AUDITED FINANCIAL STATEMENTS

Puerto Rico Aqueduct and Sewer Authority
(A Component Unit of the Commonwealth of Puerto Rico)
Years Ended June 30, 2010 and 2009
With Report of Independent Auditors

ERNST & YOUNG

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

Audited Financial Statements

Years Ended June 30, 2010 and 2009

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Report of Independent Auditors

The Board of Directors
Puerto Rico Aqueduct and Sewer Authority

We have audited the accompanying balance sheets of the Puerto Rico Aqueduct and Sewer Authority, a component unit of the Commonwealth of Puerto Rico (the Authority), as of June 30, 2010 and 2009, and the related statement of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Authority's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Puerto Rico Aqueduct and Sewer Authority at June 30, 2010 and 2009, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

The management's discussion and analysis and schedule of funding progress on pages 3 through 17 and page 64 are not a required part of the basic financial statements but are supplementary information required by the *Governmental Accounting Standards Board*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Ernst & Young LLP

October 15, 2010

Stamp No. 2576639
affixed to
original of
this report.

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, 2010, 2009 and 2008. Please read it in conjunction with the Authority's financial statements, which follow this section.

June 30, 2010 and 2009 Financial Highlights

- The Authority's net assets increased by $830.8 million to $3,046.6 million, or 37%, primarily as the net result of an increase in water and sewer revenues of $8.3 million, an increase in total operating expenses, including depreciation, of $2.9 million, an increase in non operating expenses of $18.2 million and an increase of capital contributions of $947.2 million.
- Operating revenues increased by $8.3 million to $712.8 million, or 1%, due to an increase in water and sewer revenues of $3.4 million and a decrease in the provision for bad debts of $4.9 million.
- Operating expenses, including depreciation, increased by $2.9 million to $771.1 million, or 0.4%, primarily as a result of a decrease in payroll and related expenses of $13.5 million, a decrease of the service contract of the Superaqueduct of $2.6 million, an increase of professional and consulting services of $3.6 million, a decrease in chemical expenses of $1.0 million, an increase in repairs and maintenance expense of $7.9 million, an increase in electricity expense of $3.6 million and an increase in depreciation expense of $8.1 million.
- Capital contributions increased by $947.2 million to $969.4 million, primarily as a result of capital assets transferred by Puerto Rico Infrastructure Authority (PRIFA) for the amount of $933.4 million.
- Total assets increased by $1,082.8 million to $7,566.5 million or 17%, primarily due to an increase by $1,092.2 million in the Authority's capital assets transfer attributable to PRIFA. Total liabilities increased by $252.0 million to $4,519.9 million or 6%, primarily as a result of an increase in long term debt of $358.7 million and a decrease in other liabilities of $106.7 million.

June 30, 2009 and 2008 Financial Highlights

- The Authority's net assets decreased by $140.0 million to $2,215.8 million, or 6%, primarily as the net result of a increase in water and sewer revenues of $8.7 million, a decrease in operating expenses of $28.7 million, a decrease of non operating revenues (expenses) of $300.7 million and a decrease of capital contributions of $11.9 million.

- Operating revenues increased by $8.7 million to $704.5 million, or 1%, due to the net effect of an increase in water and sewer revenues of $17.5 million and an increase of the provision for bad debt of $8.8 million.
- Operating expenses decreased by $28.7 million to $768.2 million, or 4%, primarily as a result of a decrease in payroll expenses of $16.0 million, a decrease in other operating expenses of $25.4 million, a decrease of professional and consulting services of $2.8 million, an increase in the service contract of the Superaqueduct of $2.5 million, an increase in electricity expense of $3.3 million and an increase in depreciation expense of $9.7 million.
- Capital contributions decreased by $11.9 million to $22.1 million, or 35%, primarily as a result of a decrease in federal grants and other contributions.
- Total assets increased by $330.1 million to $6,483.7 million or 5%, primarily due to an increase by $330.6 million in the Authority's capital assets. Total liabilities increased by $470.1 million to $4,267.9 million or 12%, primarily as a result of an increase in long term debt of $373.4 million and an increase in other liabilities of $96.7 million.

Overview of the Financial Statements

This annual report includes the management's discussion and analysis report, the independent auditors' report, 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.

Financial Analysis of the Authority

The balance sheets and the statement of revenues, expenses, and changes in net assets report the net assets of the Authority and the changes therein. The Authority's net assets –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 assets 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.

Analysis of Financial Results

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

	June 30		
	2010	**2009**	**Change**
Current and other assets	**$ 481,507**	$ 490,941	$ (9,434)
Capital assets, net	**7,084,994**	5,992,747	1,092,247
Total assets	**7,566,501**	6,483,688	1,082,813
Long-term debt outstanding	**3,952,743**	3,594,067	358,676
Other liabilities	**567,128**	673,793	(106,665)
Total liabilities	**4,519,871**	4,267,860	252,011
Net assets:			
Invested in capital assets, net of related debt	**3,544,720**	2,963,993	580,727
Restricted	**17,642**	14,481	3,161
Unrestricted deficit	**(515,732)**	(762,646)	246,914
Total net assets	**$ 3,046,630**	$ 2,215,828	$ 830,802

	June 30		
	2009	**2008**	**Change**
Current and other assets	$ 490,941	$ 491,426	$ (485)
Capital assets, net	5,992,747	5,662,162	330,585
Total assets	6,483,688	6,153,588	330,100
Long-term debt outstanding	3,594,067	3,220,643	373,424
Other liabilities	673,793	577,077	96,716
Total liabilities	4,267,860	3,797,720	470,140
Net assets:			
Invested in capital assets, net of related debt	2,963,993	2,907,374	56,619
Restricted	14,481	12,024	2,457
Unrestricted deficit	(762,646)	(563,530)	(199,116)
Total net assets	$ 2,215,828	$ 2,355,868	$ (140,040)

Net Assets

June 30, 2010 and 2009

The Authority's net assets as of June 30, 2010 were approximately $3,046.6 million. This is an $830.8 million increase from the net assets as of June 30, 2009 of $2,215.8 million. Total assets increased by $1,082.8 million during the fiscal year ended June 30, 2010. This is primarily a result of a net increase in capital assets of $1,092.2 million due to current year net additions of $1,242.9 million offset by current year depreciation and amortization of $150.6 million. This increase in capital assets is mainly due to the assets transferred from PRIFA for the amount of $933.4 million.

Unrestricted and restricted cash and cash equivalents as of June 30, 2010, increased by $13.6 million when compared with June 30, 2009. The increase is primarily due to deposits made to restricted accounts to pay debt service and reimbursement of funds requested for payment of capital projects. Accounts receivable, net, decreased by approximately $22.8 million primarily due the net effect of an increase of $35.5 million in accounts receivable from water and sewer services customers and an increase in the allowance for doubtful accounts of $58.3 million.

Total liabilities increased by $252.0 million. This is primarily due to an increase of $358.7 million in long-term debt outstanding, mainly representing the net effect of an (1) increase in lines of credit of $292.9 million, (2) an increase in notes payable of $51.8 million (3) an increase in bonds payable of $14 million to finance the Authority's capital improvement program. A decrease of $106.7 million in other current and noncurrent liabilities is primarily due to a decrease of $111.3 million in accounts payable, accrued liabilities and accrued interest and an increase of $4.6 million customer's deposits and compensated absences and postemployment benefits.

June 30, 2009 and 2008

The Authority's net assets as of June 30, 2009 were approximately $2,215.8 million. This is a $140.0 million decrease from the net assets as of June 30, 2008 of $2,355.8 million. Total assets increased by $330.1 million during the fiscal year ended June 30, 2009. This is primarily a result of a net increase in capital assets of $330.6 million due to current year net additions of $474.3 million offset by current year depreciation and amortization of $143.7 million.

Unrestricted and restricted cash and cash equivalents as of June 30, 2009, decreased by $43.9 million when compared with June 30, 2008. The decrease is primarily due to the uses of funds to pay debt service. Accounts receivable, net, increased by approximately $45.1 million primarily due the net effect of an increase of $95.7 million, mainly from water and sewer services customers and an increase in the allowance for doubtful accounts of $50.6 million.

Total liabilities increased by $470.1 million primarily due to an increase of $373.4 million in long-term debt outstanding, mainly representing the net effect of an (1) increase in line of credit of $348.9 million and an (2) increase in notes payable of $25.4 million to finance the Authority's capital improvement program, a decrease in bonds payable of $.9 million, and an increase of $96.7 million in other current and noncurrent liabilities, primarily due to an increase of $95.0 million in accounts payable, accrued liabilities and accrued interest.

Capital Assets

Capital assets as of June 30, 2010 and 2009 were as follows (in thousands):

	June 30		
	2010	**2009**	**Change**
Capital assets being depreciated	**$ 8,049,013**	$ 6,831,835	$ 1,217,178
Accumulated depreciation and amortization	**(2,642,053)**	(2,491,389)	(150,664)
	5,406,960	4,340,446	1,066,514
Land	**61,765**	60,323	1,442
Construction in progress	**1,616,269**	1,591,978	24,291
Capital assets, net	**$ 7,084,994**	$ 5,992,747	$ 1,092,247

	June 30		
	2009	**2008**	**Change**
Capital assets being depreciated	$ 6,831,835	$ 6,578,154	$ 253,681
Accumulated depreciation and amortization	(2,491,389)	(2,347,871)	(143,518)
	4,340,446	4,230,283	110,163
Land	60,323	58,414	1,909
Construction in progress	1,591,978	1,373,465	218,513
Capital assets, net	$ 5,992,747	$ 5,662,162	$ 330,585

June 30, 2010 and 2009

The net increase of $1,092.2 million in capital assets includes additions of $1,242.8 million, reduced by $150.6 million in depreciation and amortization. The $1,242.8 million in capital investment is broken down as follows:

- $261.6 million in the Authority's capital improvement program;
- $47.8 million in renewal and replacement projects;
- $933.4 million for projects transferred from PRIFA, component unit of the Commonwealth.

The Authority has approximately $1,616.3 million in construction in progress as of June 30, 2010, and has construction commitments of approximately $688.4 million.

June 30, 2009 and 2008

The net increase of $330.6 million in capital assets includes an investment of $474.1 million, reduced by $143.5 million in depreciation and amortization. The $474.1 million in capital investment is broken down as follows:

- $420.1 million in the Authority's capital improvement program;
- $51.6 million in renewal and replacement projects;
- $2.4 million for emergency projects and consent decree projects

The Authority had approximately $1,592.0 million in construction in progress as of June 30, 2009, and had construction commitments of approximately $447.1 million.

Debt Administration

Long-term debt for the years ended June 30, 2010 and 2009 was as follows (in thousands):

	June 30		
	2010	**2009**	**Change**
Bonds payable:			
2001 Series A Commonwealth Appropriation Bonds	**$ 17,600**	$ 25,875	$ (8,275)
Act 164 PFC Commonwealth Appropriation Bonds	**341,565**	341,565	–
2004 Series A Commonwealth Appropriation Bonds	**326,785**	326,785	–
Revenue Bonds:			
2008 Series A, Serial Bonds	**93,155**	93,155	–
2008 Series A, Convertible Capital Appreciation	**146,843**	138,245	8,598
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	–
Rural Development Serial Bonds	**312,079**	302,742	9,337
Add premium on bonds refunding	**36,316**	38,025	(1,709)
Less :			
Bond discount	**(16,244)**	(16,683)	439
Deferred loss from refunding	**(79,445)**	(85,006)	5,561
Total bonds	**$ 2,580,979**	$ 2,567,028	$ 13,951

(Continued)

	June 30 2010	2009	Change
Bonds payable	**$ 2,580,979**	$ 2,567,028	$ 13,951
Notes payable:			
Water Pollution Control and Drinking Water Treatment Revolving Funds Loans	**375,793**	321,215	54,578
Notes with commercial banks	**244,688**	247,436	(2,748)
Total notes	**620,481**	568,651	51,830
Lines of credit	**751,283**	458,387	292,896
Long-term debt outstanding	**3,952,743**	3,594,066	358,677
Other long term liabilities:			
Accrued compensated absences	**49,338**	51,352	(2,014)
Net OPEB obligation	**12,453**	7,928	4,525
Early retirement obligation	**3,639**	3,960	(321)
Customer deposits	**79,840**	77,555	2,285
Total other liabilities	**145,270**	140,795	4,475
Total – long-term obligations	**4,098,013**	3,734,861	$ 363,152
Current portion	**48,631**	297,100	
Long-term obligations, less current portion	**$ 4,049,382**	$ 3,437,761	

The Authority's long-term debt increased by $358.7 million from $3,594.1 million as of June 30, 2009 to $3,952.7 million as of June 30, 2010.

June 30, 2010

Bonds Payable

Bonds outstanding as of June 30, 2010 increased by $13.9 million, mainly from the net effect of an increase in accreted value of 2008 Series A Revenue Bonds of $8.6 million, an increase of $15 million on issuance of Rural Development Bonds Series GG, a decrease of $14 million in payments of principal and an increase for the amortization of bonds discount, bonds premium, and bonds deferred lost from bonds refunding of $4.3 million.

Notes Payable

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, 2010, the Authority's loans outstanding under these programs amounted to $375.8 million. These loans increased approximately $54.6 million due to the net effect of drawings of approximately $69.5 million for payment of capital improvements and payment of principal on loans outstanding of $14.9 million.

On September 8, 2006, the Authority entered into a term loan agreement with various commercial banks amounting to $250 million to repay various lines of credit with Government Development Bank (GDB) and to pay the costs associated with the loan. As of June 30, 2010, the outstanding balance of the term loan was $244.7 million.

Lines of Credit

During 2010, the Authority entered into revolving lines of credit with GDB for the purpose of financing the Authority's capital improvement program for $125 million, $36.7 million, $150 million, $70 million and $113 million. As of June 30, 2010, approximately $413.7 million under these lines of credit was outstanding.

The existing $250 million and $87.6 million capital improvement program revolving lines of credit with GDB had an outstanding balance as of June 30, 2010 of $250 million and $87.6 respectively.

The $150 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, 2010.

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

June 30, 2009

Bonds Payable

Bonds outstanding as of June 30, 2009 decreased by $0.8 million, mainly from the net effect of an increase in accreted value of 2009 Series A Revenue Bonds of $8.1 million, a decrease of $14.9 million in payments of principal and an increase for the amortization of bonds discount, bonds premium, and bonds deferred lost from bonds refunding of $6 million.

Notes Payable

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, 2009, the Authority's loans outstanding under these programs amounted to $321.2 million. These loans increased approximately $27.9 million due to the net effect of drawings of approximately $39.6 million for payment of capital improvements and payment of principal on loans outstanding of $11.7 million.

On September 8, 2006, the Authority entered into a term loan agreement with various commercial banks amounting to $250 million to repay various lines of credit with Government Development Bank (GDB) and to pay the costs associated with the loan. As of June 30, 2009, the outstanding balance of the term loan was $247.4 million.

Lines of Credit

During 2009, the Authority entered into a new $87.6 million revolving line of credit with GDB for the purpose of financing the Authority's capital improvement program. As of June 30, 2010, approximately $43.8 million under this line of credit was outstanding.

The existing $190 million capital improvement program revolving line of credit with GDB was increased to $250 million. As of June 30, 2009, $250 million under this line of credit was outstanding.

The $150 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 has an outstanding balance of $150 million as of June 30, 2009.

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

Summary of Revenues, Expenses, and Changes in Net Assets

The following table provides a summary of the Authority's changes in net assets for the years ended June 30, 2010 and 2009 (in thousands):

	Years Ended June 30		
	2010	**2009**	**Change**
Operating revenue:			
Revenues from water and sewer, net	**$ 712,788**	$ 704,457	$ 8,331
Operating expenses:			
Payroll and payroll related expenses	**266,099**	279,606	(13,507)
Service contract – Superaqueduct	**22,800**	25,476	(2,676)
Professional and consulting services	**21,395**	17,796	3,599
Chemicals	**26,279**	27,310	(1,031)
Materials and replacements	**14,529**	15,454	(925)
Repairs and maintenance of capital assets	**39,990**	32,003	7,987
Electricity	**140,131**	136,497	3,634
Insurance	**9,443**	9,513	(70)
Other operating expenses	**78,685**	80,849	(2,164)
Operating expenses (excluding depreciation and amortization)	**619,351**	624,504	(5,153)
Depreciation and amortization	**151,767**	143,687	8,080
Total operating expenses	**771,118**	768,191	2,927
Operating loss	**(58,330)**	(63,734)	5,404
Nonoperating expenses, net	**(80,245)**	(98,439)	18,194
Loss before capital contributions	**(138,575)**	(162,173)	23,598
Capital contributions	**969,377**	22,133	947,244
Increase (decrease) in net assets	**830,802**	(140,040)	970,842
Net assets at beginning of year	**2,215,828**	2,355,868	(140,040)
Net assets at end of year	**$ 3,046,630**	$ 2,215,828	$ 830,802

The following table provides a summary of the Authority's changes in net assets for the years ended June 30, 2009 and 2008 (in thousands):

	Years Ended June 30 2009	2008	Change
Operating revenue:			
Revenues from water and sewer, net	$ 704,457	$ 695,735	$ 8,722
Operating expenses:			
Payroll and payroll related expenses	279,606	295,566	(15,960)
Service contract – Superaqueduct	25,476	22,950	2,526
Professional and consulting services	17,796	31,096	(13,300)
Chemicals	27,310	27,611	(301)
Materials and replacements	15,454	15,814	(360)
Repairs and maintenance of capital assets	32,003	31,141	862
Electricity	136,497	133,180	3,317
Insurance	9,513	9,815	(302)
Other operating expenses	80,849	95,755	(14,906)
Operating expenses (excluding depreciation and amortization)	624,504	662,928	(38,424)
Depreciation and amortization	143,687	133,972	9,715
Total operating expenses	768,191	796,900	(28,709)
Operating loss	(63,734)	(101,165)	37,431
Nonoperating (expenses) income, net	(98,439)	202,249	(300,688)
(Loss) income before capital contributions	(162,173)	101,084	(263,257)
Capital contributions	22,133	34,023	(11,890)
(Decrease) increase in net assets	(140,040)	135,107	(275,147)
Net assets at beginning of year	2,355,868	2,220,761	135,107
Net assets at end of year	$ 2,215,828	$ 2,355,868	$ (140,040)

June 30, 2010 and 2009

Net assets increased by $830.8 million, from $2,215.8 million in 2009 to $3,046.6 million in 2010, due to the results of current year operations.

Major fluctuations that resulted in an increase in net assets are broken down as follows (in thousands):

Increase in operating revenues	$	8,331
Increase in operating expenses		(2,927)
Decrease in nonoperating expenses		18,194
Increase in capital contributions		947,244
Net change	$	970,842

Operating revenues increased as a result of an increase in water and sewer billed of $3.4 million and a decrease in the provision for bad debt of $4.9 million during the fiscal year ended June 30, 2010.

Operating expenses increased by $2.9 million primarily due to the net effect of the following:

- A decrease of $13.5 million in payroll and payroll related expenses.
- A decrease of $2.6 million in Service Contract – Superaqueduct expenses.
- A decrease of $2.2 million in other operating expenses.
- An increase of $7.9 million in depreciation expense.
- An increase of $8.0 million in repair and maintenance of capital assets.
- An increase of $3.6 million in electricity expenses.
- An increase of $3.5 million in professional and consulting services expenses

The decrease in payroll expenses are the result of a reduction in the number of employees and changes in benefits granted.

Service contract – Superaqueduct expenses pertain to a contract signed with Thames-Dick for the operation and maintenance of the North Coast Aqueduct (Superaqueduct).

Nonoperating revenue increased by $18.2 million when compared with previous fiscal year. This is primarily the net effect of an increase of $10.1 in interest expense on bonds, notes and lines of credits and the increase in Commonwealth contributions of $27.2 for the payment of principal and interest on outstanding debt.

Capital contributions increased by $947.2 million. This is primarily due to capital assets transferred from by PRIFA for the amount of $933.4 million.

June 30, 2009 and 2008

Net assets decreased by $140.0 million, from $2,355.9 million in 2008 to $2,215.8 million in 2009, due to the results of current year operations.

Major fluctuations that resulted in the net increase in net assets are broken down as follows (in thousands):

Increase in operating revenues	$	8,722
Decrease in operating expenses		28,709
Decrease in nonoperating revenue (expenses), net		(300,688)
Decrease in capital contributions		(11,890)
Net change	$	(275,147)

Operating revenue increased as a result of an increase in water and sewer consumption of $17.5 million and an increase in the provision for bad debt of $8.8 million during the fiscal year ended June 30, 2009.

Operating expenses decreased by $28.7 million primarily due to the net effect of the following:

- A decrease of $15.9 million in payroll and payroll related expenses.
- A decrease of $2.8 million in professional and consulting services expenses
- A decrease of $25.4 million in other operating expenses.
- An increase of $2.5 million in Service Contract – Superaqueduct expenses.
- An increase of $3.3 million in electricity expenses.
- An increase of $1.0 million in repair and maintenance of capital assets.
- An increase of $9.7 million in depreciation expense.

Service contract – Superaqueduct expenses pertain to a contract signed with Thames-Dick for the operation and maintenance of the North Coast Aqueduct (Superaqueduct).

Nonoperating revenue decreased by $300.7 million when compared with previous fiscal year. This is primarily due to contributions of $369.0 million that was received from Puerto Rico Sales Tax Financing (known as COFINA for its Spanish acronym) during fiscal year ended June 30, 2009, reduced by a charge of $75.3 million related to the termination of forward interest rate swap agreements.

Capital contributions decreased by $11.9 million. This decrease is primarily the net effect of the following:

- Federal grants and other contributions decreased by approximately $12.4 million.
- Other Commonwealth contributions increased by $0.5 million.

Economic Factors and Next Year's Budgets and Rates

Puerto Rico's economy is currently in a recession that began in the fourth quarter of fiscal year 2006. Although Puerto Rico's economy is closely linked to the United States economy, for fiscal years 2007, 2008 and 2009, Puerto Rico's real gross national product decreased by 1.2%, 2.8%, and 3.7%, respectively, while the United States economy grew at a rate of 1.8% and 2.8%, respectively, and contracted during fiscal year 2009 at a rate of 2.5%. According to the Puerto Rico Planning Board's latest projections, the economic impact of a delay in the disbursement of funds from the American Recovery and Reinvestment Act and other economic factors, the gross national product for fiscal year 2010 was forecasted to contract by 3.6%. The gross national product for fiscal year 2011, however, is forecasted to grow by 0.4%.

The economic situation impacted the Authority's collection rate. During fiscal year 2010 the management has been focusing in minimize the financial impact of the current situation by the implementation of a revenue optimization program directed to, among other things, increase collections and replace meters to increase billed water consumption.

During June 2010, the Authority adopted a balanced operational budget for fiscal year 2011. In addition the Authority's Capital Improvement Program for the fiscal year 2011 is estimated in $360.0 million.

The Authority's credit ratings are "Baa1" by Moody's Investors Service, "BBB-" by Standard and Poor's Ratings Services and "BBB" by Fitch Ratings.

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

(In thousands)

	June 30 2010	June 30 2009
Assets		
Current assets:		
Cash and cash equivalents	**$ 12,713**	$ 2,183
Accounts receivable, net	**192,703**	215,456
Receivables from federal agencies	**3,417**	3,170
Materials and supplies inventory, net	**24,163**	22,431
Prepayments and other current assets	**5,870**	5,800
Total current assets	**238,866**	249,040
Noncurrent assets:		
Restricted cash and cash equivalents	**185,425**	182,357
Capital assets:		
Capital assets being depreciated	**8,049,013**	6,831,835
Accumulated depreciation and amortization	**(2,642,053)**	(2,491,389)
	5,406,960	4,340,446
Land	**61,765**	60,323
Construction in progress	**1,616,269**	1,591,978
Total capital assets, net	**7,084,994**	5,992,747
Other assets:		
Deferred debt issuance cost, net of accumulated amortization of $9,897 and $7,570 for 2010 and 2009, respectively	**57,216**	59,544
Total assets	**$ 7,566,501**	$ 6,483,688

(Continued)

	June 30 2010	June 30 2009
Liabilities and net assets		
Current liabilities:		
Bonds payable	**$ 7,316**	$ 6,763
Notes payable	**19,448**	17,561
Lines of credit	**–**	251,192
Accounts payable	**146,862**	268,780
Accrued liabilities	**173,893**	185,311
Accrued interest	**82,141**	60,293
Unearned revenue	**18,962**	18,615
Customers' deposits	**5,766**	5,719
Compensated absences and postemployment benefits	**16,101**	15,865
Total current liabilities	**470,489**	830,099
Noncurrent liabilities:		
Bonds payable	**2,573,663**	2,560,265
Notes payable	**601,033**	551,090
Lines of credit	**751,283**	207,195
Customers' deposits	**74,074**	71,836
Compensated absences and postemployment benefits	**49,329**	47,375
Total noncurrent liabilities	**4,049,382**	3,437,761
Total liabilities	**4,519,871**	4,267,860
Net assets:		
Invested in capital assets, net of related debt	**3,544,720**	2,963,993
Restricted for environmental compliance, capital activity and other	**17,642**	14,481
Unrestricted	**(515,732)**	(762,646)
Total net assets	**3,046,630**	2,215,828
Total net assets and liabilities	**$ 7,566,501**	$ 6,483,688

See accompanying notes.

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

Statements of Revenues, Expenses, and Changes in Net Assets

(In thousands)

	Year Ended June 30	
	2010	**2009**
Operating revenues:		
Water	**$ 503,888**	$ 491,641
Sewer	**262,447**	271,280
Bad debt expense	**(53,547)**	(58,464)
Total net operating revenues	**712,788**	704,457
Operating expenses:		
Payroll and payroll related	**266,099**	279,606
Service contract – Superaqueduct	**22,800**	25,476
Professional and consulting services	**21,395**	17,796
Chemicals	**26,279**	27,310
Materials and replacements	**14,529**	15,454
Repairs and maintenance of capital assets	**39,990**	32,003
Electricity	**140,131**	136,497
Insurance	**9,443**	9,513
Other operating expenses	**78,685**	80,849
Operating expenses (excluding depreciation and amortization)	**619,351**	624,504
Depreciation and amortization	**151,767**	143,687
Total operating expenses	**771,118**	768,191
Operating loss	**(58,330)**	(63,734)
Nonoperating revenues (expenses):		
Interest expense, net of amortization of debt issuance cost, bond premium and discount, and deferred refunding loss	**(137,063)**	(126,978)
Commonwealth contributions for principal payments on bonds and notes	**8,275**	–
Commonwealth contributions for interest payments on bonds and notes	**37,190**	18,233
Interest income	**4,269**	5,202
Other income	**7,084**	5,104
Total nonoperating expenses, net	**(80,245)**	(98,439)
Loss before capital contributions	**(138,575)**	(162,173)
Capital contributions:		
Federal grants and other contributions	**26,498**	21,592
Other Commonwealth contributions	**942,879**	541
Total capital contributions	**969,377**	22,133
Change in net assets	**830,802**	(140,040)
Net assets at beginning of year	**2,215,828**	2,355,868
Net assets at end of year	**$ 3,046,630**	$ 2,215,828

See accompanying notes.

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

Statements of Cash Flows

(In thousands)

	Year Ended June 30	
	2010	**2009**
Cash flows from operating activities		
Cash received from customers	**$ 733,762**	$ 676,103
Cash paid to suppliers	**(469,108)**	(265,024)
Cash paid to employees	**(271,787)**	(282,285)
Net cash (used in) provided by operating activities	**(7,133)**	128,794
Cash flows from noncapital financing activities		
Proceeds from borrowings from lines of credit	**–**	150,000
Payment of lines of credit	**(150,000)**	–
Payments of notes	**(2,748)**	(2,564)
Net cash from other income	**7,084**	5,104
Interest paid on notes and lines of credit	**(8,121)**	(9,094)
Net cash (used in) provided by noncapital financing activities	**(153,785)**	143,446
Cash flows from capital and related financing activities		
Additions to utility plant and other capital assets	**(322,914)**	(489,740)
Proceeds from capital contributions	**40,389**	12,578
Proceeds from issuance of bonds	**15,047**	–
Proceeds from issuance of notes payable	**69,452**	39,658
Proceeds from borrowings from lines of credit	**459,156**	198,915
Payments of bonds and notes	**(20,584)**	(24,971)
Payment of lines of credit	**(16,260)**	–
Interest paid on bonds, notes and lines of credit	**(54,039)**	(57,743)
Net cash provided by (used in) capital and related financing activities	**170,247**	(321,303)
Cash flows from investing activities		
Interest received on investments	**4,269**	5,202
Net cash provided by investing activities	**4,269**	5,202
Net increase (decrease) in cash and cash equivalents	**13,598**	(43,861)
Cash and cash equivalents at beginning of year	**184,540**	228,401
Cash and cash equivalents at end of year	**$ 198,138**	$ 184,540
For purposes of the statement of cash flows, cash and cash equivalents include:		
Unrestricted	**$ 12,713**	$ 2,183
Restricted	**185,425**	182,357
	$ 198,138	$ 184,540

(Continued)

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

Statements of Cash Flows (continued)

(In thousands)

	Year Ended June 30 2010	2009
Reconciliation of operating loss to cash provided by operating activities		
Operating loss	**$ (58,330)**	$ (63,734)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization	**151,767**	143,687
Provision for uncollectible accounts	**53,547**	58,464
Change in assets and liabilities:		
Increase in accounts receivable	**(35,205)**	(98,099)
Increase in accounts receivable from federal agencies	**(247)**	(297)
Increase in materials and supplies inventory	**(1,732)**	(333)
(Increase) Decrease in prepayments and other current assets	**(70)**	141
(Decrease) Increase in accounts payable	**(110,268)**	82,724
Increase (Decrease) in unearned revenue	**347**	(452)
Increase (Decrease) in accrued compensated absences and early retirement obligation	**2,191**	(5,511)
(Decrease) Increase in accrued liabilities	**(11,418)**	471
Increase in customers' deposits	**2,285**	11,733
Total adjustments	**51,197**	192,528
Net cash (used in) provided by operating activities	**$ (7,133)**	$ 128,794
Noncash noncapital financing activities		
Amortization of debt issuance cost	**$ 332**	$ 332
Noncash capital and related financing activities		
Net additions to utility plant and other capital assets	**921,100**	15,637
Write-off of capital contributions	**4,411**	9,555
Amortization of:		
Debt issuance cost	**1,995**	1,995
Bond premiums and discounts	**1,269**	1,269
Deferred refunding loss	**5,561**	5,561
Accretion of interest on capital appreciation bonds	**8,598**	8,093
Principal paid by the Commonwealth	**8,275**	–
Interest paid by the Commonwealth	**37,190**	18,233

See accompanying notes.

1. Reporting Entity and Summary of Significant Accounting Policies

Puerto Rico Aqueduct and Sewer Authority (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 its 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.

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). Under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting,* the Authority has elected not to apply Financial Accounting Standards Board pronouncements issued after November 30, 1989. 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 sheet, and revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

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

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

Measurement Focus and Basis of Accounting (continued)

The Authority distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods 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 nonoperating 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, 2010 and 2009, the account balances amounted to approximately $21.7 million and $27.2 million, respectively. The accounts are held under the Puerto Rico 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, 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, 2010 and 2009 the net asset value per unit of the Trust Fund was $1.

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

Restricted Assets

Funds set aside for construction 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.

Receivables

Receivables are stated net of estimated allowances for uncollectible accounts, which allowances 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 reserve for obsolescence totaling approximately $3.5 million and $3.4 million as of June 30, 2010 and 2009 respectively.

Unamortized Debt Issuance Costs, Premiums, Discounts and Deferred Refunding Losses

Debt issuance costs, premiums and discounts are deferred and amortized to expense over the life of the related debt using the straight-line method, which approximates 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 straight-line method over the remaining life of the original debt, or the life of the new debt, whichever is shorter.

Bonds payable are reported net of applicable bond premium or discount and deferred refunding loss. Unamortized debt issuance costs are reported as an asset on the balance sheets.

Capital Assets

The Authority defines capital assets as tangible assets used in the Authority's operations; with a useful live longer than a year, not for sale and with individual cost of over $100 for technology hardware and software and over $500 for other capital assets.

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

Capital Assets (continued)

Utility plant is carried at 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, 2010 and 2009 amounted to approximately $57 million and $53.8 million, respectively.

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

All utility plant and other capital assets are recorded at historical cost or estimated historical cost.

Depreciation is calculated using the straight-line method over an estimated useful life of the assets as follows:

Description	Useful Life
Wells, tanks and meters	Forty-eight (48) years
Equipment and vehicles	Five (5) years
Furniture and fixtures	Ten (10) years
Water and sewer plants, tanks and pump stations	Forty-eight (48) years
Buried infrastructure	Forty-eight (48) years
Dams	Range from fifty (50) to one hundred (100) years
Buildings	Range from twenty (20) to fifty (50) years

Construction in progress represents the accumulated cost 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 by residential, commercial or industrial customers over periodic billings that are adjusted.

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

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 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. Accrued compensated absences include payroll related expenses.

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.

The Authority has the obligation to contribute a maximum of $125 monthly per retired employee for coverage under the medical plan. Beginning on July 1, 2007, the contribution for postretirement healthcare benefits is accrued as incurred in accordance with GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*.

The Authority maintains an Early Retirement Program established during fiscal year 2002, which provides for a monthly payment to certain retired employees to cover healthcare premiums for a maximum of $280 per month, up to the age of seventy (70) years or for a maximum of ten (10) years, whichever occurs first. The present value of future healthcare benefit contributions for these early retired employees is accrued and reported as a liability in the accompanying balance sheets. As of June 30, 2010 and 2009, the accrued liability for early retirement amounted to approximately $2.9 million and $4 million, respectively.

The cost of healthcare benefits paid to retired employees amounted to approximately $2.9 and $2.8 million for 2010 and 2009 respectively.

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

Pension Benefits

The Authority's employees participate in the Government of Puerto Rico Employees Retirement System (the Plan), a cost-sharing multiple-employer plan. The Authority recognizes annual pension expense equal to its required contribution to the Plan. The Commonwealth funds any past or future unfunded liability related to the Authority's employees.

Net Assets

Net assets are reported in three categories:

- ***Invested in Capital Assets, Net of Related Debt*** – These consists 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 invested in capital assets, net of related debt.

- ***Restricted Net Assets*** – 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, 2010 and 2009, the Authority had no assets restricted by enabling legislation.

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

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		Adoption required in fiscal year
57	OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans	2012
59	Financial Instruments Omnibus	2011

The impact of these standards has not yet been determined.

Effects of New Pronouncements

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This Statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. Such guidance should be applied in addition to the existing authoritative guidance for capital assets. The Authority adopted the provisions of GASB Statement No. 51 during the year ended June 30, 2010. The adoption of GASB Statement No. 51 had no impact on the Authority.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This Statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. Derivative instruments are often complex financial arrangements used by governments to manage specific risks or to make investments. By entering into these arrangements, governments receive and make payments based on market prices without actually entering into the related financial or commodity transactions. Derivative instruments associated with changing financial and commodity prices result in changing cash flows and fair values that can be used as effective risk management or investment tools. Derivative instruments, however, also can expose governments to significant risks and liabilities. Common types of derivative instruments used by governments include interest rate and commodity swaps, interest rate locks, options (caps, floors,

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

Effects of New Pronouncements (continued)

and collars), swaptions, forward contracts, and futures contracts. The Authority adopted the provisions of GASB Statement No. 53 during the year ended June 30, 2010. The adoption of GASB Statement No. 53 had no impact on the Authority.

In December, 2009, GASB issued Statement No. 58, Accounting *and Financial Reporting for Chapter 9 Bankruptcies.* The objective of this Statement is to provide accounting and financial reporting guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code. It requires governments to remeasure liabilities that are adjusted in bankruptcy when the bankruptcy court confirms (that is, approves) a new payment plan. The Authority adopted the provisions of GASB Statement No. 58 during the year ended June 30, 2010. The adoption of GASB Statement No. 58 had no impact on the Authority.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year's presentation.

2. Deposits

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

	June 30			
	2010		2009	
	Carrying amount	Bank balance	Carrying amount	Bank balance
Unrestricted deposits in commercial banks in Puerto Rico	**$ 12,713**	**$ 30,184**	$ 2,183	$ 9,902
Restricted deposits in commercial banks in Puerto Rico	**144,825**	**144,825**	140,308	140,308
Restricted deposits in governmental banks:				
GDB	**39,351**	**39,351**	41,442	41,442
EDB	**1,249**	**1,249**	607	607
Total	**$ 198,138**	**$ 215,609**	$ 184,540	$ 192,259

2. Deposits (continued)

Cash and cash equivalents consist of demand deposits, interest-bearing accounts, and certificates of deposit.

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 GDBs or EDBs failure, the Authority may not be able to recover these deposits. GDB and EDB are component units of the Commonwealth.

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

	June 30	
	2010	**2009**
Uninsured and uncollateralized:		
GDB	**$ 39,351**	$ 41,442
EDB	**1,249**	607
	$ 40,600	$ 42,049

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	
	2010	**2009**
Water and sewer services:		
Residential, industrial, and commercial	**$ 458,079**	$ 414,965
Government agencies and municipalities	**88,886**	97,247
	546,965	512,212
Other receivables:		
Government agencies, municipalities, and private entities	**23,360**	22,522
Less allowance for uncollectible accounts	**(377,622)**	(319,278)
Total	**$ 192,703**	$ 215,456

4. Receivables from Federal Agencies

The receivables from federal agencies of approximately $3.4 million and $3.2 million as of June 30, 2010 and 2009, respectively, consisted primarily of amounts pending to be received from the U.S. Department of Homeland Security (USDHS) as reimbursement for expenses incurred by the Authority's disaster recovery activities.

5. Materials and Supplies Inventory

As of June 30, 2010 and 2009, 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.

6. Capital Assets

Utility plant and other capital assets as of June 30, 2010 and 2009 and the changes therein for the years then ended are as follows (in thousands):

	June 30, 2010			
	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated:				
Land	$ 60,323	$ 1,442	$ –	$ 61,765
Construction in progress	1,591,978	1,243,851	(1,219,560)	1,616,269
Total capital assets not being depreciated	1,652,301	1,245,293	(1,219,560)	1,678,034
Capital assets being depreciated:				
Infrastructure (water and sewer facilities)	6,236,119	1,157,324	(766)	7,392,677
Wells, tanks and meters	345,899	43,168	(171)	388,896
Buildings and improvements	67,645	2,433	–	70,078
Equipment, furniture, fixtures and vehicles	182,172	15,190	–	197,362
Total capital assets being depreciated	6,831,835	1,218,115	(937)	8,049,013
Less accumulated depreciation and amortization:				
Infrastructure (water and sewer facilities)	(2,198,535)	(130,566)	766	(2,328,335)
Wells, tanks and meters	(121,460)	(7,408)	26	(128,842)
Buildings and improvements	(26,111)	(2,227)	–	(28,338)
Equipment, furniture, fixtures and vehicles	(145,283)	(11,255)	–	(156,538)
Total accumulated depreciation and amortization	(2,491,389)	(151,456)	792	(2,642,053)
Total capital assets being depreciated, net	4,340,446	1,066,659	(145)	5,406,960
Total capital assets, net	$ 5,992,747	$ 2,311,952	$ (1,219,705)	$ 7,084,994

6. Capital Assets (continued)

	June 30, 2009			
	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated:				
Land	$ 58,414	$ 1,909	$ –	$ 60,323
Construction in progress	1,373,465	474,305	(255,792)	1,591,978
Total capital assets not being depreciated	1,431,879	476,214	(255,792)	1,652,301
Capital assets being depreciated:				
Infrastructure (water and sewer facilities)	6,004,087	232,236	(204)	6,236,119
Wells, tanks and meters	341,768	4,131	–	345,899
Buildings and improvements	66,855	790	–	67,645
Equipment, furniture, fixtures and vehicles	165,444	16,728	–	182,172
Total capital assets being depreciated	6,578,154	253,885	(204)	6,831,835
Less accumulated depreciation and amortization:				
Infrastructure (water and sewer facilities)	(2,075,401)	(123,303)	169	(2,198,535)
Wells, tanks and meters	(114,404)	(7,056)	–	(121,460)
Buildings and improvements	(24,140)	(1,971)	–	(26,111)
Equipment, furniture, fixtures and vehicles	(133,926)	(11,357)	–	(145,283)
Total accumulated depreciation and amortization	(2,347,871)	(143,687)	169	(2,491,389)
Total capital assets being depreciated, net	4,230,283	110,198	(35)	4,340,446
Total capital assets, net	$ 5,662,162	$ 586,412	$ (255,827)	$ 5,992,747

7. Restricted Assets

Restricted assets at June 20, 2010 and 2009 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.

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. Also includes fines and penalties assessed by EPA that will be used for construction of infrastructure projects to provide water 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. Also includes deposits required by the Master Agreement of Trust.

Restricted assets by category consist of:

	June 30	
	2010	**2009**
Construction funds	**$ 24,201**	$ 28,339
Capital activity funds	**13,088**	13,710
Debt service funds	**148,136**	140,308
	$ 185,425	$ 182,357

8. Accrued Liabilities

Accrued liabilities consisted of the following (in thousands):

	June 30	
	2010	**2009**
Payroll and related accruals	**$ 54,712**	$ 56,654
Legal, labor related and environmental contingencies	**70,762**	76,666
Contract retentions	**48,419**	51,991
	$ 173,893	$ 185,311

9. Long-Term Liabilities

Long-term debt activity for the years ended June 30, 2010 and 2009 was as follows (in thousands):

	June 30, 2010					
	Beginning Balance	Additions/ Amortization	Reductions	Ending Balance	Due Within One Year	Due Thereafter
Bonds payable:						
2001 Series A Commonwealth Appropriation Bonds	$ 25,875	$ –	$ (8,275)	$ 17,600	$ 8,615	$ 8,985
Act 164 PFC Commonwealth Appropriation Bonds	341,565	–	–	341,565	–	341,565
2004 Series A Commonwealth Appropriation Bonds	326,785	–	–	326,785	–	326,785
2008 Series A Revenue Bonds	1,326,525	8,598	–	1,335,123	–	1,335,123
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
Rural Development Serial Bonds	302,742	15,047	(5,710)	312,079	2,992	309,087
Add bond premium	38,025	–	(1,709)	36,316	1,709	34,607
Less bond discount	(16,683)	–	439	(16,244)	(439)	(15,805)
Less deferred loss on refunding	(85,006)	–	5,561	(79,445)	(5,561)	(73,884)
Total bonds	2,567,028	23,645	(9,694)	2,580,979	7,316	2,573,663
Notes payable:						
Water Pollution Control and Safe Drinking Water Treatment Revolving Funds Loans	321,215	69,452	(14,874)	375,793	16,504	359,289
Notes with commercial banks	247,436	–	(2,748)	244,688	2,944	241,744
Total notes	568,651	69,452	(17,622)	620,481	19,448	601,033
Lines of credit	458,387	459,156	(166,260)	751,283	–	751,283
Other long term liabilities:						
Accrued compensated absences	51,352	14,079	(16,093)	49,338	12,674	36,664
Net OPEB obligation	7,928	7,010	(2,485)	12,453	2,402	10,051
Early retirement obligation	3,960	–	(321)	3,639	1,025	2,614
Customers' deposits	77,555	8,285	(6,000)	79,840	5,766	74,074
Total other liabilities	140,795	29,374	(24,899)	145,270	21,867	123,403
Total – long-term obligations	$ 3,734,861	$ 581,627	$ (218,475)	$ 4,098,013	$ 48,631	$ 4,049,382

9. Long-Term Liabilities (continued)

	June 30, 2009					
	Beginning Balance	Additions/ Amortization	Reductions	Ending Balance	Due Within One Year	Due Thereafter
Bonds payable:						
2001 Series A Commonwealth Appropriation Bonds	$ 33,825	$ –	$ (7,950)	$ 25,875	$ 8,275	$ 17,600
Act 164 PFC Commonwealth Appropriation Bonds	341,565	–	–	341,565	–	341,565
2004 Series A Commonwealth Appropriation Bonds	326,785	–	–	326,785	–	326,785
2008 Series A Revenue Bonds	1,318,432	8,093	–	1,326,525	–	1,326,525
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
Rural Development Serial Bonds	308,030	–	(5,288)	302,742	2,780	299,962
Add bond premium	39,733	–	(1,708)	38,025	1,708	36,317
Less bond discount	(17,122)	–	439	(16,683)	(439)	(16,244)
Less deferred loss on refunding	(90,567)	–	5,561	(85,006)	(5,561)	(79,445)
Total bonds	2,567,881	8,093	(8,946)	2,567,028	6,763	2,560,265
Notes payable:						
Water Pollution Control and Safe Drinking Water Treatment Revolving Funds Loans	293,290	39,658	(11,733)	321,215	14,813	306,402
Notes with commercial banks	250,000	–	(2,564)	247,436	2,748	244,688
Total notes	543,290	39,658	(14,297)	568,651	17,561	551,090
Lines of credit	109,472	348,915	–	458,387	251,192	207,195
Other long term liabilities:						
Accrued compensated absences	56,526	10,566	(15,740)	51,352	11,990	39,362
Net OPEB obligation	4,360	6,425	(2,857)	7,928	2,850	5,078
Early retirement obligation	7,865	–	(3,905)	3,960	1,025	2,935
Customers' deposits	69,895	12,789	(5,129)	77,555	5,719	71,836
Total other liabilities	138,646	29,780	(27,631)	140,795	21,584	119,211
Total – long-term obligations	$ 3,359,289	$ 426,446	$ (50,874)	$ 3,734,861	$ 297,100	$ 3,437,761

10. Bonds Payable

Bonds payable consisted of the following (in thousands):

	June 30 2010	June 30 2009
Commonwealth Appropriation Bonds:		
Series 2001:		
Series A, 4.00% – 5.50% due in semiannual interest payments through 2011 and annual principal installments from August 1, 2007 through 2011	**$ 17,600**	$ 25,875
Act 164 PFC, 4.00% – 6.15% due in semiannual interest and annual principal payments from July 15, 2004 through 2030	**341,565**	341,565
Series 2004:		
Series A, 1.25% – 5.75% due in semiannual interest payments through August 1, 2031 and annual principal installments from July 15, 2004 to 2031	**326,785**	326,785
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	**93,155**	93,155
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	**130,152**	130,152
Series A, Term Bonds, 5.00% – 6.00%, due semiannual interest payments through July 1, 2047 and annual principal payments from July 1, 2026 to 2047	**1,111,816**	1,103,218
Series B, Serial Bonds, 6.15% due in monthly interest payments through July 1, 2038 and one principal payment on July 1, 2038	**22,445**	22,445
Rural development serial bonds:		
Serial bonds, 4.25% – 5.00%, due semiannually through July 1, 2050	**312,079**	302,742
Subtotal	**2,640,352**	2,630,692
Bond premium	**36,316**	38,025
Bond discount	**(16,244)**	(16,683)
Deferred amount on refundings	**(79,445)**	(85,006)
Total	**$ 2,580,979**	$ 2,567,028

10. Bonds Payable (continued)

2001 Series A and B Bonds

Joint Resolution No. 523 (J.R. 523) of the Commonwealth, approved on August 24, 2000, authorized the Authority to restructure and refinance a line of credit with GDB in a principal amount not to exceed approximately $390 million. The funds from the line of credit were used to finance the construction of the north coast superaqueduct project (Superaqueduct). The line of credit was restructured and refinanced through the issuance by Puerto Rico Public Finance Corporation (PFC), a component unit of GDB, on August 1, 2001, of approximately $356.7 million of Series A Bonds at a premium of approximately $2.3 million and approximately $33.3 million of Series B Bonds. The net proceeds of the 2001 Series A and B Bonds of approximately $381.1 million, after payment of the cost of issuance of approximately $9.6 million and approximately $1.6 million, set aside to cover capitalized interest, were used by PFC to purchase the outstanding promissory note of the Authority from GDB.

The Authority's 2001 Series A and B Bonds are secured by promissory note payments made by the Commonwealth to PFC pursuant to a Debt Restructuring and Assignment Agreement, dated August 1, 2001, between the Authority and PFC. In accordance with J.R. 523, such payments shall be funded by Commonwealth appropriations approved annually up to a maximum of approximately $34.9 million per fiscal year for a term of 30 years ending in fiscal year 2031-2032. The Commonwealth is not legally bound to appropriate funds for such promissory payments. Payments of principal and interest on the bonds are due on or before July 15 of each fiscal year, commencing July 15, 2004.

Act 164 PFC Bonds

On December 17, 2001, Act No. 164 (Act 164) of the Commonwealth authorized departments, agencies, instrumentalities, and public corporations of the Commonwealth, including the Authority, to restructure their outstanding obligations with GDB, for which no repayment source existed, over a period not exceeding 30 years.

Pursuant to Act 164, on January 16, 2002, PFC issued approximately $771.3 million of Series C Bonds, approximately $40.7 million of Series D Bonds, and $1,091.0 million of Series E Bonds, for the purpose of funding the purchase by PFC of certain promissory notes held by GDB. The Authority's then outstanding debt with GDB of approximately $609.2 million was restructured with proceeds of approximately $712.1 million from these issuances which included capitalized interest and issuance cost and its note evidencing this debt was purchased by PFC from GDB.

10. Bonds Payable (continued)

Act 164 PFC Bonds (continued)

The 2001 Series C and E Bonds are secured by promissory note payments made by the Commonwealth to PFC pursuant to a Debt Restructuring and Assignment Agreement dated July 1, 2001, between the debtors, including the Authority, and PFC. In accordance with Act 164, such payments shall be funded by Commonwealth appropriations approved annually up to a maximum of approximately $225 million per fiscal year for a term of 30 years. The Commonwealth is not legally bound to appropriate funds for such promissory notes payments. Payments of principal and interest on bonds are due on or before July 15 of each fiscal year, commencing July 15, 2004.

On June 28, 2004, PFC issued approximately $1,206.1 million of Series A Refunding Bonds at a premium of approximately $89.4 million, and approximately $146.9 million of Series B Refunding Bonds, for the purpose of refunding a portion of certain of its outstanding bonds.

The net proceeds from the 2004 Series A and B Refunding Bonds amounting to approximately $1,395 million, after payment of the cost of issuance and bond premium of approximately $47.4 million, were used to advance refund a portion of PFC's previously issued bonds in order to obtain lower interest rates. The Authority's allocable share of the total refunded debt was approximately $734 million at the issuance date including the unrefunded original PFC debt and the refunded debt through 2004 Series A and B. This refunding resulted in the Authority's recognition of net debt issuance cost of approximately $11.7 million, a net premium of approximately $44.4 million, and deferred refunding loss of approximately $67.2 million, all of which is being amortized over the term of the new debt, which is through 2031.

The 2004 Series A and B Bonds are secured by promissory notes payments made by the Commonwealth to PFC pursuant to Supplemental Debt Restructuring and Assignment Agreements, between the debtors, including the Authority, and PFC. In accordance with various Appropriation Acts, principal and interest payments on such notes shall be funded by Commonwealth appropriations approved annually for the number of fiscal years specified in such Appropriation Acts. The Commonwealth is not legally bound to appropriate funds for such repayments. Until the fiscal year beginning July 1, 2005, the Authority's promissory note payments were made by Commonwealth appropriations authorized by J.R. 523 and Act 164. Payments of principal and interest on bonds are due on or before July 15 of each fiscal year.

10. Bonds Payable (continued)

Act 164 PFC Bonds (continued)

On July 31, 2007, December 20, 2007 and June 26, 2008, the Puerto Rico Sales Tax Financing Corporation (known as COFINA for its Spanish acronym), a component unit of the Commonwealth, issued its Sales Tax Revenue Bonds Series 2007A and B, Series 2007C and Series 2009A, 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 2009A 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 legally 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 2009A Bonds were used to purchase and cancel approximately $127.4 million of the Authority's share of the Act 164 PFC Bonds.

As of June 30, 2007, the Authority's share of the Act 164 PFC Bonds was approximately $721.3 million. After the COFINA debt refunding, the balance was reduced to approximately $341.6.

2004 Series A Refunding Bonds

The 2004 Series A Refunding Bonds mentioned above, also refinanced outstanding debt related to the Superaqueduct. The 2004 Series A balance related to the Superaqueduct was approximately $326.8 million as of the refunding date, with maturity dates ranging from August 1, 2013 to August 1, 2031.

2008 Revenue Bonds Series A and B

On March 18, 2008, the Authority issued approximately $1,338.6 million of Revenue Bonds, Series A and B (the 2008 Revenue Bonds). The 2008 Revenue Bonds Series A 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 dates ranging from July 1, 2017 to 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, 2026 to July 1, 2047.

10. Bonds Payable (continued)

2008 Revenue Bonds Series A and B (continued)

As of June 30, 2010, the outstanding balance for the 2008 Revenue Bonds Series A was approximately $1,335.1 million, which included approximately $18.9 million of accreted value. The 2008 Revenue Bonds Series B consist of an approximately $22.4 million term bond bearing interest at 6.15% per annum and maturing on July 1, 2038. The 2008 Revenue Bonds were issued, to raise funds to be used by the Authority to repay certain outstanding bond anticipation notes and lines of credit and to pay a portion of the cost of the Authority's capital improvement program. The 2008 Revenue Bonds are considered senior debt.

2008 Revenue Refunding Bonds Series A and B

On March 18, 2008, the Authority issued approximately $284.8 million of Revenue Refunding Bonds, Series A and B (the 2008 Revenue Refunding Bonds), (guaranteed by the Commonwealth) to refund the Authority's outstanding Revenue Refunding Bonds, Series 1995 (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 Revenue Refunding Bonds, Series A and B 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 Series 1995 Bonds to their respective dates of redemption or maturity. As a result, the 1995 Series Bonds are considered to be legally defeased and the liability for those bonds has been removed from the Authority's balance sheets.

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 deduction from bonds payable, is being charged to operations through the year 2019 following a method substantially equivalent to the effective interest method.

10. Bonds Payable (continued)

2008 Revenue Refunding Bonds Series A and B (continued)

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.

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, 2010, the USDA Rural Development Program Serial Bonds consisted of twenty-four (24) separate series, issued from 1983 through 2009, bearing interest from 4.25% to 5% due in semiannual installments through 2050. The outstanding balance of the USDA Rural Development Program Serial Bonds as of June 30, 2010 and 2009 was approximately $312.1 million and $302.7 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 Serial Bonds. The USDA Rural Development Program Serial Bonds are subordinate to all senior and senior subordinated.

10. Bonds Payable (continued)

Debt Service Payments

Future principal and interest payments on all bonds payable outstanding at June 30, 2010 are as follows (in thousands):

	Principal	Interest	Total
Fiscal year:			
2011	$ 11,608	$ 129,701	$ 141,309
2012	15,169	141,509	156,678
2013	18,693	136,162	154,855
2014	33,406	135,516	168,922
2015	34,970	134,035	169,005
2016 – 2020	215,914	638,842	854,756
2021 – 2025	290,873	571,006	861,879
2026 – 2030	580,661	466,526	1,047,187
2031 – 2035	505,580	316,357	821,937
2036 – 2040	298,581	218,819	517,400
2041 – 2045	370,966	123,180	494,146
2046 – 2050	263,931	20,706	284,637
Total	2,640,352	$ 3,032,359	$ 5,672,711
Plus unamortized premium	36,316		
Less:			
Unamortized discount	(16,244)		
Deferred loss on debt refunding	(79,445)		
Bonds payable, net	$ 2,580,979		

11. Notes Payable

Notes payable consisted of the following (in thousands):

	June 30	
	2010	**2009**
Puerto Rico Water Pollution Control Revolving Fund	**$ 249,687**	$ 207,016
Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund	**126,106**	114,199
Notes with commercial banks	**244,688**	247,436
	$ 620,481	$ 568,651

The Puerto Rico Water Pollution Control Revolving Fund and 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 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 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). 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, 2010 and 2009, the Authority had outstanding approximately $375.8 million and $321.2 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 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.

11. Notes Payable (continued)

On September 8, 2006, the Authority entered into a $250 million term loan agreement with various commercial banks. The proceeds were used to repay various lines of credit with GDB and pay costs and fees associated with the term loan. During fiscal year 2010 the loan bored interest at 3.25%. The loan is payable in quarterly installments commencing on September 1, 2008 and due on September 1, 2011. The outstanding balance as of June 30, 2010 and 2009 was approximately $244.7 million and $247.4 million respectively. The net revenue of the Authority, as defined in the Term Loan Agreement, is pledged toward payment of debt service on this term loan. The notes are considered senior subordinated debt and are subordinated to the senior debt.

The combined future aggregate amount of debt service for these loans as of June 30, 2010 was as follows (in thousands):

	Principal	Interest	Total
Year ending June 30:			
2011	$ 19,448	$ 13,078	$ 32,526
2012	258,002	6,715	264,717
2013	16,001	4,384	20,385
2014	16,323	4,062	20,385
2015	16,592	3,734	20,326
2016 – 2020	73,774	13,932	87,706
2021 – 2025	61,610	7,211	68,821
2026 – 2030	38,867	1,621	40,488
	500,617	$ 54,737	$ 555,354
Interim construction loans:			
Puerto Rico Water Pollution Control Revolving Fund	96,735		
Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund	23,129		
Total	$ 620,481		

12. Lines of Credit

On October 19, 2000, the Authority entered into a line of credit agreement with GDB. This agreement provides the Authority with an available maximum amount of approximately $103.9 million. On October 29, 2004, the maximum available amount was increased to approximately $276 million to assist the Authority in financing the construction of aqueduct and sewer facilities in rural areas. As of June 30, 2009, the Authority had an outstanding balance of approximately $14.6 million. During fiscal year 2010 the line of credit was repaid and a new line of credit of $37.6 million was established for construction of rural projects.

On November 13, 2006, the Authority entered into a line of credit agreement with GDB. This agreement provides the Authority with an available maximum amount of $190 million to be used to provide funding for the capital improvement program of the Authority. On February, 2010, an increase of $60 million for a maximum amount of $250 million was approved. As of June 30, 2010 and 2009, the Authority had an outstanding balance of $250 million under this line of credit agreement.

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 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 2009 Revenue Bonds. This line of credit is due on June 30, 2013. As of June 30, 2009, the Authority had an outstanding balance of $150 million and no outstanding balance as of June 30, 2010.

On May 4, 2009, the Authority entered into a revolving line of credit agreement with GDB. This agreement provides the Authority with an available maximum amount of $87.6 million to be used to provide funding for the capital improvement program of the Authority. As of June 30, 2010 and 2009, the Authority had an outstanding balance of approximately $87.6 and $43.8 million respectively.

On November 12, 2009, the Authority entered into a revolving line of credit agreement with GDB. This agreement provides the Authority with an available maximum amount of $125 million to be used to provide funding for the capital improvement program of the Authority. As of June, 2010, the Authority had an outstanding balance of $125 million.

12. Lines of Credit (continued)

On December 8, 2009, the Authority entered into a line of credit agreement with GDB. This agreement provides the Authority with an available maximum amount of approximately $37.6 million to assist the Authority in financing the construction of aqueduct and sewer facilities in rural areas. As of June 30, 2010, the Authority had an outstanding balance of approximately $8.5 million under this line of credit agreement.

On December 30, 2009, the Authority entered into a line of credit agreement with GDB. This agreement provides the Authority with an available maximum amount of $150 million to be used to provide funding for the capital improvement program of the Authority. As of June, 2010, the Authority had an outstanding balance of $150 million.

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 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, and the American Recovery Act ("ARRA"). 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, 2010, the Authority had an outstanding balance of $16.8 million on this line of credit.

On April 16, 2010, the Authority entered into a revolving line of credit agreement with GDB. This agreement provides the Authority with an available maximum amount of $50 million to be used to provide funding for the capital improvement program of the Authority. On June 7, 2010, the maximum available amount was increased to approximately $113.9 million. As of June 30, 2010, the total amount was outstanding.

Future amounts required to pay principal balances at June 30, 2010 are as follows (in thousands):

Fiscal year:	
2011	$ –
2012	–
2013	751,283
	$ 751,283

13. Financial Covenants

The Master Agreement of Trust (the MAT) governing the 2008 Revenue Bonds and the Term Loan Agreement governing the notes with commercial banks, each contain distinct financial covenants requiring the maintenance of certain financial ratios.

The MAT contains a rate covenant requiring the Authority to fix, charge, collect and revises rates, fees and other charges for the use of and the services furnished by its systems so as to meet in each fiscal year, the following annual debt service requirements: (i) net revenues shall be at least equal to 120% of the annual debt service with respect to the senior indebtedness for such fiscal year; (ii) net revenues shall be at least equal to 110% of the annual debt service with respect to senior indebtedness and senior subordinated indebtedness for such fiscal year; and (iii) net revenues shall be sufficient to pay 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, 2010 and 2009, the Authority was in compliance with the senior indebtedness and the senior and senior subordinated indebtedness annual debt service coverage requirements.

During fiscal year 2009, the Authority was unable to make the deposits required under the MAT for the Commonwealth Supported Obligations debt, and the payment as its due date was made by the Commonwealth. This constitutes an event of non compliance of the rate covenant, however, failure by the Authority to pay principal of or interest on Commonwealth Guaranteed Indebtedness or Commonwealth Supported Obligations does not constitute an event of default under the MAT.

The Term Loan Agreement requires the Authority to maintain, for each fiscal year, a senior and senior subordinated debt service coverage ratio equal to at least 1.20. As of June 30, 2010 and 2009, the Authority was in compliance with the senior and senior subordinated debt service coverage ratio under the Term Loan Agreement.

14. Capital Contributions

Capital contributions for the fiscal years ended June 30, 2010 and 2009 were as follows (in thousands):

	June 30 2010		June 30 2009	
Appropriations from Commonwealth	**$**	**3,802**	$	1,725
Other contributions from Commonwealth		**942,879**		541
Federal grants:				
USDA Rural Development Program		**8,044**		11,250
Federal Emergency Management Agency		**4,325**		1,279
Developer contributions - Net		**1,976**		5,609
Other contributions		**8,351**		1,729
	$	**969,377**	$	22,133

Other contributions from the Commonwealth include capital assets transferred from PRIFA for the amount of $933.4 million for the year ended June 30, 2010.

15. Related-Party Transactions

Operating revenues for services provided to the Commonwealth and its component units amounted to approximately $84.5 million and $78.6 million during the years ended June 30, 2010 and 2009, respectively. Further, operating, administrative, and general expenses during the fiscal years ended June 30, 2010 and 2009 included approximately $140.1 million and $136.5 million, respectively, of charges from Puerto Rico Electric Power Authority (PREPA), a component unit of the Commonwealth.

As of June 30, 2010 and 2009, the Authority had approximately $65 million and $71.4 million, respectively, of receivables from the Commonwealth and its component units, which were reported in accounts receivable in the accompanying basic financial statements.

The Authority had approximately $1.1 million and $1.6 million of excess of collections over billings from the Commonwealth, recorded as unearned revenue in the basic financial statements as of June 30, 2010 and 2009, respectively.

Over the years, GDB, as fiscal agent and bank of the Commonwealth, had extended lines of credit to the Authority in order to finance capital improvement projects and operational deficits. As of June 30, 2010 and 2009, the Authority had an outstanding balance of approximately $751.3 million and $458.4 million, respectively, under these lines of credit.

16. Pension Plan

The Government of Puerto Rico Employees Retirement System (ERS) is a cost-sharing multiple-employer defined benefit pension plan sponsored by, and reported as a component unit of, the Commonwealth. All regular employees of the Authority under the age of 55 at the date of employment 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 nonoccupational disabilities are available to members enrolled in the plan before January 1, 2000. Benefits vest after ten years of plan participation.

The amount of the annuity shall be one and one half percent (1.5%) of the average compensation multiplied by the number of years of creditable service up to twenty (20) years, plus two percent (2%) of the average compensation multiplied by the number of years of creditable service in excess of twenty years. In no case shall the annuity be less than $200 per month.

Participants who have completed at least thirty years of creditable service are entitled to receive a Merit Annuity. Such participants who have not attained fifty-five years of age will receive 65% of the average compensation or if they have attained fifty-five years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and nonoccupational disability. However, for nonoccupational disability a member must have at least ten years of service. No benefits are payable if participants receive a refund of their accumulated contributions.

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

Total employer contributions during years ended June 30, 2010, 2009, and 2008 amounted to approximately $10 million, $10.7 million, and $10.9 million, respectively, which represented 100% of required contributions.

16. Pension Plan (continued)

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). System 2000 became effective on 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. Employees joining the Authority on or after January 1, 2000 are only allowed to become members of System 2000.

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 reduces the retirement age from 65 years to 60 for those employees who joined the ERS on or after April 1, 1990. Disability pensions are not granted under System 2000. The employers' contributions (9.275% of the employee's salary) are used to fund the defined benefit plan.

Total employer contributions during the fiscal years ended June 30, 2010, 2009, and 2008, amounted to approximately $4 million, $4 million, and $3.4 million, respectively, which represented 100% of required contributions.

Additional information on the ERS is provided in its financial statements for the years ended June 30, 2010 and 2009, a copy of which can be obtained from the Administrator of the Retirement System: P.O. Box 42003, San Juan, Puerto Rico 00940.

17. 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. Benefits consist of 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 "Union Independiente Autentica" (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 employees. All employees with more than 20 years of rendered service within the Authority are eligible for the healthcare benefit upon retirement age. Normal retirement age is as follows:

- For those employees employed by the Authority before March 30, 1990, normal retirement age would be at:
  - 30 years of service;
  - 10 to 24 years of service and 58 years old; or
  - 25 years of service and 55 years old.
- For employees employed by the Authority after March 30, 1990, normal retirement age would be at:
  - 10 years of service and 65 years old; or
  - 25 years of service and 55 years old.

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 each collective bargain agreement. 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 year ended June 30, 2010 and 2009 was approximately $2.5 million and $2.9 million, respectively, which is in accordance with the funding policy. There is no contribution requirement for plan members.

17. Other Postemployment Benefits (continued)

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, 2010 in accordance with parameters of GASB Statement No. 45 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.

The annual required contribution estimated for the years ended June 30, 2010 and 2009 amounted to (in thousands):

	2010	2009
Annual Required Contribution (ARC):		
Normal costs:	**$ 1,715**	$ 1,395
Amortization of initial UAAL:	**4,100**	5,029
Amortization of (Gain)/Loss:	**1,738**	–
GASB Statement No. 45 Annual Required Contribution	**$ 7,553**	$ 6,424

OPEB costs components for the years ended June 30, 2010 and 2009 are as follows (in thousands):

	2010	2009
Annual OPEB Costs		
ARC for fiscal year	**$ 7,553**	$ 6,424
Interest on Net OPEB Obligation	**278**	–
ARC Amortization Adjustment	**(821)**	–
Total Annual OPEB Costs	**$ 7,010**	$ 6,424

17. Other Postemployment Benefits (continued)

Annual OPEB costs and Net OPEB obligation (continued)

The net OPEB obligation change for the years ended June 30, 2010 and 2009 is as follows (in thousands):

	2010	2009
Change in net OPEB obligation:		
Net OPEB obligation:	**$ 7,928**	$ 4,360
Total annual OPEB costs:	**7,010**	6,424
Actual benefit payments:	**(2,485)**	(2,856)
Net OPEB obligation:	**$ 12,453**	$ 7,928

The net OPEB obligation is recorded as a component of compensated absences and postemployment benefits in the accompanying balance sheet as of June 30, 2010 and 2009.

Funded Status

Funded status of the plan as of June 30, 2010, the most recent actuarial valuation date, is as follows (in thousands):

	2010	2009
Unfunded Actuarial Accrued Liability (UAAL):		
Active employees	**$ 23,721**	$ 21,289
Retirees	**32,693**	25,775
Actuarial accrued liability	**56,414**	47,064
Actuarial value of assets	**–**	–
UAAL	**$ 56,414**	$ 47,064

The schedule of funding progress included as required supplementary information presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

17. Other Postemployment Benefits (continued)

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, 2010 and 2009 was 3.5% and 4.59% respectively. For fiscal year 2010 US 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 for the years ended June 30, 2010 and 2009. 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.

Turnover

For the years ended June 30, 2010 and 2009, the turnover table used for the valuation was the Standard Hewitt Withdrawal Table for Hourly Union Employees – 5 years of service select period.

Healthy Mortality

The RP-2000 Combined Healthy Mortality Table projected to 2009 by Scale AA was used for the valuation of the benefit granted by the plan.

17. Other Postemployment Benefits (continued)

Disability Table

The Hunter disability table was used for the valuation.

Actuarial Cost Method

The actuarial cost method used for by the Authority is 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 on fiscal year ended June 30, 2008. The years of service projection considers multiple decrement tables and the latest age of retirement, considered to be 65 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.

18. Labor Union Contracts

The collective bargaining agreement with the HIEPAAA union, which covers approximately 170 professional employees, was signed effective June 1, 2005 until May 31, 2009. On August 22, 2009, the agreement was extended up to May 31, 2010. As of June 30, 2010 the labor agreement is currently under negotiation.

The collective bargaining agreement with the UIA union, which covers approximately 3,800 blue-collar and clerical employees, expired on June 30, 2003. During the year ended June 30, 2005, the UIA employees went on strike for eighty-four (84) days. At the conclusion of the strike, the UIA and the Authority reached an agreement as to a new labor contract. As of June 30, 2010, the contract was in process of being formalized and signed by the parties.

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

During fiscal year 2001, Thames-Dick Superaqueduct Partners and the Authority signed a contract for the operation and maintenance of the water intakes and the interconnections tanks with the Authority distribution system, along the PR North Coast route, from Arecibo to Bayamon (Superaqueduct). The contract also includes the operation of a filter plant. Thames-Dick is responsible for the operation, maintenance, security, and for the environmental and regulatory compliance (water quality) for all the operations under the contract. All costs associated with the contract ($22.8 million and $25.5 million for the years ended June 30, 2010 and 2009, respectively) are reported under the caption of *Service contract – Superaqueduct* in the accompanying statements of revenues, expenses, and changes in net assets.

20. Commitments and Contingencies

Environmental Matters

Facilities and operations of the Authority's water and sewer system are subject to regulations under numerous 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) known as, PRASA IV with EPA to attain compliance with the Clean Water Act in relation to the Authority's wastewater pump stations (WWPSs). The Authority completed all improvements projects required by EPA for these WWPSs. This agreement also required the Authority to invest $1 million in the implementation of a Supplemental Environmental Project (SEP). This project consists of the hook up of three NON-PRASA communities to the Authority's drinking water system. The agreement also required the implementation of the Preventive Maintenance Program (PMP) for all of PRASA's WWPSs. This is scheduled to be completed by December of 2010.

  The Authority has paid stipulated penalties ranging from $30 to $150 thousands on a quarterly basis for by-passes that occurred at the pump stations. The amount paid during fiscal year 2010 was $.4 million.

20. Commitments and Contingencies (continued)

Environmental Matters (continued)

- On June 22, 2006, the Authority entered into a consent decree (Civil Action No. 06-1624) with EPA that requires the Authority to implement system-wide remedial measures at all of the wastewater treatment plants operated by the Authority. The decree establishes deadlines for the compliance with the conditions set forth in the agreement and stipulates penalties for violation of any of those deadlines. The Authority was assessed a penalty of $1 million which was paid during fiscal year 2008. In accordance with this consent decree, the Authority deposited in an escrow account with GDB the amount of $3 million. These funds will be used for providing sewer service to a community that has not been connected to the Authority's sewer system. The Authority has paid stipulated penalties ranging from $.3 million to $.5 million on a yearly basis for non compliance with the agreement. During fiscal year 2010 the Authority deposited the amount of $.5 million in an escrow account.

- 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. In addition, the agreement required the Authority 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 million to prevent direct discharges to the Martin Peña Channel, (ii) upgrade nine waste water treatment plants for a cost not less than $109 million, and (iii) comply with a 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, PRASA is in compliance with the deadlines and requirements of this Consent Order.

- 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 PRASA's water systems.

20. Commitments and Contingencies (continued)

Environmental Matters (continued)

As part of the agreement, the Authority paid a penalty of $1 million during fiscal year ended June 30, 2007. 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. During fiscal year ended June 30, 2010, the Authority paid the amount of $100 thousand, part paid in penalties and part deposited in an escrow account.

- 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 closed 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 penalty of $3.2 million which will be paid during fiscal year 2011. In accordance with this consent decree, from the amount of $3.2 million, the Authority will have to pay a civil penalty of approximately $1 million to the Treasurer of the United States of America and will have to deposit in an escrow account with GDB, $2.5 million for the design and construction of a SEP. One of the projects that are under evaluation is the installation of aerations systems to improve water quality in Lake Cidra and Lake Toa Vaca.

The Authority is a defendant in other environmental minor lawsuits, pending trial or final judgment. The Authority intends to vigorously defend itself against all of the allegations. Management, based on the advice of legal counsel, is of the opinion that any liability that may result from such lawsuits would not have a material adverse effect on the Authority's financial position as of June 30, 2010.

20. Commitments and Contingencies (continued)

Risk Management

The Authority has acquired 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. 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:

Coverage	Deductible	Policy Limit
Real and personal property:		
Windstorm	$25 million plus a 2% additional deductible up to a maximum of $7.5 million per location	$150 million
Flood	$25 million plus a 2% additional deductible up to a maximum of $3 million per location	$300 million
Earthquake	$25 million plus a 5% additional deductible up to a maximum of $7.5 million per location	$300 million
All other	$25 million plus $150 thousand occurrence	$150 million
Comprehensive general liability:		
General liability	$100 thousand per occurrence	$2 million
First excess liability	—	In excess of $2 million up to $20 million
Second excess liability	—	In excess of $20 up to $40 million
Automobile	—	$1 million

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

20. Commitments and Contingencies (continued)

Construction Projects

The Authority enters in construction projects for the replacements or expansion of its facilities. As of June 30, 2010, there were outstanding commitments for projects in process for approximately $688.4 million.

Operating Leases

Certain commercial offices and warehouse facilities of the Authority are leased under operating lease agreements. During the years ended June 30, 2010 and 2009, the Authority incurred approximately $3.8 million and $4.9 million, respectively, in rent expense.

Future minimum noncancelable lease payments on existing operating leases at June 30, 2010, which have an initial term of one year or more, are as follows (in thousands):

2011	$	1,859
2012		1,343
2013		1,029
2014		497
2015		417
2016 – 2020		1,264
2021 – 2025		128
	$	6,537

Litigation

The Authority is defendant various lawsuits presented by customers alleging that the Authority has over billed them due to the methodology used to estimate consumption. The plaintiffs requested a certification of the suit as a class action and seek recovery of damages in the amount of approximately $793 million and an injunction enjoining the Authority from continuing to bill using the current methodology. The Authority's potential exposure from these lawsuits cannot be presently determined and, as such, no liability is being reported on the accompanying basic financing statements.

The Authority is the defendant or codefendant in various other lawsuits. The ultimate outcome of the lawsuits cannot presently be determined. However, management, based on the advice of legal counsels, is of the opinion that these lawsuits will not have a material impact on the basic financial statements.

20. Commitments and Contingencies (continued)

Future Commitments

On August 17, 2009, the Authority entered into an Asset Purchase Agreement (the Agreement) with the Puerto Rico Industrial, Tourism, Educational, Medical and Environmental Facilities Financing Authority (AFICA), a public corporation of the Commonwealth of Puerto Rico. Subject to the terms and conditions set forth in the Agreement, no later than August 16, 2011, the Authority will purchase from AFICA certain assets that were being used to develop the Southern Gas Pipeline Project for the total purchase price of $23.5 million and will assume the rights and obligations of PREPA under a Subordinated Loan Agreement between AFICA and PREPA and a Subordinated Note issued thereunder up to $35 million.

Required Supplementary Information

Puerto Rico Aqueduct and Sewer Authority

(A Component Unit of the Commonwealth of Puerto Rico)

Required Supplementary Information
Schedule of Funding Progress for Postemployment Healthcare Benefits

(In thousands)

Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded Actuarial Liability	Funded Ratio	Annual Covered Payroll	UAAL as a Percentage of Covered Payroll
July 1, 2009	$ –	$ 56,414	$ 56,414	—%	$ 159,564	35%

See accompanying independent auditors' report.

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