AUDITED FINANCIAL STATEMENTS

Puerto Rico Aqueduct and Sewer Authority

(A Component Unit of the Commonwealth of Puerto Rico)
Years Ended June 30, 2013 and 2012
With Report of Independent Auditors

Ernst & Young LLP

Building a better
working world

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

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Years Ended June 30, 2013 and 2012

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Report of Independent Auditors

The Board of Directors
Puerto Rico Aqueduct and Sewer Authority

Report on the Financial Statements

We have audited the accompanying financial statements of Puerto Rico Aqueduct and Sewer Authority (a component unit of the Commonwealth of Puerto Rico) (the Authority), which comprise the balance sheets as of June 30, 2013 and 2012, and the related statements of revenues, expenses and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles, this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States, and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Puerto Rico Aqueduct and Sewer Authority at June 30, 2013 and 2012, 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 31, 2013, on our consideration of the Puerto Rico Aqueduct and Sewer Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 4 through 24 and the schedule of funding progress on page 85 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that the Authority's basic financial statements. The supplemental schedule of financial results and debt coverage calculation per 2012 amended and restated master agreement of trust (schedule) on page 86 is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The schedule is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements of the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the schedule is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Ernst & Young LLP

December 31, 2013

Stamp No. E88342
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, 2013, 2012 and 2011. Please read it in conjunction with the Authority's financial statements, which follow this section.

June 30, 2013 and 2012 Financial Highlights

- The Authority's net position decreased by $459.4 million to $2,539.5 million, or 15.3%, which represents a decrease of $524 million when compared to the 2012 increase in net position on of $64.5 million. The decrease was primarily as the net result of a decrease in operating revenues of $77.4 million, an increase of total operating expenses, including depreciation and amortization of $77.7 million, an increase in nonoperating expenses of $336.9 million, and a decrease in capital contributions of $32 million.
- Operating revenues decreased by $77.4 million to $735.7 million, or 9.5%, mainly due to a decrease of $70.2 million from appropriations from the Central Government and an increase in the provision for bad debts of $8 million.
- Operating expenses, including depreciation and amortization, increased by $77.7 million to $1,027.6 million, or 8.2%, primarily as a result of an decrease in chemical expenses of $6.7 million, an increase of other operating expenses of $2.4 million, a decrease in payroll and related expenses of $3.5 million, a decrease in repairs and maintenance expenses of $3.4 million and the net effect of a an increase in electricity expenses of $9 million, an increase in depreciation and amortization expense of $21.1 million, and an increase of cost of asset disposition of $63.9 million.
- Non operating revenues and (expenses) decreased by $336.9 million to a net expense of $187.6 million, primarily as a result of a reduction of $304 million in Commonwealth contributions of debt refunding on PFC bonds occurred during fiscal year ended June 30, 2012, an increase of $40.1 million in interest expense, net of amortization of debt issuance cost, bond premium and discount, and deferred refunding losses, an increase of $5.9 million of Commonwealth contributions for payment of interest on PFC bonds, and an increase of $2.8 million in interest income.

June 30, 2013 and 2012 Financial Highlights (continued)

- Capital contributions decreased by $32 million to $20.1 million, primarily as a result of a decrease of $12.7 million in federal grants received from Rural Development, a decrease of $13.6 million of American Recovery & Reinvestment Act funds and a decrease of $5.7 million from Federal Emergency Management Agency.
- Total assets decreased by $368 million to $8,229.7 million or 4.3%, primarily due to an increase in current assets of $9.1 million, a decrease in restricted assets of $437.9 million, and an increase in Authority's capital assets net of depreciation and amortization of $61.7 million. Total liabilities increased by $91.5 million to $5,690.2 million or 1.6%, primarily as a result of a net increase of $47.8 million in accounts payable and accrued liabilities, an increase in long term debt of $27.3 million, and an increase in other liabilities of $16.4 million.

June 30, 2012 and 2011 Financial Highlights

- The Authority's net position increased by $64.5 million to $2,998.9 million, or 2.2%, which represents an increase of $176.7 million when compared to the 2010 decrease in net position of $112.7 million. The increase was primarily as the net result of an increase in operating revenues of $4 million, an increase of total operating expenses, including depreciation and amortization and cost of asset disposition, of $101.2 million, a decrease in nonoperating expenses of $256.1 million, and an increase in capital contributions of $17.8 million.
- Operating revenues increased by $4 million to $813.2 million, or 1.0%, due to an increase in water and sewer revenues of $23.8 million, an increase in the provision for bad debts of $5.0 million and a decrease of $14.7 million from appropriations received from the Central Government.
- Operating expenses, including depreciation and amortization, increased by $101.2 million to $949.9 million, or 11.9%, primarily as a result of an increase in payroll and related expenses of $24.6 million, an increase in repairs and maintenance expenses of $3.3 million, an increase in electricity expenses of $43.6 million, an increase of other operating expenses of $41.9 million, an increase in chemical expenses of $6.1 million, an increase in depreciation and amortization expense of $10.1 million, a decrease of the service contract of the Superaqueduct of $22.7 million as a result of the Authority reassuming control of its operations, a decrease of professional and consulting services of $2.4 million, and a decrease in materials an replacements of $3.7 million.

June 30, 2012 and 2011 Financial Highlights (continued)

- Non operating revenues and (expenses) increased by $256.1 million to $149.2 million, primarily as a result of an increase of $319.6 million for a contribution from Puerto Rico Sales Tax Financing Corporation (known as COFINA, for its Spanish acronym), a component unit of the Commonwealth of Puerto Rico (the Commonwealth) to repay certain Commonwealth Appropriations Bonds, a loss of $15.6 million on COFINA debt redemption, a decrease of $38.5 million of Commonwealth contributions for interest payments of bonds and notes, and an increase of $13.1 million in interest expense, net of amortization of debt issuance cost, bond premium and discount, and deferred refunding losses.
- Capital contributions increased by $17.8 million to $52.1 million, primarily as a result of an increase of $20.1 million in federal grants received from Rural Development.
- Total assets increased by $856.6 million to $8,597.6 million or 11.1%, primarily due to an increase in current assets of $54.7 million, increase in noncurrent assets of $645.8 million as a result of the proceeds of 2012 Series A and B Revenue Bonds, other assets for the amount of $9.2 million and an increase of $146.8 million in the Authority's capital assets. Total liabilities increased by $792.1 million to $5,598.7 or 16.5%, primarily as a result of an increase in long term debt of $790.1 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 position report the net position of the Authority and the changes therein. The Authority's net position – the difference between assets and liabilities – can be used to measure its financial health or financial position. Increases or decreases in the Authority's net position are one indicator of whether its financial health is improving or deteriorating. However, other nonfinancial factors need to be considered such as changes in economic conditions and new or changed government regulations.

Analysis of Financial Results

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

	June 30		
	2013	**2012**	**Change**
Current and other assets	**$ 809,247**	$ 1,238,818	$ (429,571)
Capital assets, net	**7,420,468**	7,358,802	61,666
Total assets	**8,229,715**	8,597,620	(367,905)
Long-term debt outstanding	**5,082,304**	5,055,030	27,274
Other liabilities	**607,936**	543,675	64,261
Total liabilities	**5,690,240**	5,598,705	91,535
Net position:			
Net investment in capital assets	**2,745,582**	3,205,651	(460,069)
Restricted	**82,760**	26,186	56,574
Unrestricted deficit	**(288,867)**	(232,922)	(55,945)
Total net position	**$ 2,539,475**	$ 2,998,915	$ (459,440)

	June 30		
	2012	**2011**	**Change**
Current and other assets	$ 1,238,818	$ 529,006	$ 709,812
Capital assets, net	7,358,802	7,212,020	146,782
Total assets	8,597,620	7,741,026	856,594
Long-term debt outstanding	5,055,030	4,264,882	790,148
Other liabilities	543,675	541,732	1,943
Total liabilities	5,598,705	4,806,614	792,091
Net position:			
Invested in capital assets, net of related debt	3,205,651	3,374,252	(168,601)
Restricted	26,186	24,482	1,704
Unrestricted deficit	(232,922)	(464,322)	231,400
Total net position	$ 2,998,915	$ 2,934,412	$ 64,503

Net Position

June 30, 2013 and 2012

The Authority's net position as of June 30, 2013 was approximately $2,539.5 million. This is a decrease of $459.4 million from the net position as of June 30, 2012 of $2,998.9 million.

Total assets decreased by $367.9 million during the fiscal year ended June 30, 2013.

Restricted cash and unrestricted cash and cash equivalents as of June 30, 2013, decreased by $437.9 million when compared with June 30, 2012. The decrease is primarily due to uses of 2012A Bonds proceeds for financing capital improvement projects of $200 million, the request of the Budgetary Reserve funds balance of $145 million, and the use of capitalized interest fund for 2008 Series A and B Revenue Bonds of $78 million.

Current assets increased by $9.1 million, primarily a net effect of an increase in cash and cash equivalents of $39.6 million, an increase in material and supply inventory of $3.9 million, and a decrease in accounts receivables of $33.5 million.

Capital Assets increased by $61.7 million due to net current year additions of $390.4 million offset by current year depreciation and amortization including retirements of $328.7 million.

Total liabilities increased by $91.5 million to $5,690.2 million, or 1.6%. Total current liabilities increased by $150.5 million mainly as a result of an increase $47.8 million in accounts payable and accrued liabilities, an increase in the current portion of long term debt of $90.5 million, and an increase of $14.3 million in accrued interest.

Total non-current liabilities decreased by $58.9 million, primarily as a result of the net effect of the reclassification of the lines of credit from noncurrent liabilities to current liabilities of $89.8 million, an increase in bonds payable of $26.7 million as a net result of the issuance of the Series II Rural Development Bonds of $45.5 million, the payment of principal on 2008 Series A and B Revenue Bonds of $13 million the payment of principal on Rural Development Bonds of $9.0 million, an amortization of $3.7 million in bonds premiums, discounts and deferred refunding losses, and an increase in notes payable of $19.7 million due to the net effect of borrowings and payments of the Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund.

Net Position (continued)

June 30, 2012 and 2011

The Authority's net position as of June 30, 2012 was approximately $2,998.9 million. This is an increase of $64.5 million from the net position as of June 30, 2011 of $2,934.4 million.

Total assets increased by $856.6 million during the fiscal year ended June 30, 2012.

Restricted cash and unrestricted cash and cash equivalents as of June 30, 2012, increased by $645.3 million when compared with June 30, 2011. The increase is primarily due to deposits made to restricted accounts of the net proceeds from the issuance of 2012 Series A and B Revenue Bonds and Series HH Rural Development Bonds.

Accounts receivable, net, increased by $9.9 million primarily due the net effect of a an increase of $38.5 million in accounts receivable from water and sewer services customers, an increase of $2.4 million in other receivables, reduced for an increase in the allowance for doubtful accounts of $30.9 million.

Receivable from Commonwealth for the amount of $51.8 million as of June 30, 2012, represents proceeds from PFC 2011 Series A, 2011 Series B and 2012 Series A Refunding Bonds that will be used by the Commonwealth to pay interest on bonds.

Capital Assets increased by $146.8 million due to net current year additions and retirements of $340.4 million offset by current year depreciation and amortization including retirements of $193.5 million

Total liabilities increased by $792.1 million. This is primarily due to a net increase of $790.1 million in long-term debt outstanding. Bonds payable increased by $1,915.4 million. This represents the net effect of (1) issuance of bonds, (2) payment of principal, (3) amortization of premium, discount and deferred refunding losses, and (4) defeasance of PFC Bonds by the issuance of COFINA Series C Refunding Bonds. Notes payable decreased $205.1 million and lines of credit decreased $920.1 million. Decrease in notes payable and lines of credits is mainly due to the payment of commercial loan and certain lines of credit with the proceeds of 2012 Series A and B Revenue Bonds.

An increase of $1.9 million in other current and noncurrent liabilities is primarily due to a net effect of a decrease of $17.8 million in accounts payable, a decrease in accrued liabilities of $11.4 million, an increase in accrued interest of $26.7 million, and an increase of $4.4 million in unearned revenues, accrued compensated absences and customer deposits.

Capital Assets

Capital assets as of June 30, 2013 and 2012 were as follows (in thousands):

	June 30		
	2013	**2012**	**Change**
Capital assets being depreciated	**$ 9,499,207**	$ 8,677,917	$ 821,290
Accumulated depreciation and amortization	**(3,246,296)**	(3,036,651)	(209,645)
	6,252,911	5,641,266	611,645
Land and other nondepreciable assets	**71,188**	69,931	1,257
Construction in progress	**1,096,369**	1,647,605	(551,236)
Capital assets, net	**$ 7,420,468**	$ 7,358,802	$ 61,666

	June 30		
	2012	**2011**	**Change**
Capital assets being depreciated	$ 8,677,917	$ 8,276,363	$ 401,554
Accumulated depreciation and amortization	(3,036,651)	(2,843,090)	(193,561)
	5,641,266	5,433,273	207,993
Land and other nondepreciable assets	69,931	66,851	3,080
Construction in progress	1,647,605	1,711,896	(64,291)
Capital assets, net	$ 7,358,802	$ 7,212,020	$ 146,782

Capital Assets (continued)

June 30, 2013 and 2012

The net increase of $61.7 million in capital assets includes additions of $372.6 million, reduced by $232.2 million in depreciation and amortization and $96.5 million in net retirements. The $390.4 million in capital investment is broken down as follows:

- $322.0 million in the Authority's capital improvement program;
- $68.4 million in renewal and replacement projects;

The Authority has approximately $1,096.4 million in construction in progress as of June 30, 2013, and has construction commitments of approximately $88.3 million.

June 30, 2012 and 2011

The net increase of $146.8 million in capital assets includes additions of $384.5 million, reduced by $211.1 million in depreciation and amortization and $33.1 million in net retirements. The $384.5 million in capital investment is broken down as follows:

- $358.4 million in the Authority's capital improvement program;
- $32.1 million in renewal and replacement projects;

The Authority has approximately $1,647.6 million in construction in progress as of June 30, 2013, and has construction commitments of approximately $191.3 million.

Debt Administration

Long-term debt for the years ended June 30, 2013 and 2012 was as follows (in thousands):

	June 30 2013	June 30 2012	Change
Bonds payable:			
2011 Series A PFC Commonwealth Appropriation Bonds	**$ 90,099**	$ 90,099	$ –
2011 Series B PFC Commonwealth Appropriation Bonds	**102,183**	102,183	–
2011 Series B PFC Commonwealth Appropriation Bonds (SA)	**162,700**	162,700	–
2012 Series A PFC Commonwealth Appropriation Bonds	**56,247**	56,247	–
Revenue Bonds:			
2008 Series A Serial Bonds	**80,865**	93,155	(12,290)
2008 Series A Convertible Capital Appreciation Bonds	**155,975**	155,975	–
2008 Series A Term Bonds	**1,095,125**	1,095,125	–
2008 Series B Serial Bonds	**22,445**	22,445	–
2008 Series A and B Revenue Refunding Term Bonds	**284,755**	284,755	–
2012 Series A Serial Bonds	**418,455**	418,455	–
2012 Series A Term Bonds	**1,381,995**	1,381,995	–
2012 Series B Serial Bonds	**188,130**	188,130	–
2012 Series B Term Bonds	**107,115**	107,115	–
Rural Development Serial Bonds	**405,064**	368,511	36,553
Add premium on bonds refunding	**27,302**	27,762	(460)
Less :			
Bond discount	**(16,386)**	(16,547)	161
Deferred loss from refunding	**(39,343)**	(42,907)	3,564
Total bonds	**$ 4,522,726**	$ 4,495,198	$ 27,528

(Continued)

Debt Administration (continued)

	June 30 2013	June 30 2012	Change
Bonds payable	**$ 4,522,726**	$ 4,495,198	$ 27,528
Notes payable:			
Water Pollution Control and Drinking Water Treatment Revolving Funds Loans	**469,743**	450,044	19,699
Total notes	**469,743**	450,044	19,699
Lines of credit	**89,835**	109,788	(19,953)
Long-term debt outstanding	**5,082,304**	5,055,030	27,274
Other long term liabilities:			
Accrued compensated absences	**43,136**	45,271	(2,135)
Net OPEB obligation	**28,141**	22,652	5,489
Early retirement obligation	**93**	886	(793)
Customer deposits	**82,247**	80,976	1,271
Total other liabilities	**153,617**	149,785	3,832
Total – long-term obligations	**5,235,921**	5,204,815	31,106
Current portion	**150,194**	60,102	90,092
Long-term obligations, less current portion	**$ 5,085,727**	$ 5,144,713	$ (58,986)

The Authority's long-term debt increased by $27.3 million from $5,055 million as of June 30, 2012, to $5,082.3 million as of June 30, 2013.

Debt Administration (continued)

June 30, 2013

Bonds Payable

Bonds outstanding as of June 30, 2013 increased by $27.5 million, mainly from the net effect of issuance of $45.6 principal amounts of new bonds, payment of principal on outstanding bonds of approximately $21.3 million, and an amortization of $3.7 million in bonds premium, discounts and deferred refunding losses.

The bonds issued during fiscal year 2013 include Series II of the Rural Development Serial Bonds for the amount of $45.6 million for the purpose to pay interim lines of credit with GDB and establish a construction fund to complete capital projects under construction.

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, 2013, the Authority's loans outstanding under these programs amounted to approximately $470 million. These loans increased approximately $19.7 million due to the net effect of drawings of approximately $39.3 million for payment of capital improvements projects and payment of principal outstanding of approximately $19.7 million.

Lines of Credit

The existing $70.0 million line of credit with GDB used to provide funding for the capital improvement program of the Authority had an outstanding balance as of June 30, 2013 of approximately $17.5 million.

The existing $150.0 million line of credit with GDB used to cover the cash flow needs during the transition period after amending and restating the Master Agreement of Trust on February 29 2012, had an outstanding balance as of June 30, 2013 of approximately $72.3 million.

The $180.0 million revolving line of credit with GDB for the purpose of financing the operating reserve, required by the Master Agreement of Trust securing its revenue bonds, had no outstanding balance as of June 30, 2013.

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

Debt Administration (continued)

June 30, 2012

Bonds Payable

Bonds outstanding as of June 30, 2012 increased by $1,915.4 million, mainly from the net effect of issuance of $2,577.1 principal amounts of new bonds, payment of principal on outstanding bonds of approximately $685.1 million, a decrease of $6.8 million in bonds premiums, and a decrease of $30.2 million in bonds discounts and deferred refunding losses.

The bonds issued during fiscal year 2012 for $2,557.1 million primarily include (1) 2012 Series A and B Revenue Bonds issued on February 29, 2012 for the par amount of $2,095.7 million for the purpose of pay off certain lines of credit and commercial loans, establish reserves for debt service and operating costs, and establish a construction fund for the capital improvement program, (2) Series HH of the Rural Development Serial Bonds for the amount of $70.2 million for the purpose to pay interim lines of credit with GDB and establish a construction fund to complete the capital projects under construction, and (3) 2011 Series A, 2011 Series B, and 2012 Series A Series PFC Refunding Bonds for the amount of $411.2 million to refinance 2001 Series C, 2003 Series A, 2004 Series A and B PFC Bonds.

On December 13, 2011, COFINA issued 2011 Series C Sales Tax Revenue Bonds to refinance certain series of Act 164 and others PFC Bonds outstanding and retired various notes issued to PFC by certain agencies and component units of the Commonwealth (including the Authority). Proceeds were used to purchase, cancel or deposit in an escrow to advance refund the Authority's share of the Act 164 and other PFC Bonds. This transaction had a net effect of $304.0 million and was presented as a contribution from COFINA in the Statement of Revenues and Expenses for the period ended June 30, 2012. The liability was considered defeased or cancelled and was removed from the Authority's balance sheet as of June 30, 2012.

Debt Administration (continued)

June 30, 2012 (continued)

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, 2012, the Authority's loans outstanding under these programs amounted to approximately $450.0 million. These loans increased approximately $36.6 million due to the net effect of drawings of approximately $54.9 million for payment of capital improvements and payment of principal on loans outstanding of approximately $18.3 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. The outstanding balance of the loan was paid on January 17, 2012 with the issuance of 2012 Series A Bond Anticipation Notes (BAN) from Bank of America and Merrill Lynch for the amount of $241.0 million.

The proceeds of 2012 Series A and B Revenue Bonds were used in part to repay the 2012 Series A Bond Anticipation Notes.

Lines of Credit

On August 16, 2011, the Authority entered into an Asset Purchase Agreement with the Puerto Rico Industrial, Tourism, Educational, Medical and Environmental Facilities Financing Authority (AFICA), a public corporation of the Commonwealth of Puerto Rico to purchase certain assets that were being used to develop the Southern Gas Pipeline Project for the total purchase price of approximately $23.5 million and assumed the rights and obligations of PREPA (Puerto Rico Electric Power Authority) under a Subordinated Loan Agreement between AFICA and PREPA and a Subordinated Note and Loan Agreement of approximately $31.0 million. On February 29, 2012 this line of credit was paid in full with the proceeds of 2012 Series A and B Revenue Bonds.

Debt Administration (continued)

June 30, 2012 (continued)

Lines of Credit (continued)

On February 29, 2012, the Authority entered into non revolving line of credit with GDB for the purpose of assisting with the Authority's cash flow needs during the transition period after amending and restating the Trust Agreement after the issuance of 2012 Series A and B Revenue Bonds. As of June 30, 2012, approximately $72.3 million under this line of credit was outstanding.

The existing $70.0 million line of credit with GDB used to provide funding for the capital improvement program of the Authority had an outstanding balance as of June 30, 2012 of approximately $37.4 million.

The outstanding balance as of December 31, 2011 of $269.0 million, $87.6 million, $125.0 million, $150.0 million, $200.0 million, and $250.0 million lines of credit were paid in full with the proceeds of 2012 Series A and B Revenue Bonds on February 29, 2012.

The $180.0 million revolving line of credit with GDB for the purpose of financing the operating reserve, required by the Master Agreement of Trust securing its revenue bonds, had no outstanding balance as of June 30, 2012.

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

Summary of Revenues, Expenses, and Changes in Net Position

The following table provides a summary of the Authority's changes in net position for the years ended June 30, 2013 and 2012 (in thousands):

	Years Ended June 30		
	2013	**2012**	**Change**
Operating revenue:			
Revenues from water and sewer, net	**$ 735,693**	$ 742,891	$ (7,198)
Central Government appropiations	**–**	70,264	(70,264)
Total operating revenues	**735,693**	813,155	(77,462)
Operating expenses:			
Payroll and payroll related expenses	**272,092**	275,613	(3,521)
Service contract – Superaqueduct	**5,679**	5,813	(134)
Professional and consulting services	**31,575**	31,707	(132)
Chemicals	**28,872**	35,577	(6,705)
Materials and replacements	**12,731**	12,387	344
Repairs and maintenance of capital assets	**45,214**	48,668	(3,454)
Electricity	**209,168**	200,195	8,973
Insurance	**9,493**	9,687	(194)
Other operating expenses	**84,046**	86,516	(2,470)
Operating expenses (excluding depreciation and amortization)	**698,870**	706,163	(7,293)
Depreciation and amortization	**232,191**	211,127	21,064
Cost of assets disposition	**96,508**	32,631	63,877
Total operating expenses	**1,027,569**	949,921	77,648
Operating loss	**(291,876)**	(136,766)	(155,110)
Nonoperating revenues (expenses), net	**(187,699)**	149,173	(336,872)
Income (loss) before capital contributions	**(479,575)**	12,407	(491,982)
Capital contributions	**20,135**	52,096	(31,961)
Increase (decrease) in net position	**(459,440)**	64,503	(523,943)
Net position at beginning of year	**2,998,915**	2,934,412	64,503
Net position at end of year	**$ 2,539,475**	$ 2,998,915	$ (459,440)

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

The following table provides a summary of the Authority's changes in net position for the years ended June 30, 2012 and 2011 (in thousands):

	Years Ended June 30		
	2012	**2011**	**Change**
Operating revenue:			
Revenues from water and sewer, net	$ 742,891	$ 724,108	$ 18,783
Central Government appropiations	70,264	85,000	(14,736)
Total operating revenues	813,155	809,108	4,047
Operating expenses:			
Payroll and payroll related expenses	275,613	250,968	24,645
Service contract – Superaqueduct	5,813	28,473	(22,660)
Professional and consulting services	31,707	34,138	(2,431)
Chemicals	35,577	29,453	6,124
Materials and replacements	12,387	16,110	(3,723)
Repairs and maintenance of capital assets	48,668	45,405	3,263
Electricity	200,195	156,583	43,612
Insurance	9,687	9,276	411
Other operating expenses and cost of assets disposition	119,147	77,248	41,899
Operating expenses (excluding depreciation and amortization)	738,794	647,654	91,140
Depreciation and amortization	211,127	201,037	10,090
Total operating expenses	949,921	848,691	101,230
Operating loss	(136,766)	(39,583)	(97,183)
Nonoperating revenues (expenses), net	149,173	(106,910)	256,083
Income (loss) before capital contributions	12,407	(146,493)	158,900
Capital contributions	52,096	34,275	17,821
Increase (decrease) in net position	64,503	(112,218)	176,721
Net position at beginning of year	2,934,412	3,046,630	(112,218)
Net position at end of year	$ 2,998,915	$ 2,934,412	$ 64,503

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

June 30, 2013 and 2012

Net position decreased by $459.4 million, from $2,998.9 million in 2012 to $2,539.5 million in 2013, due to the results of current year operations.

Major fluctuations that resulted in a decrease in net position of $459.5 million when compared to 2012 operational results are broken down as follows (in thousands):

Decrease in operating revenues	$	(77,462)
Increase in operating expenses		(77,648)
Increase in nonoperating revenues (expenses), net		(336,872)
Decrease in capital contributions		(31,961)
Other changes		64,503
Net change	$	(459,440)

Operating revenues decreased by $77.5 million for fiscal year ended June 30, 2013 when compared to fiscal year ended June 30, 2012. The decrease is mainly due to a decrease of $70.2 million from appropriations received from the Commonwealth, and an increase in the provision for bad debt of $8.0 million.

Operating expenses increased by $77.7 million primarily due to the net effect of the following:

- An increase of $63.8 million in cost of assets disposition.
- An increase of $21.1 million in depreciation and amortization expense.
- An increase of $9.0 million in electricity expenses.
- A decrease of $6.7 million in chemical expenses.
- A decrease of $3.5 million in payroll and payroll related expenses.
- A decrease of $3.5 million in repairs and maintenance of capital assets expense.
- A decrease of $2.5 million in other operating expenses.

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

June 30, 2013 and 2012 (continued)

Nonoperating revenues (expenses) decreased by $336.9 million when compared with previous fiscal year. This is primarily the net effect of a reduction of $304 million in Commonwealth contributions as a result of debt refunding on PFC bonds during fiscal year ended June 30, 2012. Interest expense, net of amortization of debt issuance cost, bond premium and discount, and deferred refunding losses increased by $40.1 million. Commonwealth contributions for payments of interest on PFC Bonds increased by $5.9 million and, interest income increased by $2.8 million.

Capital contributions decreased by $32 million, primarily due to a decrease in Rural Development contributions of $12.7 million, a decrease of $13.6 of American Recovery & Reinvestment Act and, a decrease in other contributions of $5.7 million.

June 30, 2012 and 2011

Net position increased by $64.5 million, from $2,934.4 million in 2011 to $2,998.9 million in 2012, due to the results of current year operations.

Major fluctuations that resulted in an increase in net position of $176.7 million when compared to 2011 operational results are broken down as follows (in thousands):

Increase in operating revenues	$ 4,047
Increase in operating expenses	(101,230)
Increase in nonoperating revenues (expenses), net	256,083
Increase in capital contributions	17,821
Net change	$ 176,721

Operating revenues increased by $4.0 million for fiscal year ended June 30, 2012 when compared fiscal year ended June 30, 2011. The increase is a net effect of an increase in water and sewer billed of $23.8 million, a decrease in the provision for bad debt of $14.7 million and a decrease of $5.0 million from appropriations received from the Commonwealth during the fiscal year ended June 30, 2012.

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

June 30, 2012 and 2011 (continued)

Operating expenses increased by $101.2 million primarily due to the net effect of the following:

- An increase of $43.6 million in electricity expenses.
- An increase of $41.9 million in other operating expenses.
- An increase of $24.6 million in payroll and payroll related expenses.
- An increase of $10.1 million in depreciation and amortization expense.
- An increase of $6.1 million in chemical expenses.
- An decrease of $3.7 million in material and replacements expenses
- A decrease of $22.6 million in Service Contract – Superaqueduct expenses.

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

On July 19, 2011, the Authority and Thames-Dick agreed to cancel the Master Agreement and transferred to the Authority the responsibility of the operation and administration of the North Coast Aqueduct.

Actually, the Authority has an agreement with Caribbean Water Specialist Corp. and pays a management fee for the operation of the North Coast Aqueduct. This amount is reported under the caption of *Service Contract - Superaqueduct.* All other operational cost considered as pass-through cost under the Thames-Dick Agreement (electricity, chemicals, etc.) associated with the operation of the system were captioned in their respective expense category.

Nonoperating revenues (expenses) increased by $256.1 million when compared with previous fiscal year. This is primarily the net effect of contributions received from COFINA for $319.6 million to purchase and cancel or legally defease a portion of the Authority's share of certain series of the Act 164 and 2004 Series A PFC Bonds, a loss of $15.6 million of PFC bonds redemption, an increase of $13.1 million in interest expense on bonds, notes and lines of credits, a decrease in Commonwealth contributions of $38.5 million for the payment of principal and interest on outstanding debt, and an increase other income of $3.6 million.

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

June 30, 2012 and 2011 (continued)

Capital contributions increased by $17.8 million. This is primarily due to an increase in Rural Development contributions of $20.1 million and a decrease in other contributions of $2.3 million.

Economic Factors, Ratings and Next Year's Budgets

The Puerto Rico Planning Board's preliminary reports on the performance of the Puerto Rico economy for fiscal year 2012 indicate that real gross national product increased 0.1% over fiscal year 2011. Nominal gross national product was $69.5 billion in fiscal year 2012, compared to $65.6 billion in fiscal year 2011. Aggregate personal income increased from $61.6 billion in fiscal year 2011 to $62.3 billion in fiscal year 2012, and personal income per capita increased from $16,611 in fiscal year 2011 to $16,934 in fiscal year 2012. According to the Household Survey, the number of persons employed in Puerto Rico during fiscal year 2013 averaged 1,030,000, a decrease of 0.6% compared to the previous fiscal year; and the unemployment rate averaged 14.1%, a reduction of 1.1% when compared to the average unemployment rate for fiscal year 2012 of 15.2%. The Planning Board's forecast for fiscal year 2014 projects an increase in gross national product of 0.2%.

On July 3 2013, the Authority adopted a balanced operational budget for fiscal year 2014, which included additional revenues from a rate increase. In addition, the Authority's Capital Improvement Program for the fiscal year 2014 is estimated in approximately $400 million.

On July 3, 2013, the Authority's Board of Directors approved a rate increase to be effective on July 15, 2013. Subsequently, on December 18, 2013 the Board amended the rates for non-residential customers. The approved rate structure includes increases of the base and volume charges and incorporates a new monthly charge for environmental compliance and regulatory costs, this varies by customer class, consumption or meter size. Also, there is an additional $2 monthly charge for special projects, such as the protection and remediation of watersheds and improvements to systems not connected to the Authority. The rate increase was designed to generate enough revenues to cover the Authority's expenses and debt service until fiscal year 2017. Detailed information on the new rate structure is available at the Authority's webpage www.acueductospr.com.

The Authority's credit ratings are "Ba1" by Moody's Investor Services, "BB+" by Standard and Poor's Ratings Services and "BBB-" by Fitch Ratings.

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

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 2013	June 30 2012
Assets		
Current assets:		
Cash and cash equivalents	**$ 101,680**	$ 62,060
Accounts receivable, net	**158,218**	173,584
Receivables from federal agencies	**2,702**	2,883
Receivables from Commonwealth	**33,837**	51,816
Materials and supplies inventory, net	**25,284**	21,357
Prepayments and other current assets	**6,377**	7,289
Total current assets	**328,098**	318,989
Restricted assets:		
Restricted cash and cash equivalents	**417,814**	855,702
Capital assets:		
Capital assets being depreciated	**9,499,207**	8,677,917
Accumulated depreciation and amortization	**(3,246,296)**	(3,036,651)
	6,252,911	5,641,266
Land and other nondepreciable assets	**71,188**	69,931
Construction in progress	**1,096,369**	1,647,605
Total capital assets, net	**7,420,468**	7,358,802
Other assets:		
Deferred debt issuance cost, net of accumulated amortization of $2,762 and $1,913 for 2013 and 2012, respectively	**63,335**	64,127
Total assets	**$ 8,229,715**	$ 8,597,620

(Continued)

Balance Sheets (continued)

(In thousands)

	June 30	
	2013	**2012**
Liabilities and net assets		
Current liabilities:		
Bonds payable	**$ 13,471**	$ 12,658
Notes payable	**19,605**	19,658
Lines of credit	**89,835**	–
Accounts payable	**216,517**	145,020
Accrued liabilities	**116,702**	140,334
Accrued interest	**102,922**	88,606
Unearned revenue	**18,178**	19,930
Customers' deposits	**6,584**	6,408
Compensated absences and postemployment benefits	**20,699**	21,378
Total current liabilities	**604,513**	453,992
Noncurrent liabilities:		
Bonds payable	**4,509,255**	4,482,540
Notes payable	**450,138**	430,386
Lines of credit	**–**	109,788
Customers' deposits	**75,663**	74,568
Compensated absences and postemployment benefits	**50,671**	47,431
Total noncurrent liabilities	**5,085,727**	5,144,713
Total liabilities	**5,690,240**	5,598,705
Net Position:		
Net Investment in capital assets	**2,745,582**	3,205,651
Restricted for environmental compliance, capital activity and other	**82,760**	26,186
Unrestricted (deficit)	**(288,867)**	(232,922)
	2,539,475	2,998,915
Total net assets and liabilities	**$ 8,229,715**	$ 8,597,620

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 Position

(In thousands)

	Year Ended June 30	
	2013	**2012**
Operating revenues:		
Water	**$ 504,676**	$ 502,600
Sewer	**266,422**	267,726
Central Government appropiations	**–**	70,264
Bad debt expense	**(35,405)**	(27,435)
Total net operating revenues	**735,693**	813,155
Operating expenses:		
Payroll and payroll related	**272,092**	275,613
Service contract – Superaqueduct	**5,679**	5,813
Professional and consulting services	**31,575**	31,707
Chemicals	**28,872**	35,577
Materials and replacements	**12,731**	12,387
Repairs and maintenance of capital assets	**45,214**	48,668
Electricity	**209,168**	200,195
Insurance	**9,493**	9,687
Other operating expenses	**84,046**	86,516
Operating expenses (excluding depreciation and amortization)	**698,870**	706,163
Depreciation and amortization	**232,191**	211,127
Cost of assets disposition	**96,508**	32,631
Total operating expenses	**1,027,569**	949,921
Operating loss	**(291,876)**	(136,766)
Nonoperating revenues (expenses):		
Interest expense, net of amortization of debt issuance cost, bond premium and discount, and deferred refunding loss	**(206,235)**	(166,134)
Loss on COFINA debt redemption	**–**	(15,644)
COFINA contributions for debt refunding	**–**	319,617
Commonwealth contributions for principal payments on bonds and notes	**–**	–
Commonwealth contributions for interest payments on bonds and notes	**5,856**	–
Interest income	**7,478**	4,670
Other income	**5,202**	6,664
Total nonoperating revenues (expenses), net	**(187,699)**	149,173
Income (loss) before capital contributions	**(479,575)**	12,407
Capital contributions:		
Federal grants and other contributions	**19,859**	48,327
Other Commonwealth contributions	**276**	3,769
Total capital contributions	**20,135**	52,096
Change in net position	**(459,440)**	64,503
Net position at beginning of year	**2,998,915**	2,934,412
Net position at end of year	**$ 2,539,475**	$ 2,998,915

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 2013	2012
Cash flows from operating activities		
Cash received from customers	**$ 750,007**	$ 731,126
Cash received from Commonwealth	**–**	70,264
Cash paid to suppliers	**(392,936)**	(456,715)
Cash paid to employees	**(284,289)**	(276,146)
Net cash provided by operating activities	**72,782**	68,529
Cash flows from noncapital financing activities		
Proceeds from issuance of bonds	**–**	535,245
Proceeds from bond anticipation notes	**–**	241,000
Payments of bond anticipation notes	**–**	(241,000)
Payments of notes	**–**	(241,744)
Debt issuance cost paid	**–**	(3,853)
Net cash from other income	**5,202**	6,664
Interest paid on notes and lines of credit	**(4,342)**	(4,915)
Net cash provided by noncapital financing activities	**860**	291,397
Cash flows from capital and related financing activities		
Additions to utility plant and other capital assets	**(364,417)**	(353,651)
Proceeds from capital contributions	**20,705**	55,406
Proceeds from issuance of bonds	**45,562**	1,630,661
Proceeds from issuance of notes payable	**39,357**	54,892
Proceeds from borrowings from lines of credit	**35,367**	266,307
Proceeds from premium on bonds issuance	**–**	22,014
Payments of bonds and notes	**(40,957)**	(35,012)
Payment of lines of credit	**(55,320)**	(1,216,483)
Debt issuance cost paid	**–**	(16,489)
Interest paid on bonds, notes and lines of credit	**(159,685)**	(126,729)
Net cash provided by (used in) capital and related financing activities	**(479,388)**	280,916
Cash flows from investing activities		
Interest received on investments	**7,478**	4,438
Net cash provided by investing activities	**7,478**	4,438
Net change in cash and cash equivalents	**(398,268)**	645,280
Cash and cash equivalents at beginning of year	**917,762**	272,482
Cash and cash equivalents at end of year	**$ 519,494**	$ 917,762
For purposes of the statement of cash flows, cash and cash equivalents include:		
Unrestricted	**$ 101,680**	$ 62,060
Restricted	**417,814**	855,702
	$ 519,494	$ 917,762

(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	
	2013	**2012**
Reconciliation of operating loss to net cash provided by operating activities		
Operating loss	**$ (291,876)**	$ (136,766)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization	**232,191**	211,127
Cost of Assets Disposition	**96,508**	32,631
Provision for uncollectible accounts	**35,405**	27,435
Change in assets and liabilities:		
Accounts receivable	**(20,610)**	(40,739)
Accounts receivable from federal agencies	**181**	461
Materials and supplies inventory	**(3,927)**	7,215
Prepayments and other current assets	**912**	(1,159)
Accounts payable	**45,549**	(24,713)
Unearned revenue	**(1,752)**	661
Accrued compensated absences and early retirement obligation	**2,562**	2,911
Accrued liabilities	**(23,632)**	(11,413)
Customers' deposits	**1,271**	878
Total adjustments	**364,658**	205,295
Net cash provided by operating activities	**$ 72,782**	$ 68,529
Noncash noncapital financing activities		
Amortization of debt issuance cost	**$ –**	$ 83
Noncash capital and related financing activities		
Net additions to utility plant and other capital assets	**25,948**	36,890
Write-off of capital contributions	**570**	3,310
Refunding of PFC bonds by Commonwealth	–	411,229
Issuance cost related to debt issuance	–	4,232
Premium cost related to debt issuance	–	6,127
Defeasance of debt related to PFC refunding bonds	–	668,350
Net increase in refunding loss from PFC bonds transactions	–	19,556
Cancellation of principal on lines of credit by Commonwealth	–	30,014
Capitalized interest on PFC refunding bonds held by the Commonwealth	–	50,732
Amortization of:		
Debt issuance cost	**792**	(1,031)
Bond premiums and discounts	**299**	1,907
Deferred refunding loss	**3,564**	3,229
Write-off of debt issuance cost, and deferred refunding loss related to COFINA debt refunding.	–	63,589
Write-off of premium related to COFINA debt refunding	–	33,824
COFINA contribution for debt refunding	–	319,617
Loss on COFINA debt redemption	–	15,644
Interest paid by the Commonwealth	**23,835**	11,111

See accompanying notes.

1. Reporting Entity and Summary of Significant Accounting Policies

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

Measurement Focus and Basis of Accounting

The Authority's operations are accounted for on a flow of economic resources measurement focus, using the accrual basis of accounting. Under this method, all assets and liabilities associated with operations are included on the balance 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 allowances for 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, 2013 and 2012, the account balances amounted to approximately $35 million and $33.8 million, respectively. The accounts are held under the Puerto Rico Government Investment Trust Fund (the Trust Fund), a collective investment trust created by the Secretary of the Treasury of Puerto Rico as settler and the Government Development Bank of Puerto Rico as trustee. The Trust Fund seeks to maintain a constant net asset value per unit of $1 through investment in high-grade short term money market instruments with a dollar-weighted average portfolio maturity of less than 60 days, including, but not limited to, obligations of the U.S. Government, the Puerto Rico Government, their respective agencies and instrumentalities, repurchase agreements with respect to obligations of the U.S. Government, certificates of deposit, time deposits, bank notes and banker's acceptances issued by the U.S. or Puerto Rico regulated banks, commercial paper and corporate obligations. The Authority can invest, reinvest or redeem units acquired at any time without charge or penalty.

The Trust Fund values its investments on the basis of amortized cost. Although the Trust Fund's policies are designed to help maintain a stable net asset value per unit of $1, 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, 2013 and 2012, 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, debt service payments or other specific purposes are classified as restricted assets since their use is limited for these purposes by the applicable agreements.

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

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 a reserve for obsolescence totaling approximately $1.0 million and $3.9 million as of June 30, 2013 and 2012, 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 effective interest method.

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

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

Capital Assets

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

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

Capital Assets (continued)

Utility plant and other capital assets are carried at historical cost or estimated historical cost, which includes capitalized labor, materials, administrative costs, and interest on debt financed construction. Interest capitalized by the Authority for the years ended June 30, 2013 and 2012 amounted to approximately $56.9 million and $70.0 million, respectively.

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

Depreciation and amortization expense is calculated using the straight-line method.

Description	Useful life
Wells and tanks	Fifty (50) years
Vehicles, Computers and Software,	Five (5) years
Furniture and fixtures, water meters,	Ten (10) years
Water and sewer plants and pump Station	Thirty (30) years
Buried infrastructure	Range from fifty (50) to Seventy (70) years
Dams	Seventy (70) years
Buildings	Forty (40) years

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

Unearned Revenue

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

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. The Authority accounts for its postretirement healthcare benefits in accordance with GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions,* as detailed in Note 17.

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, 2013 and 2012, the accrued liability for early retirement amounted to approximately $0.1 million and $0.9 million, respectively.

The total cost of healthcare benefits paid to retired employees amounted to approximately $3.2 million and $3.8 million for 2013 and 2012, 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 Position

Net position is reported in three categories:

- ***Net Investment in Capital Assets*** – 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 net investment in capital assets.

- ***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, 2013 and 2012, 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 that can be removed or modified.

Use of Estimates

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

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

Future Adoption of Accounting Standards

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

GASB Statement No.		Adoption required in fiscal year
65	Deferred Inflows of Resources, and Net Position Items Previously Reported as Assets and Liabilities	2014
66	Technical Corrections—2012—an amendment of GASB GASB Statements No. 10 and No. 62.	2014
67	Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25	2014
68	Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27	2015
69	Government Combinations and Disposals of Government Operations	2015
70	Accounting and Financial Reporting for Nonexchange Financial Guarantees	2014
71	Pension Transition for Contributions Made Subsequent to the Measurement Date, an Amendment of GASB Statement No. 68	2015

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

Effects of New Pronouncements

The following statements GASB Standards were effective for fiscal year 2013: Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*; Statement No. 61, *Accounting and Financial Reporting Entity: Omnibus-an amendment of GASB Statement No. 14 and No. 34*; and Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncement*s. These statements had no impact on the Authority.

GASB No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*, issued on June 2011, changed the structure of government balance sheet. Deferred outflows of resources should be reported in a separate section following assets using the new term and, deferred inflows of resources should be reported in a separate section following liabilities. As a result assets plus deferred outflows of resources less liabilities and deferred inflows of resources equals to net position. GASB No. 63 indicates that the net position, rather that net assets, should be reported in three components: net investment in capital assets, restricted and unrestricted. GASB No. 63 is effective for financial statements periods beginning after December 15, 2011. The Authority has adopted the provisions of the GASB Statement No. 63 for the year ended on June 30, 2013. The adoption of this Statement had no impact on the Authority other than updating statement categories and titles.

Commonwealth Appropriations

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

2. Deposits

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

	June 30			
	2013		2012	
	Carrying amount	Bank balance	Carrying amount	Bank balance
Unrestricted deposits in commercial banks in Puerto Rico	**$ 101,680**	**$ 105,860**	$ 62,060	$ 104,721
Restricted deposits in commercial banks in Puerto Rico	**273,358**	**273,358**	695,070	695,070
Restricted deposits in governmental banks:				
GDB	**116,382**	**116,382**	58,036	58,036
EDB	**28,074**	**28,074**	102,596	102,596
Total	**$ 519,494**	**$ 523,674**	$ 917,762	$ 960,423

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

Custodial Credit Risks Related to Deposits

Pursuant to the laws of the Commonwealth, the Authority's cash is required to be held only in banks designated as depository institutions of public funds by the Commonwealth's Secretary of the Treasury. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth.

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

2. Deposits (continued)

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

	June 30 2013	June 30 2012
Uninsured and uncollateralized:		
GDB	**$ 116,382**	$ 58,036
EDB	**28,074**	102,596
	$ 144,456	$ 160,632

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 2013	June 30 2012
Water and sewer services:		
Residential, industrial, and commercial	**$ 514,375**	$ 501,224
Government agencies and municipalities	**82,997**	76,227
	597,372	577,451
Other receivables:		
Government agencies and municipalities	**3,374**	3,374
Private entities	**29,347**	28,658
	32,721	32,032
	630,093	609,483
Less allowance for uncollectible accounts	**(471,875)**	(435,899)
Total	**$ 158,218**	$ 173,584

4. Other Receivables

Receivables from Federal Agencies

Receivables from federal agencies of approximately $2.7 million and $2.9 million as of June 30, 2013 and 2012, 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.

Receivables from Commonwealth

Receivables from Commonwealth of approximately $33.8 million and $51.8 million as of June 30, 2013 and 2012, respectively, consisted of proceeds from PFC 2011 Series A and B, and 2012 Series A Refunding Bonds that will be used by the Commonwealth to pay interest on bonds.

5. Materials and Supplies Inventory

As of June 30, 2013 and 2012, 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, 2013 and 2012 and the changes therein for the years then ended are as follows (in thousands):

	June 30, 2013			
	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated:				
Land	$ 61,004	$ 981	$ (2)	$ 61,983
Easement	8,927	285	(7)	9,205
Construction in progress	1,647,605	371,323	(922,559)	1,096,369
Total capital assets not being depreciated	1,717,536	372,589	(922,568)	1,167,557
Capital assets being depreciated:				
Infrastructure (water and sewer facilities)	7,794,495	788,688	(22,848)	8,560,335
Wells, tanks and meters	582,149	57,426	(6,918)	632,657
Buildings and improvements	76,637	1,787	(2)	78,422
Equipment, furniture, fixtures and vehicles	224,636	17,815	(14,658)	227,793
Total capital assets being depreciated	8,677,917	865,716	(44,426)	9,499,207
Less accumulated depreciation and amortization:				
Infrastructure (water and sewer facilities)	(2,663,384)	(202,738)	12,633	(2,853,489)
Wells, tanks and meters	(159,593)	(19,753)	3,833	(175,513)
Buildings and improvements	(31,601)	(1,834)	–	(33,435)
Equipment, furniture, fixtures and vehicles	(182,073)	(7,866)	– 6,080	(183,859)
Total accumulated depreciation and amortization	(3,036,651)	(232,191)	22,546	(3,246,296)
Total capital assets being depreciated, net	5,641,266	633,525	(21,880)	6,252,911
Total capital assets, net	$ 7,358,802	$ 1,006,114	$ (944,448)	$ 7,420,468

6. Capital Assets (continued)

	June 30, 2012			
	Beginning Balance	**Increases**	**Decreases**	**Ending Balance**
Capital assets not being depreciated:				
Land	$ 58,394	$ 2,610	$ –	$ 61,004
Easement	8,457	470	–	8,927
Construction in progress	1,711,896	381,392	(445,683)	1,647,605
Total capital assets not being depreciated	1,778,747	384,472	(445,683)	1,717,536
Capital assets being depreciated:				
Infrastructure (water and sewer facilities)	7,580,214	261,042	(46,761)	7,794,495
Wells, tanks and meters	414,524	170,954	(3,329)	582,149
Buildings and improvements	70,517	6,120	–	76,637
Equipment, furniture, fixtures and vehicles	211,108	13,528	–	224,636
Total capital assets being depreciated	8,276,363	451,644	(50,090)	8,677,917
Less accumulated depreciation and amortization:				
Infrastructure (water and sewer facilities)	(2,502,281)	(176,604)	15,501	(2,663,384)
Wells, tanks and meters	(141,438)	(19,642)	1,487	(159,593)
Buildings and improvements	(29,914)	(1,687)	–	(31,601)
Equipment, furniture, fixtures and vehicles	(169,457)	(12,616)	–	(182,073)
Total accumulated depreciation and amortization	(2,843,090)	(210,549)	16,988	(3,036,651)
Total capital assets being depreciated, net	5,433,273	241,095	(33,102)	5,641,266
Total capital assets, net	$ 7,212,020	$ 625,567	$ (478,785)	$ 7,358,802

7. Restricted Assets

Restricted assets at June 30, 2013 and 2012 consisted of the following:

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

***Capital Activity Funds* –** Amounts in capital activity funds represent amounts deposited as a result of agreements between commonwealth agencies and municipalities for construction of infrastructure projects, fines and penalties assessed by EPA that will be used for construction of infrastructure projects to provide water 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	
	2013	**2012**
Construction funds	**$ 91,018**	$ 287,806
Capital activity funds	**104,997**	123,425
Debt service funds	**221,799**	444,471
	$ 417,814	$ 855,702

8. Accrued Liabilities

Accrued liabilities consisted of the following (in thousands):

	June 30	
	2013	**2012**
Payroll and related accruals	**$ 33,656**	$ 38,393
Legal, labor related and environmental contingencies	**52,624**	63,263
Contract retentions	**30,423**	38,678
	$ 116,703	$ 140,334

9. Long-Term Liabilities

Long-term debt activity for the years ended June 30, 2013 and 2012 was as follows (in thousands):

	June 30, 2013					
	Beginning Balance	Additions/ Amortization	Reductions	Ending Balance	Due Within One Year	Due Thereafter
Bonds payable:						
2011 Series A PFC Commonwealth Appropriation Bonds	$ 90,099	$ –	$ –	$ 90,099	$ –	$ 90,099
2011 Series B PFC Commonwealth Appropriation Bonds	102,183	–	–	102,183	–	102,183
2011 Series B PFC Commonwealth Appropriation Bonds (Superaqueduct)	162,700	–	–	162,700	–	162,700
2012 Series A PFC Commonwealth Appropriation Bonds	56,247	–	–	56,247	–	56,247
2008 Series A Revenue Bonds	1,344,255	–	(12,290)	1,331,965	12,905	1,319,060
2008 Series B Revenue Bonds	22,445	–	–	22,445	–	22,445
2008 Series A Revenue Refunding Bonds	159,055	–	–	159,055	–	159,055
2008 Series B Revenue Refunding Bonds	125,700	–	–	125,700	–	125,700
2012 Series A Revenue Bonds	1,800,450	–	–	1,800,450	–	1,800,450
2012 Series B Revenue Bonds	295,245	–	–	295,245	–	295,245
Rural Development Serial Bonds	368,511	45,561	(9,008)	405,064	3,995	401,069
Sub total bonds	4,526,890	45,561	(21,298)	4,551,153	16,900	4,534,253
Add bond premium	27,762	–	(460)	27,302	486	26,816
Less bond discount	(16,547)	–	161	(16,386)	(170)	(16,216)
Less deferred loss on refunding	(42,907)	–	3,564	(39,343)	(3,745)	(35,598)
Total bonds	4,495,198	45,561	(18,033)	4,522,726	13,471	4,509,255
Notes payable:						
Water Pollution Control and Safe Drinking Water Treatment Revolving Funds Loans	450,044	39,357	(19,658)	469,743	19,605	450,138
Total notes	450,044	39,357	(19,658)	469,743	19,605	450,138
Lines of credit	109,788	35,367	(55,320)	89,835	89,835	–
Other long-term liabilities:						
Accrued compensated absences	45,271	10,753	(12,888)	43,136	12,725	30,411
Net OPEB obligation	22,652	7,881	(2,392)	28,141	7,881	20,260
Early retirement obligation	886	–	(793)	93	93	–
Customers' deposits	80,976	9,266	(7,995)	82,247	6,584	75,663
Total other liabilities	149,785	27,900	(24,068)	153,617	27,283	126,334
Total – long-term obligations	$ 5,204,815	$ 148,185	$ (117,079)	$ 5,235,921	$ 150,194	$ 5,085,727

9. Long-Term Liabilities (continued)

	June 30, 2012					
	Beginning Balance	Additions/ Amortization	Reductions	Ending Balance	Due Within One Year	Due Thereafter
Bonds payable:						
2001 Series A PFC Commonwealth Appropriation Bonds	$ 8,985	$ –	$ (8,985)	$ –	$ –	$ –
Act 164 PFC Commonwealth Appropriation Bonds	341,565	–	(341,565)	–	–	–
2004 Series A PFC Commonwealth Appropriation Bonds	326,785	–	(326,785)	–	–	–
2011 Series A PFC Commonwealth Appropriation Bonds	–	90,099	–	90,099	–	90,099
2011 Series B PFC Commonwealth Appropriation Bonds	–	102,183	–	102,183	–	102,183
2011 Series B PFC Commonwealth Appropriation Bonds (Superaqueduct)	–	162,700	–	162,700	–	162,700
2012 Series A PFC Commonwealth Appropriation Bonds	–	56,247		56,247	–	56,247
2008 Series A Revenue Bonds	1,344,255	–	–	1,344,255	12,290	1,331,965
2008 Series B Revenue Bonds	22,445	–	–	22,445	–	22,445
2008 Series A Revenue Refunding Bonds	159,055	–	–	159,055	–	159,055
2008 Series B Revenue Refunding Bonds	125,700	–	–	125,700	–	125,700
2012 Series A Revenue Bonds	–	1,800,450	–	1,800,450	–	1,800,450
2012 Series B Revenue Bonds	–	295,245	–	295,245	–	295,245
Rural Development Serial Bonds	306,030	70,211	(7,730)	368,511	3,633	364,878
Sub total bonds	2,634,820	2,577,135	(685,065)	4,526,890	15,923	4,510,967
Add bond premium	34,609	28,141	(34,988)	27,762	459	27,303
Less bond discount	(15,805)	–	(742)	(16,547)	(161)	(16,386)
Less deferred loss on refunding	(73,884)	(19,556)	50,533	(42,907)	(3,563)	(39,344)
Total bonds	2,579,740	2,585,720	(670,262)	4,495,198	12,658	4,482,540
Notes payable:						
Water Pollution Control and Safe Drinking Water Treatment Revolving Funds Loans	413,449	54,892	(18,297)	450,044	19,658	430,386
Bond Anticipation Notes 2012A		241,000	(241,000)	–	–	–
Notes with commercial banks	241,744	–	(241,744)	–	–	–
Total notes	655,193	295,892	(501,041)	450,044	19,658	430,386
Lines of credit	1,029,949	297,295	(1,217,456)	109,788	–	109,788
Other long-term liabilities:						
Accrued compensated absences	46,442	11,301	(12,472)	45,271	12,704	32,567
Net OPEB obligation	17,148	7,881	(2,377)	22,652	7,881	14,771
Early retirement obligation	2,308	–	(1,422)	886	793	93
Customers' deposits	80,098	9,123	(8,245)	80,976	6,408	74,568
Total other liabilities	145,996	28,305	(24,516)	149,785	27,786	121,999
Total – long-term obligations	$ 4,410,878	$ 3,207,212	$ (2,413,275)	$ 5,204,815	$ 60,102	$ 5,144,713

10. Bonds Payable

Bonds payable consisted of the following (in thousands):

	June 30 2013	June 30 2012
PFC Commonwealth Appropriation Bonds:		
Series 2011:		
Series A, 6.50%, due in semiannual interest payments through August 1, 2028 and annual principal installments from August 1, 2027 to 2028	**$ 90,099**	$ 90,099
Series B, 5.50% - 6.00% due in semiannual interest payments through August 1, 2031 and annual principal installments from August 1, 2024 to 2031	**102,183**	102,183
Series B - Superaqueduct, 5.50% - 6.00% due in semiannual interest payments through August 1, 2031 and annual principal installments from August 1, 2024 to 2031	**162,700**	162,700
Series 2012:		
Series A, 3.10% - 5.35%, due in monthly interest payments through August 1, 2031 and annual principal installments from August 1, 2015 to 2031	**56,247**	56,247
Revenue Refunding Bonds:		
Series 2008:		
Series A and B, Term Bonds, 5.80% – 6.10%, due in montly 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	**80,865**	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	**155,975**	155,975

(Continued)

10. Bonds Payable (continued)

	June 30 2013	2012
Series A, Term Bonds, 5.00% - 6.00%, due in semiannual interest payments through July 1, 2047 and annual principal payments from July 1, 2026 to 2047	**1,095,125**	1,095,125
Series B, Serial Bonds, 6.15% due in montly interest payments through July 1, 2038 and one principal payment on July 1, 2038	**22,445**	22,445
Series 2012:		
Series A, Serial Bonds 4.00% - 5.25%, due in semiannual payments through July 1, 2030 and annual principal payments from July 1, 2015 to July 1, 2030	**418,455**	418,455
Series A, Term Bonds, 5.00% – 6.00%, due in semiannual interest payments through July 1, 2047 and annual principal payments from July 1, 2033 to July 1, 2047	**1,381,995**	1,381,995
Series B, Serial Bonds, 3.35% - 5.00%, due in semiannual payments through July 1, 2023 and annual principal payments from July 1, 2014 to July 1, 2023	**188,130**	188,130
Series B, Term Bonds, 5.35%, due in semiannual interest payments through July 1, 2027 and one principal payment on July 1, 2027	**107,115**	107,115
Rural development serial bonds:		
Serial bonds, 2.00% - 5.00%, due semiannually through July 1, 2050	**405,064**	368,511
Subtotal	**4,551,153**	**4,526,890**
Bond premium	**27,302**	27,762
Bond discount	**(16,386)**	(16,547)
Deferred loss on refundings	**(39,343)**	(42,907)
Total	**$ 4,522,726**	$ 4,495,198

10. Bonds Payable (continued)

2001 Series A and B PFC 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 subsidiary corporation 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.

On June 28, 2004, $321.4 million of the Authority's share of the 2001 Series A and B Bonds was advanced refunded upon the issuance by PFC of its 2004 Series A and B Refunding Bonds.

As of June 30, 2011, the outstanding balance of 2001 Series B Bonds was $8.9 million. On July, 2011, the amount of $8.9 million was paid in full.

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.

10. Bonds Payable (continued)

Act 164 PFC Bonds (continued)

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.

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 2004 Series A Refunding Bonds at a premium of approximately $89.4 million, and approximately $146.9 million of 2004 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

10. Bonds Payable (continued)

Act 164 PFC Bonds (continued)

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.

On July 31, 2007, December 20, 2007 and June 26, 2008, the Puerto Rico Sales Tax Financing Corporation (known as COFINA), issued its Sales Tax Revenue Bonds Series 2007A and 2007B, Series 2007C and Series 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 million.

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

The Authority's share of 2011 Series A, 2011 Series B and 2012 Series A PFC Refunding Bonds of approximately $90.1 million, $264.9 million and $56.2 million, respectively was recorded in Authority's balance sheets at June 30, 2013 and 2012.

10. Bonds Payable (continued)

Act 164 PFC Bonds (continued)

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

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

2004 Series A PFC Refunding Bonds

On June 28, 2004, PFC restructured debt related to 2001 Series A and B Bonds. As a result of this refunding process, $326.8 of 2004 Series A and B Bonds were issued and $321.4 million from 2001 Series A Bonds were reduced. Additionally, net debt issuance cost of $1.2 million, net premium of $23.2 million and deferred refunding losses for $27.3 million were recorded by the Authority. The issuance cost and the deferred loss are amortized for the term of the debt. Maturity dates ranges from August 1, 2013 to August 1, 2031.

On December 8, 2011, PFC issued 2011 Series B Refunding Bond for the amount of $437.6 million, for the purpose of refunding a portion of certain of its 2004 Series A outstanding bonds. The net proceeds from the refunding bonds, after payment of the cost of issuance and bond premium, were used to advance refund a portion of PFC's previously issued bonds in order to obtain lower interest rates.

The Authority's share of the 2011 Series B Refunding Bonds is approximately $162.7 million.

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

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

10. Bonds Payable (continued)

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

On August 18, 2011, December 8, 2011 and June 28, 2012 PFC issued 2011 Series A, 2011 Series B and 2012 Series A Refunding Bonds for the amount of $242.4 million, $437.6 million, and $410.6 million, respectively for the purpose of refunding a portion of certain of its outstanding bonds.

The net proceeds from the refunding bonds, after payment of the cost of issuance and bond premium, were used to advance refund a portion of PFC's previously issued bonds. These bonds issuances refunded previous Act 164 and 2004 Series A PFC Bonds. Authority's share on these previous bond issuances was removed from balance sheets.

As of June 30, 2013, the Authority's share for the 2011 Series A, 2011 Series B and 2012 Series A Refunding Bonds including Superacueduct 2011 Series B is approximately $90.1 million, $264.9 million and $56.2 million, respectively.

2008 Series A and B Revenue Bonds

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

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

The 2008 Series A Revenue Bonds consist of (1) $93.2 million of serial bonds bearing interest at 5% per annum with maturity dates ranging from July 1, 2012 to July 1, 2025, (2) $127.9 million of capital appreciation term bonds bearing interest at 6 1/8% per annum and with maturity date of July 1, 2024, and (3) $1,095.1 million of term bonds bearing interest at rates ranging from 5% to 6% per annum with maturity dates ranging from July 1, 2028 to July 1, 2047. As of June 30, 2013 and 2012, the outstanding balance for the 2008 Revenue Bonds Series A was approximately $1,331.9 million and $1,344.2 million respectively, which included approximately $28 million of accreted value.

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

The 2008 Series A and B Revenue Bonds are considered senior debt.

10. Bonds Payable (continued)

2008 Series A and B Revenue Refunding Bonds

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

The 2008 Revenue Refunding Bonds are guaranteed by the Commonwealth and the Authority's net revenue, as defined in the corresponding trust indenture, is pledged toward the payment of debt service on these bonds. The 2008 Revenue Refunding Bonds are subordinated to all senior and senior subordinated debt. As of June 30, 2013 and 2012 the outstanding balance for the 2008 Series A and B refunding Bonds was $284.8 million.

10. Bonds Payable (continued)

2012 Series A and B Revenue Bonds

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

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

The 2012 Series A Revenue Bonds consist of (1) $418.4 million of serial bonds bearing interest at rates ranging from 4.0% to 5.25% per annum with maturity dates ranging from July 1, 2015 to July 1, 2030, and (2) $1,382.0 million of term bonds bearing interest at rates ranging from 5% to 6% per annum with maturity dates ranging from July 1, 2033 to July 1, 2047.

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

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

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

The 2012 Revenue Bonds are considered senior debt. As of June 30 2013 and 2012 the outstanding balance for 2012 Series A and B were $2,095.7.

10. Bonds Payable (continued)

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.

On June 12, 2013, the Authority issued approximately $45.5 million of Series II of USDA Rural Development Program Bonds, at a maximum interest of 3.50%, payable semiannually and maturing in semiannually installments through July 1, 2053. The funds raised by this issuance were used to partially repay the outstanding balance of USDA Rural Development Program lines of credit for construction projects from GDB.

As of June 30, 2013, the USDA Rural Development Program Bonds consisted of twenty-six (26) separate series, issued from 1983 through 2013, bearing interest from 2% to 5% due in semiannual installments through 2053. The outstanding balance of the USDA Rural Development Program Serial Bonds as of June 30, 2013 and 2012 was approximately $405 million and $368.5 million, respectively.

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

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

10. Bonds Payable (continued)

Debt Service Payments

Future principal and interest payments on all bonds payable outstanding at June 30, 2013 was as follows (in thousands):

	Principal	Interest	Total
Fiscal year:			
2014	$ 16,900	$ 234,901	$ 251,801
2015	52,832	241,624	294,456
2016	62,607	239,134	301,741
2017	63,852	236,360	300,212
2018	66,487	233,331	299,818
2019 – 2023	397,351	1,111,497	1,508,848
2024 – 2028	641,314	986,023	1,627,337
2029 – 2033	905,113	757,324	1,662,437
2034 – 2038	770,022	531,814	1,301,836
2039 – 2043	911,116	308,191	1,219,307
2044 – 2048	642,799	92,168	734,967
2049 – 2053	20,760	1,608	22,368
Total	4,551,153	$ 4,973,975	$ 9,525,128
Plus unamortized premium	27,302		
Less:			
Unamortized discount	(16,386)		
Deferred loss on debt refunding	(39,343)		
Bonds payable, net	$ 4,522,726		

11. Notes Payable

Notes payable consisted of the following (in thousands):

	June 30 2013		June 30 2012	
Puerto Rico Water Pollution Control Revolving Fund	**$**	**315,334**	$	304,799
Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund		**154,409**		145,245
	$	**469,743**	$	450,044

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, 2013 and 2012, the Authority had outstanding approximately $469.7 million and $450 million, respectively, under these loan agreements.

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

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 2013 and 2012, the loan bear 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, 2011 was approximately $241.7 million. The net revenue of the Authority, as defined in the Term Loan Agreement, was pledged toward payment of debt service on this term loan. The notes are considered senior subordinated debt and are subordinated to the senior debt.

On August 17, 2011, the maturity date of this term loan was extended from September 1, 2011 to January 16, 2012. The Authority was required to make quarterly principal payments of $736,000 on September 1, 2011 and December 1, 2011.

The outstanding balance of $240.6 million of the term loan was paid with 2012 Series A Bond Anticipation Notes issued for $241.0 million by Bank of America Merrill Lynch on January 17, 2012.

On February 29, 2012, the outstanding balance of $241.0 million of the 2012 A Bond Anticipation Notes was paid in full with the proceeds of the issuance of 2012 Series B Revenue Bonds.

11. Notes Payable (continued)

The combined future aggregate amount of debt service for these loans as of June 30, 2013 was as follows (in thousands):

	Principal	Interest	Total
2014	$ 19,605	$ 5,412	$ 25,017
2015	19,941	5,018	24,959
2016	19,500	4,619	24,119
2017	19,399	4,232	23,631
2018	18,625	3,842	22,467
2019 – 2023	83,559	14,024	97,583
2024 – 2028	76,485	5,895	82,380
2029 – 2033	18,340	476	18,816
	275,454	$ 43,518	$ 318,972
Interim construction loans:			
Puerto Rico Water Pollution Control Revolving Fund	125,745		
Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund	68,544		
Total	$ 469,743		

12. Lines of Credit

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. On November, 2010, the line was increased by $19.5 million to $269.5 million to capitalize unpaid accrued interest payable. As of June 30, 2011, the Authority had an outstanding balance of $269.5 million. On February 29, 2012, the outstanding balance of $269.5 million was paid in full with the proceeds of the issuance of 2012 Series A Revenue Bonds.

12. Lines of Credit (continued)

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 2008 Revenue Bonds. On February 29, 2012, the maximum amount was increased to $180.0 million. This line of credit is due on June 30, 2016. There was no outstanding balance as of June 30, 2013 and 2012.

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. On February 29, 2012, the outstanding balance of $94.1 million, including capitalized interests, was paid in full with the proceeds of the issuance of 2012 Series A Revenue Bonds.

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. On February 29, 2012, the outstanding balance of $125.0 million was paid in full with the proceeds of the issuance of 2012 Series A Revenue Bonds.

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 for the purpose of providing interim financing for the construction of aqueduct and sewer facilities in rural areas. On September 14, 2011, the outstanding balance of $13.4 million was paid in full with the proceeds of bond issuance by USDA Rural Development Series HH.

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. On February 29, 2012, the outstanding balance of $150 million was paid in full with the proceeds of the issuance of 2012 Series A Revenue Bonds.

12. Lines of Credit (continued)

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, 2013 and 2012, the Authority had an outstanding balance of approximately $17.5 million and $37.4 million on this line of credit, respectively. The line of credit is due on January 31, 2014.

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 $113.9 million. On August 3, 2010 the maximum available amount was increased to $200 million. On February 29, 2012, the outstanding balance of $200 million was paid in full with the proceeds of the issuance of 2012 Series A Revenue Bonds.

On November 30, 2010, the Authority entered into a line of credit agreement with GDB. This agreement provides the Authority with an available maximum amount of approximately $21.7 million for the purpose of providing interim financing for the construction of aqueduct and sewer facilities in rural areas. On September 14, 2011, the outstanding balance of $10.5 million was paid in full with the proceeds of the issuance of Series HH USDA Rural Development Bonds.

On March 8, 2011, the Authority entered into a line of credit agreement with GDB. This agreement provides the Authority with an available maximum amount of $250 million to be used to provide funding for the capital improvement program of the Authority. On February 29, 2012, the outstanding balance of $250 million was paid in full with the proceeds of the issuance of 2012 Series A Revenue Bonds.

12. Lines of Credit (continued)

On August 17, 2009, the Authority entered into an Asset Purchase Agreement with the Puerto Rico Industrial, Tourism, Educational, Medical and Environmental Facilities Financing Authority (AFICA), a public corporation of the Commonwealth of Puerto Rico, to purchase certain assets that were being used to develop the Southern Gas Pipeline Project for the total purchase price of approximately \$23.5 million and assumed the rights and obligations of PREPA under Subordinated Loan Agreement between AFICA and PREPA and a Subordinated Note and Loan Agreement of approximately \$31 million. As established in the Asset Purchase Agreement the abovementioned transfers occurred two years after the date of the Agreement, on August 16, 2011, and the transaction was recorded on the Authority's books during fiscal year 2012. On February 29, 2012, the outstanding balance of \$31 million was paid in full with the proceeds of the issuance of 2012 Series B Revenue Bonds.

On February 29, 2012, the Authority entered into a line of credit agreement with GDB. This agreement provides an available maximum amount of \$150 million for the purpose of assisting with the Authority's cash flows needs during the transition period after amending and restating the Master Agreement of Trust as a result of the issuance of 2012 Revenue Bonds Series A and B. As of June 30, 2013, the Authority had an outstanding balance of approximately \$72.3 million. The line of credit is due on June 30, 2014.

Future amounts required to pay principal balances at June 30, 2013 are as follows (in thousands):

Fiscal year:	
2014	$ 89,835
2015	–
	$ 89,835

13. Financial Covenants

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

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

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

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

As of June 30, 2013 and 2012, the Authority was in compliance with the senior annual debt service coverage requirements.

14. Capital Contributions

Capital contributions for the fiscal years ended June 30, 2013 and 2012 were as follows (in thousands):

	June 30	
	2013	**2012**
Other contributions from Commonwealth	**$ 276**	$ 3,769
Contributions from governmental agencies and municipalities	**44**	200
Federal grants:		
USDA Rural Development Program	**10,975**	23,648
Federal Emergency Management Agency	**11**	7,571
American Recovery and Reinvestment Act Funds	**2,058**	15,672
Developer contributions	**5,545**	71
Other contributions	**1,226**	1,165
	$ 20,135	$ 52,096

15. Related Party Transactions

Operating revenues for services provided to the Commonwealth and its component units amounted to approximately $83.6 million and $87.9 million during the years ended June 30, 2013 and 2012, respectively. Further, operating, administrative, and general expenses during the fiscal years ended June 30, 2013 and 2012 included approximately $209.2 million and $200.2 million, respectively, of charges from Puerto Rico Electric Power Authority (PREPA), a component unit of the Commonwealth.

As of June 30, 2013 and 2012, the Authority had approximately $33.8 million and $51.8 million, respectively, of receivables from the Commonwealth and its component units, which were reported in accounts receivable in the accompanying basic financial statements.

15. Related Party Transactions (continued)

The Authority had approximately $1.3 million and $2.2 million of excess of collections over billings from the Commonwealth, recorded as unearned revenue in the basic financial statements as of June 30, 2013 and 2012, 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 needs. As of June 30, 2013 and 2012, the Authority had an outstanding balance of approximately $89.8 million and $109.8 million, respectively, under these lines of credit.

On July 1, 2011, Joint Resolution No. 57 was approved by the Puerto Rico Legislature. This Resolution assigned to the Authority the amount of $183.8 million, of which $70.2 was received, to subsidize operating expenses and payment of debt service, as needed for fiscal year ended June 30, 2012. There was no assignment from Puerto Rico Legislature for fiscal year 2013.

On August 17, 2009, the Authority entered into an Asset Purchase Agreement with the Puerto Rico Industrial, Tourism, Educational, Medical and Environmental Facilities Financing Authority (AFICA), a public corporation of the Commonwealth of Puerto Rico to purchase certain assets that were being used to develop the Southern Gas Pipeline Project for the total purchase price of approximately $23.5 million and assumed the rights and obligations of PREPA under Subordinated Loan Agreement between AFICA and PREPA and a Subordinated Note and Loan Agreement of approximately $31 million. As established in the Asset Purchase Agreement the abovementioned transfers occurred two years after the date of the Agreement, on August 16, 2011, and the transaction was recorded on the Authority's books during fiscal year 2012. On February 29, 2012, the outstanding balance of $31 million was paid in full with the proceeds of the issuance of 2012 Series B Revenue Bonds.

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 become members of the ERS as a consequence of their employment.

16. Pension Plan (continued)

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

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

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

On February 16, 1990, by means of Act 1, an amendment to Act No 447 of May 15, 1951, which created the ERS, was enacted for the purpose of establishing a new age for retirement and method of computation to determine the annuity for the employees hired after April 1, 1990.
The amount of the annuity shall be one and one half percent (1.5%) of the average compensation of the last five (5) years multiplied by the number of years of creditable service. Participants will receive the annuity when attained the age of sixty-five (65) years old. In no case shall the annuity be less than $400 per month.

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

Commonwealth legislation requires that employees hired before April 1, 1990 contribute 5.775% of the first $550 of their monthly gross salary and 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.

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

16. Pension Plan (continued)

The Authority's contributions during fiscal year 2013 were 11.275% of the gross monthly salary. Total employer contributions during years ended June 30, 2013, 2012 and 2011 amounted to approximately $9.3 million, $9.2 million, and $8.5 million, respectively, which represented 100% of required contributions.

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

System 2000 is a defined contribution plan, also known as a cash balance plan. Under this new plan, there is a pool of pension assets, which are invested by the ERS, together with those of the current defined benefit plan. Benefits at retirement age are not guaranteed by the Commonwealth. The annuity is based on a formula that assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) is invested in an account, which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or (2) earn a rate equal to 75% of the return of the ERS' investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances.

System 2000 reduced the retirement age from sixty-five (65) years to sixty (60) for those employees who joined the ERS on or after April 1, 1990. Disability pensions are not granted under System 2000. The employers' contributions of 11.275% of the employee's gross salary during fiscal year 2013 were used to fund the defined benefit plan.

Total employer contributions under System 2000 plan during the fiscal years ended June 30, 2013, 2012 and 2011, amounted to approximately $7.1 million, $5.4 million, and $3.9 million, respectively, which represented 100% of required contributions.

16. Pension Plan (continued)

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

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

To qualify for an annuity under the new "Hybrid Program", participants have to meet two conditions: five years of credited service and $10,000 or more in contributions made under this program. The annuity will be based on a distribution of all contributions made, divided by a factor of life expectancy of the participant at the age of retirement.

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

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

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

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

16. Pension Plan (continued)

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

Age at June 30, 2013	Age under new program
65 years or less	65 years

For participants who entered the program after January 1, 2000 through June 30, 2013 (System 2000):

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

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

Additional information on the ERS is provided in its financial statements for the years ended June 30, 2013 and 2012, 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. The benefit consists on a fixed maximum monthly payment (annuity) to cover medical expenses. Based on the Plan's features and functionality, and for the purpose of the actuarial valuation, it has been identified as a single-employer defined benefit healthcare plan. Participants groups covered are employees under Collective Labor Agreement with "Unión Independiente Auténtica" (UIA), employees under Collective Labor Agreement with "Hermandad Independiente de Empleados Profesionales de la Autoridad de Acueductos y Alcantarillados" (HIEPAAA) and employees under Managers' Regulation, all of which are Authority 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 will be at 61 years old.
- For employees employed by the Authority on March 30, 1990 and before July 1, 2013, normal retirement age will be at 65 years old.
- For the employees hired by the Authority after July 1, 2013, normal retirement age will be at 67 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.

17. Other Postemployment Benefits (continued)

Funding Policy

The contribution requirements of the Authority are established and may be amended, by the Authority's Board of Directors. The benefits are paid directly by the Authority to the retirees at a rate of a maximum of $125 per month per retiree. The Plan is financed on a pay-as-you-go basis and the amount contributed during fiscal years ended June 30, 2013 and 2012 was approximately $2.4 million, which is in accordance with the funding policy. There is no contribution requirement for plan members.

Annual OPEB costs and Net OPEB obligation

The Annual Pension Cost (APC) and the Annual Required Contribution (ARC) were computed as part of an actuarial valuation performed as of June 30, 2013, 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, 2013 and 2012 amounted to (in thousands):

	2013	2012
Annual Required Contribution (ARC):		
Normal costs	**$ 2,379**	$ 2,379
Amortization of initial UAAL	**3,224**	3,225
Amortization of loss	**3,556**	3,555
GASB Statement No. 45 Annual Required Contribution	**$ 9,159**	$ 9,159

OPEB costs components for the years ended June 30, 2013 and 2012 are as follows (in thousands):

	2013	2012
Annual OPEB Costs		
ARC for fiscal year	**$ 9,159**	$ 9,159
Interest on Net OPEB Obligation	**343**	343
ARC Amortization Adjustment	**(1,621)**	(1,621)
Total Annual OPEB Costs	**$ 7,881**	$ 7,881

17. Other Postemployment Benefits (continued)

Annual OPEB costs and Net OPEB obligation (continued)

The net OPEB obligation change for the years ended June 30, 2013 and 2012 is as follows (in thousands):

	2013	2012
Change in net OPEB obligation		
Net OPEB obligation, July 1, 2012	**$ 22,652**	$ 17,148
Total annual OPEB costs	**7,881**	7,881
Actual benefit payments	**(2,392)**	(2,377)
Net OPEB obligation, June 30, 2013	**$ 28,141**	$ 22,652

The net OPEB obligation is recorded as a component of compensated absences and postemployment benefits in the accompanying balance sheet as of June 30, 2013 and 2012.

Funded Status

Funded status of the plan as of June 30, 2013 and 2012, the most recent actuarial valuation date, is as follows (in thousands):

	2013	2012
Unfunded Actuarial Accrued Liability (UAAL):		
Active employees	**$ 32,311**	$ 31,718
Retirees	**40,733**	39,985
Actuarial accrued liability	**73,044**	71,703
Actuarial value of assets	**–**	–
UAAL	**$ 73,044**	$ 71,703

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

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, 2013 and 2012 was 2.0%. For fiscal year 2013, a 3-year average of the U.S. Treasury Bond 10-year term investments represents the Authority's expected long-term return on internal assets used to finance the payment of plan benefits.

Medical Increase Rate

As the retirement healthcare benefit is fixed, such that it will not increase the obligation under the plan (regardless of the claim experience) without negotiation of a new contract with the unions or an express Board of Directors' approval, the medical increase rate was zero for the years ended June 30, 2013 and 2012. 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, 2013 and 2012, 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 2018 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 the Projected Unit Credit (Attribution from date of hire to expected retirement ages).

Amortization of Initial UAAL

Period

The initial UAAL will be amortized in a 12-year period based on the average future years of service of the active population, starting 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 were 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 168 professional employees, was signed effective May 31, 2012 until June 30, 2016.

The collective bargaining agreement with the UIA union, which covers approximately 3,362 blue-collar and clerical employees, was signed effective January 1, 2012 until December 31, 2015.

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. On July 19, 2011, the Authority and Thames-Dick agreed to cancel the Master Agreement and transferred to the Authority the responsibility of the operation and administration of the North Coast Aqueduct. There were no costs associated with the contract for June 30, 2013 and $0.3 million for the year ended June 30, 2012, are reported under the caption of *Service contract – Superaqueduct* in the accompanying statements of revenues, expenses, and changes in net position.

During fiscal year 2012, the Authority signed an agreement with Caribbean Water Specialist Corp. and pays a management fee for the operation of the North Coast Aqueduct. This amount is reported under the caption of *Service Contract – Superaqueduct* ($5.7 million and $5.8 million for the years ended June 30, 2013 and 2012, respectively). All other operational cost considered as pass-through cost under the Thames-Dick Agreement (electricity, chemicals, etc.) associated with the operation of the system were captioned in their respective expense category.

20. Commitments and Contingencies

Environmental Matters

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

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

20. Commitments and Contingencies (continued)

Environmental Matters (continued)

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

As part of the agreement, PRASA pays stipulated penalties for pump station bypass events on a quarterly basis. The penalty calculations are based on the pumping capacity of the pump station and the time taken to correct the deficiency causing the bypass event. The amount of penalties during fiscal years 2013 and 2012 was approximately $0.3 million and $0.5 million respectively.

- 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 stipulated civil penalty of $1 million which was paid during fiscal year 2008. This penalty was assessed by the Court as payment for the discharge permit violations of several treatment facilities to the Clean Water Act.

  The agreement also required the Authority to deposit in an escrow account with the GDB an additional civil penalty in the amount of $3 million. These funds are to be used for providing sewer service to a community that has not been connected to the Authority's sanitary sewer system. As results of the discussion between PRASA and EPA, it was decided to connect The Lago La Plata Community Supplemental Environmental Project. The project consists of the installations of 7,886 meters of sanitary sewer systems, composed by gravity and forceline system for a cost of $4.1 million and has an expected date of the project completion by October 2014.

20. Commitments and Contingencies (continued)

Environmental Matters (continued)

As part of the agreement, PRASA pays stipulated penalties on a yearly basis for exceedances to each of PRASA's facilities to their individual discharge permits. The penalty calculations are based on frequency of the exceedances as well as the percentage of the exceedances with its respective limit. The amount of penalties during fiscal years 2013 and 2012 was approximately \$0.5 million and \$0.6 million, respectively. These penalty payments are deposited into an escrow account from which a fraction of the deposited amount can be reimbursed to PRASA based on completion of specific projects and initiatives.

- On May 25, 2006, the Authority entered into a plea agreement with the U. S. Department of Justice related to violations of the Clean Water Act, as amended, Title 33, USC, Sections 11311(a) and 1319(c)(2)(A). As part of the agreement (Criminal Case No. 06-CR-00202-001), the Authority paid a \$9.0 million fine. This penalty was assessed by the Court as payment for the discharge permit violations of several treatment facilities to the Clean Water Act. The Authority was placed on probation for a period of five years, which expired on April 19, 2012. As part of the probation the Authority had to comply with several special conditions, such as: (i) upgrade the collection and wastewater treatment system in the Ponce de León Avenue area of San Juan for a cost of not less than \$10 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 the consent decree signed by the Authority with the U.S. Government on June 22, 2006. The plea agreement also established stipulated penalties for violation of any of the deadlines or performance standards set forth in the agreement. As of today, the Authority is in compliance with the deadlines and requirements of this Consent Order and no penalties have been paid.

- On December 15, 2006, an agreement (Civil Case No. KPE 2006-0858) was signed between the Authority and the Department of Health of the Commonwealth related to violations of the Safe Drinking Water Act (SDWA), as amended. The agreement was preliminarily approved by the supervising court on March 15, 2007 and it was amended and finally approved by that court on June 20, 2008. The Authority agreed to implement a work plan to remediate the violations, establish preventive and mitigation measures, and execute a preventive maintenance program for the purpose of meeting the requirements of the SDWA. This Act requires the compliance with parameters of water quality and treatment techniques in the Authority's water systems. As part of the agreement, the Authority paid a civil penalty of

20. Commitments and Contingencies (continued)

Environmental Matters (continued)

$1 million during fiscal year ended June 30, 2007. The civil penalty was stipulated by the court for alleged non-compliance issues to the SDWA attended in this decree. In this Consent Decree, the Authority shall pay stipulated penalties for failing to comply with remedial measures deadlines, fail to submit deliverables or exceedances to maximum contaminant levels.

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

During fiscal years ended June 30, 2013 and 2012, the penalties amounted approximately $0.6 million and $0.4 million, respectively. The Authority deposited $0.01 million in an escrow account. The deposit in the escrow account is for parameters exceedances, and will be used for compliance projects with the approval of the Department of Health.

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

20. Commitments and Contingencies (continued)

Environmental Matters (continued)

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

The total amount of penalties paid under this agreement during the fiscal years 2013 was approximately $1.7 million. Stipulated penalties must be paid by the Authority for failing to comply with remedial measures deadlines, permit limit exceedances or fail to submit deliverables or Discharge Monitoring Reports.

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

Risk Management

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

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:

20. Commitments and Contingencies (continued)

Risk Management (continued)

Coverage	Deductible	Policy Limit
Real and personal property:		
Windstorm	Up to $32.5 million per event, with a minimum of $25 million	$150 million per event
Flood	Up to $28 million per event, with a minimum of $25 million	$300 million per event
Earthquake	Up to $32.5 million per event, with a minimum of $25 million	$300 million per event
All other	$25 million per occurrence	$150 million per event
Automobile	—	$1 million per occurence
Comprehensive general liablities	$100 thousand per occurrence	$1 million per occurence $2 million per aggregate
Umbrella liability		
First Excess General liability and automobile	Retention $1.0 million	In excess of $20 million up to $20 million
Second Excess General liability and automobile	—	From $20 million to $40 million
Pollution Liabilty	$250 thousand per ocurrence	$5 million
Crime	$10 thousand per ocurrence	From $500 thousand up to $1 million

20. Commitments and Contingencies (continued)

Risk Management (continued)

Coverage	Deductible	Policy Limit
Officers and Directors	$200 thousand per occurrence	$20 million
First Excess Directors and Officers	—	Additional $10 million
Travel and Accident	—	$500 thousand per ocurrence $2.5 million aggregate
Accident and Health Divers	—	$250 thousand per ocurrence $1.7 million aggregate
EPLI	$100 thousand per occurrence	$5.0 million
Excess EPLI	—	Additional $5.0 million

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

20. Commitments and Contingencies (continued)

Risk Management (continued)

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

Coverage	Deductible	Policy Limit
Comprehensive general liability:		
General liability	$10 thousand per ocurrence	$2 million per ocurrence $4 million aggregate
First excess liability	$10 thousand per ocurrence	$25 million per ocurrence $50 million aggregate
Second excess liability	—	$25 million per ocurrence $50 million aggregate
Builder's Risk	$20 thousand theft $100 thousand - atmospheric events	$100 million per ocurrence
Contractor's Pollution Liability	$25 thousand per ocurrence	$25 million per ocurrence $25 million aggregate
Proffesional Liability	$250 thousand per ocurrence	$25 million per ocurrence $50 million aggregate

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

Construction Projects

The Authority enters in construction projects for the replacements or expansion of its facilities. As of June 30, 2013 and 2012, there were outstanding commitments for projects in process for approximately $88.3 million and $191.3 million, respectively.

Operating Leases

Certain commercial offices and warehouse facilities of the Authority are leased under operating lease agreements. During the years ended June 30, 2013 and 2012, the Authority incurred approximately $4.2 million and $4.0 million, respectively, in rent expense.

20. Commitments and Contingencies (continued)

Operating Leases (continued)

Future minimum noncancelable lease payments on existing operating leases at June 30, 2013, which have an initial term of one year or more, are as follows (in thousands):

2014	$ 2,941
2015	2,357
2016	1,939
2017	1,668
2018	1,279
2019 - 2023	4,255
2024 - 2028	1,771
	$ 16,210

Litigation

The Authority is the defendant in various lawsuits filed by customers alleging that the Authority has over billed them due to the methodology used to estimate consumption. There are two cases in which plaintiffs requested a certification of the suit as a class action and seek recovery of damages in the total amount of approximately $386 million, plus legal costs of around $100 million (25%) and interests and an injunction enjoining the Authority from continuing to bill using the current methodology. Those cases are: (1) Fernando Toro, et al. v. Autoridad de Acueductos y Alcantarillados and (2) Joaquín Gautier, et al. v. Autoridad de Acueductos y Alcantarillados.

In the Toro case, the class certification hearings took place in the month of June 2011. The parties presented their evidence and the case is currently submitted for the consideration of the Judge for a determination of certification the class. At the present time, a Judgment has not been entered by the Court. However, after evaluating the evidence presented in the class certification hearings, the Authority's potential exposure from this lawsuit is unlikely and, as such, no liability is being reported on the financial statements.

20. Commitments and Contingencies (continued)

Litigation (continued)

In the Gautier case, the Authority consented to the class action. As of this moment, the parties have not submitted the definition of the class to the Court. Since the parties are involved in the discovery process, the Authority's potential exposure from this lawsuit cannot be presently determined and, as such, no liability is being reported on the financial statements.

The Authority is the defendant or codefendant in various other lawsuits not included in the financial statements. 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.

21. Subsequent Events

On July 3, 2013, the Authority's Board of Directors approved a rate increase to be effective on July 15, 2013. Subsequently, on December 18, 2013 the Board amended the rates for non-residential customers. The approved rate structure includes increases of the base and volume charges and incorporates a new monthly charge for environmental compliance and regulatory costs, this varies by customer class, consumption or meter size. Also, there is an additional $2 monthly charge for special projects, such as the protection and remediation of watersheds and improvements to systems not connected to the Authority. The rate increase was designed to generate enough revenues to cover the Authority's expenses and debt service until fiscal year 2017. Detailed information on the new rate structure is available at the Authority's webpage www.acueductospr.com.

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	Percentage of Covered Payroll
June 30, 2013	$ –	$ 73,044	$ 73,044	—%	$149,613	49%
June 30, 2012	$ –	$ 71,703	$ 71,703	—%	$163,753	44%
June 30, 2010	$ –	$ 56,414	$ 56,414	—%	$147,432	35%

See accompanying independent auditors' report.

Supplemental Schedule

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

Financial Results and Debt Coverage Calculations per 2012 Amended and Restated Master Agreement of Trust

Years Ended June 30, 2013 and 2012
(In thousands)

	2013	2012
Revenues		
Service revenues (cash basis)	$ 746,370	$ 724,258
Other Income	6,465	8,581
Developers Contributions	6,537	4,634
Operating revenues (cash basis)	759,372	737,473
Operational subsidy	–	70,264
Budgetary Reserve Fund	145,000	95,000
Total authority revenues	904,372	902,737
Operating expenses:		
Payroll and payroll related	272,092	275,613
Electricity	209,168	200,195
Other operating expenses	217,614	230,355
Total net operating expenses	698,874	706,163
Non cash reserve adjustments	–	40,293
Adjusted operating expenses	698,874	665,870
Total net revenues per MAT	$ 205,498	$ 236,867

	2013	2012
Debt service coverage calculation:		
Operating revenues available for Senior, Senior Subordinated and Subordinated debt	**$ 759,372**	**$ 737,473**
Senior debt	90,600	90,600
Accumulated coverage ratio (Min 2.5x)	*8.38*	*8.14*
Senior subordinated debt	–	5,825
Accumulated coverage ratio (Min 2.0x)	*8.38*	*7.65*
Subordinated debt	–	–
Accumulated coverage ratio (Min 1.5x)	*8.38*	*7.65*
Net revenues available for Commonwealth Guaranteed Indebtedness and Commonwealth Supported Obligations	**$ 205,498**	**$ 236,867**
Commonwealth Guaranteed Indebtedness	75,392	112,104
Accumulated coverage ratio (Min 1.0x)	*1.24*	*1.14*
Commonwealth Supported Obligations	–	27,714
Accumulated coverage ratio (Min 1.0x)	*1.24*	*1.00*

Other Report and Schedule

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

The Board of Directors
Puerto Rico Aqueduct and Sewer Authority

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Puerto Rico Aqueduct and Sewer Authority (the Authority), which comprise the statement of financial position as of June 30, 2013, and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 31, 2013.

Internal Control Over Financial Reporting

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described below, we identified a deficiency in internal control that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described as 2013-01 in the accompanying schedule of findings and responses to be material weaknesses.

A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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Compliance and Other Matters

As part of obtaining reasonable assurance about the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

Authority's Response to Finding

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

Purpose of this Report

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

Ernst + Young LLP

December 31, 2013

Stamp No. E88355
affixed to
original of
this report.

Financial Statements Findings

Finding No.:2013-01

Topic
Capital assets – Management of projects reported in the Construction in process account and the management of assets being depreciated

Criteria or Specific Requirement
The Authority manually processes a significant volume of transactions for their projects accounted in the construction in process account and the related assets being depreciated, which increases significantly the risk of unintentional errors going undetected.

Condition
We selected a number of projects in the construction in process (CIP) account as of June 30, 2013 and individual assets transferred during the year from CIP to assets being depreciated. For projects recorded in the construction in process account we verified that the project was classified correctly. For assets transferred during the year from CIP to assets being depreciated account we verified that the assets were transferred correctly and on a timely basis. During our audit procedures we noted that approximately $69.9 million was not transferred at June 30, 2013 from the CIP account to the asset being depreciated account. Consequently, there was approximately $2 million in depreciation expense not recorded as June 30, 2013.

In addition, during our review of the Authority's capital assets there were assets not being depreciated as required by the authoritative accounting guidance. Consequently, there was approximately $7 million depreciation expense not recorded as June 30, 2013.

Effect
Delays in the verification and reconciliation of CIP projects status between the capital assets and infrastructure departments resulted in several audit adjustments recorded in the Authority's financial statements as of and for the year ended June 30, 2013.

Cause
These errors were due to the Authority's untimely transfer of projects from CIP to assets being depreciated and the resulting impact on depreciation expense and reclass in the capital asset section in the Authority's balance sheet.

Financial Statements Findings

Finding No.:2013-01 (continued)

Cause (continued)
The lack of internal control procedures in place prevents the Authority to properly identify and transfer projects to assets being depreciated (in service) to the general ledger in an accurate and timely manner and to expense in a timely manner assets that meet the Authority's capitalization policy.

Recommendation
We recommend that the Authority coordinates and perform regular and thorough verification of projects status listed in the construction in process (CIP) subsidiary ledger with the infrastructure department to assure projects are properly classified and timely transferred to assets being depreciated once the infrastructure department determine project is completed (in service).

Also, we recommend management to develop policies and procedures requiring regular communication among departments, including project engineer(s) to provide guidance on the procedures related to the following: the proper monitoring of the construction in process projects and their dates of placement in service once determined complete, in order to comply with the U.S. generally accepted accounting principles. Evidence of this review should be properly documented.

Management's Response
Finance and Infrastructure departments will coordinate and perform regular quarterly meetings to monitor and evaluate the status of projects under construction in order to register the proper accounting transactions and perform the transfer to assets being depreciated on timely basis.

In addition, the Authority will review its policies and establish the timing in which the Finance department should receive the official documentation to classify open capital projects as completed and accepted by the Authority in order to transfer and place the projects as plant in service.

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