectively.

Statement No. 68 of the *Governmental Accounting Standards Board, Accounting and Financial Reporting for Pensions - an amendment of GASE Statement No. 27 (GASB 68)* became effective for the year ended June 30, 2015. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria as is the case of the ERS.

As of the date of the release of this report, the ERS has not provided the Authority with the required information to implement the requirements of Statement No. 68 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27 (GASB 68)*. Therefore, the accompanying financial statements do not have any adjustments that will be necessary for the Authority to account for its proportionate share of the net pension liability, deferred inflow of resources and deferred outflow of resources in the statements of net assets as of July 1, 2014 and June 30, 2015, as well as the effect in the recorded pension expense in the statement of activities for the year ended June 30, 2015. Also, additional disclosures required by GASB 68 as well as required supplementary information were not included in the basic financial statements.

The pension costs recognized in the accompanying financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions, which is not in accordance with accounting principles generally accepted in the United States of America.

The actuarial valuation of the Basic System Benefits and System Administered Benefits as of June 30, 2014 (most recently available) reflects a fiduciary net position of \$80.6 million, total pension liability of \$30.2 billion and a net pension liability of \$30.1 billion.

Additional information on the ERS can be obtained from the Administrator of the Retirement System: P.O. Box 42003, San Juan, Puerto Rico 00940.

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18. Other Postemployment Benefits

Plan Description

The Authority provides retirement healthcare benefits under the Healthcare Benefit Plan to Retirees (the Plan) pursuant to collective bargain agreements. The Plan is administered by the Authority. The benefit consists on a fixed maximum monthly payment (annuity) to cover medical expenses. Based on the Plan's features and functionality, and for the purpose of the actuarial valuation, it has been identified as a single-employer defined benefit healthcare plan. Participants groups covered are employees under Collective Labor Agreement with "Unión Independiente Auténtica" (UIA), employees under Collective Labor Agreement with "Hermandad Independiente de Empleados Profesionales de la Autoridad de Acueductos y Alcantarillados" (HIEPAAA) and employees under Managers' Regulation, all of which are Authority's employees. All employees with more than twenty (20) years of rendered service within the Authority are eligible for the healthcare benefit upon retirement age. Act No.3 of April 4, 2013, an amendment to Act No. 447, established a new retirement age.

Retirement age is as follows:

- ▶ For those employees employed by the Authority before March 30, 1990, normal retirement age will be at sixty-one (61) years old.
- ▶ For employees employed by the Authority on March 30, 1990 and before July 1, 2013, normal retirement age will be at sixty-five (65) years old.
- ▶ For the employees hired by the Authority after July 1, 2013, normal retirement age will be at sixty-seven (67) years old.

For more details in the retirement age, refer to Note 17.

The obligation ends in case of death before retirement and in case of total or permanent disability before retirement. The obligation also ends in case of death after retirement.

Funding Policy

The contribution requirements of the Authority are established and may be amended, by the Authority's Board of Directors. The benefits are paid directly by the Authority to the retirees at a rate of a maximum of \$125 per month per retiree. The Plan is financed on a pay-as-you-go basis and the amount contributed during the fiscal years ended June 30, 2015 and 2014 was approximately \$3.1million and \$2.9 million, respectively. There is no contribution requirement for plan members.

Annual OPEB costs and Net OPEB obligation

The Annual Pension Cost (APC) and the Annual Required Contribution (ARC) were computed as part of an actuarial valuation performed as of June 30, 2015, in accordance with parameters of GASB Statement No. 45 and based on current years' demographic data. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial accrued liabilities (UAAL) over a period of 12 years.

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18. Other Postemployment Benefits – (continued)

Annual OPEB costs and Net OPEB obligation – (continued)

The annual required contribution estimated for the years ended June 30, 2015 and 2014 amounted to (in thousands):

	<u>2015</u>	<u>2014</u>
Annual Required Contribution (ARC):		
Normal costs	\$ 2,252	\$ 2,314
Amortization of initial UAAL	2,341	2,739
Amortization of loss	<u>4,911</u>	<u>4,072</u>
GASB Statement No. 45 Annual Required Contribution	<u>\$ 9,504</u>	<u>\$ 9,125</u>

OPEB costs components for the years ended June 30, 2015 and 2014 are as follows (in thousands):

	<u>2015</u>	<u>2014</u>
Annual OPEB costs		
ARC for fiscal year	\$ 9,504	\$ 9,125
Interest on net OPEB obligation	743	546
ARC amortization adjustment	<u>(3,364)</u>	<u>(2,579)</u>
Total annual OPEB costs	<u>\$ 6,883</u>	<u>\$ 7,092</u>

The net OPEB obligation change for the years ended June 30, 2015 and 2014 is as follows (in thousands):

	<u>2015</u>	<u>2014</u>
Change in net OPEB obligation		
Net OPEB obligation, beginning balance	\$ 32,330	\$ 28,141
Total annual OPEB costs	6,883	7,092
Actual benefit payments	<u>(2,633)</u>	<u>(2,903)</u>
Net OPEB obligation, ending balance	<u>\$ 36,580</u>	<u>\$ 32,330</u>

The net OPEB obligation is recorded as a component of compensated absences and postemployment benefits in the accompanying balance sheets as of June 30, 2015 and 2014.

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18. Other Postemployment Benefits – (continued)

Funded Status

Funded status of the plan as of June 30, 2015 and 2014, the most recent actuarial valuation date, is as follows (in thousands):

	2015	2014
Unfunded Actuarial Accrued Liability (UAAL):		
Active employees	\$ 33,684	\$ 31,196
Retirees	42,542	40,831
Actuarial accrued liability	76,226	72,027
Actuarial value of assets	-	-
UAAL	\$ 76,226	\$ 72,027

The schedule of funding progress included as required supplementary information presents information about the actuarial value of plan assets relative to the actuarial accrued liability for the benefits.

Actuarial Assumptions

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the ARC of the employer are subject to continuous revision as actual results are compared with past expectations and new estimates are made about the future.

Economic Assumptions

Discount Rate

The discount rate considered for years ended June 30, 2015 and 2014 was 2.10%. For fiscal year 2015, a 3-year average of the U.S. Treasury Bond 10-year term investments represents the Authority's expected long-term return on internal assets used to finance the payment of plan benefits.

Medical Increase Rate

As the retirement healthcare benefit is fixed, such that it will not increase the obligation under the plan (regardless of the claim experience) without negotiation of a new contract with the unions or an express Board of Directors' approval, the medical increase rate was zero percent for the years ended June 30, 2015 and 2014. If the fixed benefit level does indeed increase sometime in the future (by negotiation or plan amendment), the higher obligation will be recognized when the new contract or amendment is adopted.

Puerto Rico Aqueduct and Sewer Authority
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Notes to Financial Statements
June 30, 2015 and 2014

18. Other Postemployment Benefits – (continued)

Turnover

For the years ended June 30, 2015 and 2014, the turnover table used for the valuation was the Standard Hewitt Withdrawal Table for Hourly Union Employees – five (5) years of service select period.

Healthy Mortality

The RP-2000 Combined Healthy Mortality Table projected to 2020 by Scale AA was used for the valuation of the benefit granted by the plan.

Disability Table

The Hunter disability table was used for the valuation.

Actuarial Cost Method

The actuarial cost method used for by the Authority is the Projected Unit Credit (Attribution from date of hire to expected retirement ages).

Amortization of Initial UAAL

Period

The initial UAAL will be amortized in a 12-year period based on the average future years of service of the active population, starting with the fiscal year ended June 30, 2008. The years of service projection considers multiple decrement tables and the latest age of retirement, considered to be 67 years. The open amortization criteria was used for the valuation.

Method

The amortization of the UAAL is calculated under the level dollar method based on the fact that there is no payroll component on the benefit.

19. Labor Union Contracts

The collective bargaining agreement with the HIEPAAA union, which covers approximately 156 professional employees, was signed effective May 31, 2012 until June 30, 2016.

The collective bargaining agreement with the UIA union, which covers approximately 3,438 blue-collar and clerical employees, was signed effective January 1, 2012 until December 31, 2015.

However, under Act 66-2014 known as the "Fiscal Sustainability for the Government of Puerto Rico Act", both collectives agreements effective terms were extended until December 31, 2017.

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Notes to Financial Statements

June 30, 2015 and 2014

20. Agreement for Operation, and Management, of the Water and Sewer System

The Authority developed the Superaqueduct, as part of the infrastructure of the water intakes and the interconnections tanks in the distribution system, along the PR North Coast route, from Arecibo to Bayamón. During fiscal year 2012, the Authority signed an agreement with Caribbean Water Specialist Corp. and paid a management fee for the operation, security, and for the environmental and regulatory compliance (water quality) for all the operations under the contract of the North Coast Aqueduct. On October 1, 2013, the Authority signed a contract agreement with CH2 Hill Puerto Rico for the operation and maintenance of the Superaqueduct for a 12-month period, the contract may be renewed on an annual basis up to five years. On October, 2014 the contract was renewed. The cost incurred under the contract is reported under the caption of *Service Contract – Superaqueduct* (\$3.5 million and \$3.9 million for the years ended June 30, 2015 and 2014, respectively). All other operational costs associated with the operation of the Superaqueduct system are captioned in their respective expense category and are presented in the statements of revenues, expenses and changes in net position as part of the financial statements.

21. Commitments and Contingencies

Facilities and operations of the Authority's water and sewer system are subject to regulations under federal and Commonwealth environmental laws. Under agreements with the United States government, acting on behalf of EPA, the Authority and the Commonwealth are subject to consent decrees to enforce compliance with environmental laws. Accordingly, the Authority could be assessed stipulated noncompliance penalties.

On July 1, 2003, the Authority entered into an agreement (Civil Action No. 01-1709) with EPA to attain compliance with the Clean Water Act in relation to the Authority's wastewater pump stations (WWPSs) in response to a significant number of sanitary sewer bypasses from these locations. The Clean Water Act prohibits discharges of sewage from any point in the collection and treatment system other than the authorized point at the treatment facility. The Authority completed all improvement projects required by EPA for these WWPSs on or before the completion dates established in the Agreement.

This agreement also required the Authority to invest \$1 million in the development and implementation of a Supplemental Environmental Project (SEP). This project consisted of the connection of three non-PRASA communities to the Authority's drinking water system. The connection has been completed and is awaiting completion of adjacent systems to fully integrate these systems to PRASA's service. The agreement also required the implementation of the Preventive Maintenance Program (PMP) for all of PRASA's WWPSs. This was fully completed in December of 2010, and is still in place.

As part of the agreement, the Authority pays stipulated penalties for pump station bypass events on a quarterly basis. The penalty calculations are based on the pumping capacity of the pump station and the time taken to correct the deficiency causing the bypass event. The amount of penalties paid during fiscal years 2015 and 2014 was approximately \$0.6 million and \$0.3 million, respectively.

Puerto Rico Aqueduct and Sewer Authority

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June 30, 2015 and 2014

21. Commitments and Contingencies (continued)

Environmental Matters – (continued)

The 2006 EPA Consent Decree also required the Authority to deposit in an escrow account with the GDB an additional civil penalty in the amount of \$3 million in an escrow account with the GDB. These funds are to be used for providing sewer service to a community that has not been connected to the Authority's sanitary sewer system, as a SEP. As a result of the discussion between PRASA and EPA, it was decided to connect The Lago La Plata Community Supplemental Environmental Project. The project consists of the installations of 7,886 meters of sanitary sewer systems, composed by gravity and force line system and will benefit La Plata community, 230 house connections, the community school and the Coliseum. The cost of this SEP was \$4.1 million and has been completed.

As part of the agreement, PRASA pays stipulated penalties on a yearly basis for exceedances to each of PRASA's facilities to their individual discharge permits. The penalty calculations are based on frequency of the exceedances as well as the percentage of the exceedances with its respective limit. The amount of penalties paid during fiscal years 2015 and 2014 were approximately \$0.1 million and \$0.6 million, respectively. These penalty payments are deposited into an escrow account from which a fraction of the deposited amount can be reimbursed to the Authority based on completion of specific projects and initiatives.

On May 25, 2006, the Authority entered into a plea agreement with the U. S. Department of Justice related to violations of the Clean Water Act, as amended, Title 33, USC, Sections 11311(a) and 1319(c)(2)(A). As part of the agreement (Criminal Case No. 06-CR--00202-001), the Authority paid a \$9 million fine. This penalty was assessed by the Court as payment for the discharge permit violations of several treatment facilities of the Clean Water Act. The Authority was placed on probation for a period of five years, which expired on April 19, 2012. As part of the probation, the Authority had to comply with several special conditions, such as: (i) upgrade the collection and wastewater treatment system in the Ponce de León Avenue area of San Juan for a cost of not less than \$10.0 million to prevent direct discharges to the Martin Peña Channel, (ii) upgrade nine waste water treatment plants for a cost not less than \$109.0 million, and (iii) comply with the consent decree signed by the Authority with the U.S. Government on June 22, 2006. The plea agreement also established stipulated penalties for violation of any of the deadlines or performance standards set forth in the agreement. As of today, the Authority is in compliance with the deadlines and requirements of this Consent Order and no penalties have been paid. The probation period expired on April 2012.

On December 15, 2006, an agreement (Civil Case No. KPE 2006-0858) was signed between the Authority and the Department of Health of the Commonwealth related to violations of the Safe Drinking Water Act (SDWA), as amended. The agreement was preliminarily approved by the supervising court on March 15, 2007 and it was amended and finally approved by that court on June 20, 2008. The Authority agreed to implement a work plan to remediate the violations, establish preventive and mitigation measures, and execute a preventive maintenance program for the purpose of meeting the requirements of the SDWA. This Act requires the compliance with parameters of water quality and treatment techniques in the Authority's water systems. As part of the agreement, the Authority paid a civil penalty of \$1 million during fiscal year ended June 30, 2007. The civil penalty was stipulated by the court for alleged non-compliance issues to the SDWA, attended in this decree. In this Consent Decree, the Authority shall pay stipulated penalties for failing to comply with remedial measures deadlines, fail to submit deliverables or exceedances to maximum contaminant levels.

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21. Commitments and Contingencies (continued)

Environmental Matters – (continued)

During fiscal year ended June 30, 2008 and based on the amendment and final approval of the agreement, the Authority accrued approximately \$2.7 million for penalties for noncompliance as stipulated by the final agreement, which were paid during fiscal year 2009. Also, as part of the penalties for noncompliance with the remedial measures of the agreement with the Department of Health during fiscal year 2009, \$1.3 million were deposited in a GDB escrow account to be used for a SEP. This SEP included three projects: (1) a chemical monitoring of 67 Non-PRASA systems, (2) the installation of a disinfection system in six Non- PRASA systems, and (3) the connection of schools that have their own deficient water systems, to the Authority's water system. PRASA is in compliance with these SEP.

During fiscal years ended June 30, 2015 and 2014, the penalties paid amounted approximately \$0.1 million and \$0.1 million, respectively. The Authority deposited \$0.1 million in an escrow account. The deposit in the escrow account is for parameters exceedances, and will be used for compliance projects with the approval of the Department of Health.

On November 2007, the Authority entered into negotiation of a consent decree (Civil Action No. 10-1365) with EPA that requires the Authority to implement system wide remedial measures at all of the sludge treatment systems at the water treatment plants owned and operated by the Authority. The consent decree was lodged on May 3, 2010 and its entry date was August 24, 2010. This consent order supersedes previous Consent Orders known as PRASA II (Civil Action No. 92-1511) and PRASA III (Civil Action No. 00-2554). This consent order establishes deadlines for the compliance with the conditions set forth in the proposed agreement and stipulates penalties for violation of any of those deadlines.

The Authority was assessed a civil penalty of approximately \$3.2 million, of which \$1.0 million was paid to the Treasurer of the United States of America as a civil penalty, and \$2.2 million was deposited in an escrow account with GDB for the design and construction of a SEP. This SEP consisted on the installation of an aeration system in the Toa Vaca Lake. The aeration system was finished and placed into operation in November 2012.

The total amount of penalties paid under this agreement during the fiscal years 2015 was approximately \$0.2 million. Stipulated penalties must be paid by the Authority for failing to comply with remedial measures deadlines, permit limit exceedances or fail to submit deliverables or Discharge Monitoring Reports.

The Authority is in the process of renegotiation of all the consent decrees and commitments mentioned above. The objective of this renegotiation is to establish a prioritization system that will smooth out the economic impact of the capital improvement projects on a yearly basis.

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21. Commitments and Contingencies (continued)

Environmental Matters (continued)

On September 15, 2015 DOJ, acting at the request of the Administrator of EPA, filed a complaint (the "Complaint") against the Authority and the Commonwealth, as a required party (pursuant to Section 309(e)) in the United States District Court for the District of Puerto Rico (the "District Court"). The Complaint seeks injunctive relief and the assessment of civil penalties against the Authority for alleged violations of the Clean Water Act. Specifically, the Complaint alleges the Authority violated Section 301(a) of the Clean Water Act, by discharging pollutants, and/or failing to comply with the terms of the National Pollutant Discharge Elimination System ("NPDES") permits issued to the Authority's facilities under Section 402 of the Clean Water Act, as well as failing to report unauthorized discharges required under such permits, and failing to meet operation and maintenance requirements for certain Authority water treatment plants and wastewater treatment plants.

Concurrently with the filing of the Complaint, DOJ also filed the 2015 EPA Consent Decree executed among EPA, the Authority and the Commonwealth settling the matters addressed in the Complaint, under the terms agreed upon by the Authority, DOJ and EPA. The 2015 EPA Consent Decree is the result of an extensive negotiation process aimed, among other things, at resolving the claims addressed in the Complaint and the requirements of previous consent decrees related to the allegations included in the Complaint, specifically with the goal of implementing system-wide NPDES permit compliance plan, continue the implementation of operational and maintenance plans in all of the Authority's facilities, implementing remedial measures to address discharges and the alleged violations to the Clean Water Act occurring within the Puerto Nuevo Sewer System in the municipality of San Juan.

Negotiations leading to the execution of the 2015 EPA Consent Decree were commenced by the Authority in order to mitigate the high capital improvement program ("CIP") costs mandated by the existing consent decrees. Despite being in material compliance with the capital improvement project requirements of the Existing Consent Decrees, the Authority began discussions with the DOJ, on behalf of EPA, EPA and DOH seeking to amend the existing consent decrees in order to, among other things: (i) reduce required annual project expenditures and extend compliance deadlines, (ii) incorporate other regulatory projects included in the Authority's CIP not currently covered by the Existing Consent Decrees, and (iii) include the operation, maintenance and capital improvement program requirements related to the Puerto Nuevo wastewater collection system, including alleged combined sewer overflows.

On May 23, 2016, the District Court entered judgement approving the 2015 EPA Consent Decree as presented on May 10, 2016. The Complaint was dismissed with prejudice and civil case number 15-2283 was closed. The Authority expects that with the final approval of the 2015 EPA Consent Decree, it will be able to finalize the proposed amendment to the 2006 Drinking Water Settlement Agreement under terms substantially similar to those currently being negotiated with DOH.

Risk Management

The Authority has commercial insurance to mitigate its exposure to certain losses involving real and personal property (including windstorm, flood and earthquake damages) and comprehensive general and automobile claims.

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21. Commitments and Contingencies (continued)

Risk Management – (continued)

Each commercial insurance policy maintained by the Authority contains specific policy limits and deductibles. A summary of the commercial insurance maintained by the Authority is as follows:

<u>Coverage</u>	<u>Deductible</u>	<u>Policy Limit</u>
Real and personal property:		
Windstorm	Up to \$32.5 million per event, with a minimum of \$25 million	\$150 million per event
Flood	Up to \$28 million per event, with a minimum of \$25 million	\$300 million per event
Earthquake	Up to \$32.5 million per event, with a minimum of \$25 million	\$300 million per event
All other	\$25 million per occurrence	\$150 million per event
Automobile	\$ 0	\$1 million per occurrence
Comprehensive general liabilities	\$100 thousand per occurrence	\$1 million per occurrence \$2 million per aggregate
Umbrella liability		
First excess general liability and automobile	Retention \$1 million	In excess of \$20 million up to \$20 million
Second excess general liability and automobile	\$ 0	From \$20 million to \$40 million
Pollution liability	\$250 thousand per occurrence	\$5 million per occurrence \$10 million per aggregate
Crime	\$10 thousand per occurrence	From \$500 thousand up to \$1 million

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Notes to Financial Statements
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21. Commitments and Contingencies (continued)

Risk Management (continued)

<u>Coverage</u>	<u>Deductible</u>	<u>Policy Limit</u>
Officers and Directors	\$200 thousand per occurrence	\$20 million
First Excess Directors and Officers	\$ 0	Additional \$10 million
Travel and accident	\$ 0	\$500 thousand per occurrence
Accident and health divers	\$ 0	\$2.5 million aggregate \$250 thousand per occurrence
EPLI	\$100 thousand per occurrence	\$1.7 million aggregate \$5.0 million
Excess EPLI	\$ 0	Additional \$5.0 million

The Authority also has an Owner Controlled Insurance Program (OCIP). The OCIP is an insurance program under which Commercial General Liability, Excess General Liability, Builders Risk, and Contractors Pollution Liability coverages are procured or provided on a project “wrap-up” basis for contractors and subcontractors of any tier, who have been properly enrolled, while performing operations at the Project Site.

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Notes to Financial Statements
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21. Commitments and Contingencies (continued)

Risk Management (continued)

Each insurance policy maintained by the Authority contains specific policy limits and deductibles. A summary of the OCIP insurance policies maintained by the Authority is as follows:

<u>Coverage</u>	<u>Deductible</u>	<u>Policy Limit</u>
Comprehensive general liability:		
General liability	\$10 thousand per occurrence	\$2 million per occurrence, \$4 million aggregate
First excess liability	\$10 thousand per occurrence	\$25 million per occurrence, \$50 million aggregate
Second excess liability	\$ 0	\$25 million per occurrence, \$50 million aggregate
Builder's risk	\$20 thousand theft \$100 thousand - atmospheric events	\$100 million per occurrence
Contractor's pollution liability	\$25 thousand per occurrence	\$25 million per occurrence, \$25 million aggregate
Professional liability	\$250 thousand per occurrence	\$25 million per occurrence, \$50 million aggregate

Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

Construction Projects

The Authority enters in construction projects for the replacements or expansion of its facilities. As of June 30, 2015 and 2014, there were outstanding commitments for projects in process for approximately \$90.7 million and \$124.2 million, respectively.

Operating Leases

Certain commercial offices and warehouse facilities of the Authority are leased under operating lease agreements. During the fiscal years ended June 30, 2015 and 2014, the Authority incurred approximately \$3.6 million and \$4.7 million, respectively, in rent expense.

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21. Commitments and Contingencies (continued)

Operating Leases – (continued)

Future minimum noncancelable lease payments on existing operating leases at June 30, 2015, which have an initial term of one year or more, are as follows (in thousands):

<u>Year ending June 30,</u>	<u>Amount</u>
2016	\$ 3,307
2017	2,811
2018	2,452
2019	1,527
2020	1,316
2021 - 2025	2,686
2026 - 2030	1,771
	<u>\$ 15,870</u>

Litigation

The Authority is the defendant in lawsuit filed by customers alleging that the Authority has over billed them due to the methodology used to estimate consumption. In the case the plaintiffs requested a certification of the suit as a class action and seek recovery of damages, and an injunction enjoining the Authority from continuing to bill using the current methodology. The case is Fernando Toro, et al. v. Autoridad de Acueductos y Alcantarillados. In this case, the class certification hearings took place in the month of June 2011. The parties presented their evidence and the Judge determined the certification to a class action. At the present time, the Authority appealed the class action certification and the Court of Appeal sustained the decision. However, after evaluating the evidence presented in the class certification hearings, the Authority's potential exposure from this lawsuit is unlikely and, as such, no liability is being reported on the financial statements.

The Authority is the defendant or codefendant in various other lawsuits arising out of the normal course of business. The ultimate outcome of the lawsuits cannot presently be determined. However, management, based on discussion with legal counsel, has accrued a liability to cover litigation claims and contingencies. See Note 8.

Puerto Rico Aqueduct and Sewer Authority

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June 30, 2015 and 2014

22. Subsequent events

On September 15, 2015, the Authority issued \$75 million of its 2015A Senior Bonds under the Master Trust Agreement, as supplemented by a Fifth Supplemental Agreement of Trust, dated as of September 15, 2015 setting the details of such bonds. The proceeds of the purchase of the 2015A Senior Bonds by Merrill Lynch, Pierce, Fenner & Smith Incorporated pursuant to a Bond Purchase Agreement, dated September 15, 2015 were used to repay part of the outstanding balance of a \$90 million term loan extended by Banco Popular under the Banco Popular Credit Agreement. The Banco Popular Credit Agreement balance was then reduced to \$15 million. Both financings were due on November 30, 2015 and on that date they were extended until February 29, 2016. On maturity date, the Authority make principal payments on both financing facilities and cancelled the amount outstanding in full. For more details, please refer to Note 11.

On October 8, 2015, the Authority issued the Series JJ under the USDA Rural Development Bonds for \$10.6 million. The proceeds of the issuance were used to repay the outstanding balance of \$7.4 million on the revolving line of credit with GDB, and to finance a fleet acquisition under capital improvements projects.

On December 8, 2015, Act No. 21, known as the “Pre-retirement Voluntary Program Act”, was enacted. The Act allows eligible active employees under the Government of Puerto Rico Employee Retirements System (ERS) under Act No. 447, hired before April 1, 1990, with a minimum of twenty years (20) of service for participating on a voluntarily retirement program. The program offers a pension of 60% of the average compensation as of December 31, 2015 until reach the age of 61 years old, up to two year of healthcare medical plan, vacation and sick leave accrual liquidation to all employees who decide to participate. In addition, the Authority will continue making contributions to the ERS until the employee reach the retirement age. The Act No. 211 requires all employers under the ERS to evaluate if the program is viable and submit an application with details of numbers of employees and positions to the Office of Management and Budget of the Commonwealth of Puerto Rico (OMB), and only those who represent the expected savings will be approve by the OMB. Also, each participant employer should maintain a minimum of 70% of the savings as a result of the implementation of the program.

Also as explained in more detail in Note 21, on May 23, 2016, the District Court entered judgement approving the 2015 EPA Consent Decree as presented on May 10, 2016. The Complaint was dismissed with prejudice and civil case number 15-2283 was closed. The Authority expects that with the final approval of the 2015 EPA Consent Decree, it will be able to finalize the proposed amendment to the 2006 Drinking Water Settlement Agreement under terms substantially similar to those currently being negotiated with DOH. The agreement established a prioritization system to manage and comply with the required capital improvements projects based on the Authority financing capability, without affecting the regulatory and compliance requirements.

On June 30, 2016, PRASA executed a Forbearance Agreement (the “Forbearance Agreement”) with the Puerto Rico Department of Health (DOH), administrator of the Drinking Water State Revolving Fund Programs, the Commonwealth’s Environmental Quality Board (EQB), administrator of the Clean Water State Revolving Fund Programs (CW-SRF), and the Puerto Rico Infrastructure Financing Authority (“PRIFA”), a public corporation and instrumentality of the Commonwealth, as operating agent for the for the SRFs, authorized to assist the DOH and the EQB in the administration, financial and accounting activities of the SRFs. Under the Forbearance Agreement, the payments due on July 1, 2016 under the

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Notes to Financial Statements

June 30, 2015 and 2014

22. Subsequent events (continued)

SRF Loans are deferred and the parties thereto agreed to forbear from exercising, or consenting to the exercise of, any enforcement of rights or remedies available to each under the SRF Loans.

PRIFA, DOH and EQB, with the acknowledgment and support of the United States Environmental protection Agency (“EPA”), granted such forbearance, subject to the terms and conditions set forth in the Forbearance Agreement, for a period of six (6) months, which may be extended for an additional six (6) months if conditions are met. During such forbearance period, the Commonwealth Guaranty will not be enforced either. PRIFA, EQB and DOH, with the support of EPA, contemplate that during the forbearance period the parties will negotiate new terms and conditions to the SRF Loans under a restructuring of such loans and a revision of underlying agreements between PRASA, PRIFA, EQB, DOH and, where applicable, EPA, understand that given current circumstances, such forbearance and possible restructuring protects the perpetuity of the DW-SRF and CW-SRF programs beyond the financially stressed scenario faced by both PRASA and the Commonwealth at this time.

Regarding the RD Bonds, PRASA also requested that USDA Rural Development Program provides a short term forbearance period, during which it would refrain from exercising its rights and remedies, including the enforcement of the Commonwealth Guaranty, under the RD Bond documents or grants or loan agreements. To this effect, PRASA and USDA Rural Development Program executed a forbearance document, effective as of June 30, 2016 (the “USDA Forbearance Agreement”). The USDA Rural Development Program granted PRASA a three (3) month forbearance period, through September 30, 2016, subject to the terms and conditions set forth in the USDA Forbearance Agreement in order to provide for additional time to examine all options available to correct PRASA’s deficiencies and restore loan repayment. Pursuant to the USDA Forbearance Agreement the payments due on July 1, 2016 under the RD Bond documents were also deferred for the duration of the forbearance period and USDA Rural Development Program agreed to forbear from exercising, or consenting to the exercise of, any enforcement of rights or remedies available to it under the RD Bond documents or any grant or loan document in relation thereto.

As explained in Note 15 on July 12, 2016, the Governor of Puerto Rico signed into law Act 68 of 2016 (“Act 68”), providing for the creation of a new public corporation, to be known as the Puerto Rico Aqueduct and Sewer Authority Revitalization Corporation (the “Corporation”), as a single purpose, bankruptcy remote entity. The Corporation is authorized to fix and collect securitization charges for the purpose of issuing bonds the proceeds of which may be used by the Authority for its Capital Improvement Program (“CIP”), refinancing of bond anticipation notes and the cancelation, defeasance and refinancing of its Bonds, among other approved financing costs. Act 68 limits the securitization charge which may be imposed by the Corporation to an amount equivalent to 20% of the Authority’s revenues and provides that the Corporation may issue up to a maximum of \$900 million in bonds for the purpose of financing the development of the Authority’s CIP. The difference between the \$900 million that may be used for the financing of the CIP and the maximum amount that can be financed with the 20% of Authority revenues may be used to retire, cancel (defease) or refinance Bonds of the Authority, subject to certain conditions.

Required Supplementary Information

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Required Supplementary Information
Schedule of Funding Progress for Postemployment Healthcare Benefits

(In thousands)

<u>Valuation Date</u>	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability</u>	<u>Unfunded Actuarial Liability</u>	<u>Funded Ratio</u>	<u>Annual Covered Payroll</u>	<u>Percentage of Covered Payroll</u>
June 30, 2015	\$ -	\$ 76,226	\$ 76,226	0%	\$ 135,965	56%
June 30, 2014	\$ -	\$ 72,027	\$ 72,027	0%	\$ 148,131	49%
June 30, 2013	\$ -	\$ 73,044	\$ 73,044	0%	\$ 149,613	49%
June 30, 2012	\$ -	\$ 71,703	\$ 71,703	0%	\$ 163,753	44%

Supplemental Schedule

Puerto Rico Aqueduct and Sewer Authority
(An Component Unit of the Commonwealth of Puerto Rico)

Financial Results and Debt Coverage Calculations per 2012 Amended and Restated Master Agreement of Trust
Years Ended June 30, 2015 and 2014

(In thousands)

	2015	2014
Revenues		
Service revenues (cash basis)	\$ 1,072,407	\$ 1,036,725
Other income	4,365	4,313
Developers contributions	3,555	4,501
Transfer to surplus fund	-	(93,000)
Operating revenues (cash basis)	1,080,327	952,539
Budgetary reserve fund	-	-
Total authority revenues	1,080,327	952,539
Operating expenses:		
Payroll and payroll related	265,339	291,639
Electricity	148,267	166,720
Other operating expenses	229,054	251,532
Total net operating expenses	642,660	709,891
Non cash reserve adjustments	9,005	39,927
Adjusted operating expenses	633,655	669,964
Total net revenues per MAT	\$ 446,672	\$ 282,575
Debt service coverage calculation:		
Operating revenues	\$ 1,080,327	\$ 952,539
Senior debt (net of funds available in the Senior Bond Fund of \$43.6 million)	355,477	193,611
<i>Accumulated coverage ratio (Min 2.5x) - Section 7.01 (i) MAT</i>	3.04	4.92
Senior subordinated debt	11,170	-
<i>Accumulated coverage ratio (Min 2.0x) - Section 7.01 (ii) MAT</i>	3.03	4.92
All bonds and other system indebtedness	356,647	193,611
<i>Accumulated coverage ratio (Min 1.5x) - Section 7.01 (iii) MAT</i>	3.03	4.92
Rate covenants:		
Authority revenues	\$ 1,080,327	\$ 952,539
All debt plus current expenses	1,082,288	944,850
<i>Accumulated coverage ratio (Min 1.0x) - Section 7.01 (iv) MAT</i>	1.00	1.01

Other Reports

**Report of Independent Auditors on Internal Control Over
Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards***

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**The Board of Directors of
Puerto Rico Aqueduct and Sewer Authority:**

We have audited, in accordance with the auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Puerto Rico Aqueduct and Sewer Authority (the Authority) as of and for the year ended June 30 2015, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements and have issued our report thereon dated July 22, 2016. Our report includes an emphasis of a matter paragraph which states along with other matters that the Authority's significant recurring operating losses, working capital deficiencies, credit downgrades, large non-discretionary capital expenditure requirement, and market access risk raises substantial doubt about its ability to continue as a going concern. Management's plans in regards to these matters are also described in Note 15 to the financial statements. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter. In addition, our report was qualified because the Authority has not implemented the requirements of Statement No. 68 of the Governmental Accounting Standard Board, *Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27* and Statement No. 71, *Pension Transition for contributions Made subsequent to the Measurement Date, an amendment of GASB Statement No. 68*, because the final audited pension information is not readily available.

Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement's amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported in accordance with *Government Auditing Standards*.

The Authority's Responses to the Findings

The Authority's response to the finding identified in our audit was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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

San Juan, Puerto Rico,
July 22, 2016.

Kevane Grant Thornton LLP

