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Financial Statements and Report of Independent Certified Public Accountants

Puerto Rico Aqueduct and Sewer Authority

(A Component Unit of the Commonwealth of Puerto Rico)

June 30, 2016 and 2015

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

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Report of Independent Certified Public Accountants

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To the Board of Directors of
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, 2016 and 2015, 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 accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Basis for Qualified Opinion

As described in Note 1 to the basic financial statements, the Authority has not implemented the requirements of Statement No. 68 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27* and Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of GASB Statement No. 68,* because the final audited pension information from the Employee Retirement System of the Government of the Commonwealth of Puerto Rico is not readily available. Therefore, the Authority has not recorded its proportionate share of net pension obligation, deferred inflow of resources and deferred outflow of resources related to pension cost, and the Authority has not recognized the effect of current period changes in net pension obligation, deferred outflow of resources and deferred inflow of resources as these relate to pension costs for the years ended June 30, 2016 and 2015.

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

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

Qualified Opinion

In our opinion, except for the effects of the matter described above in the Basis for Qualified Opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **Puerto Rico Aqueduct and Sewer Authority** as of June 30, 2016 and 2015 and the respective changes in financial position, and cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter Regarding Going Concern

The accompanying financial statements have been prepared assuming that the Authority will continue as a going concern. As discussed in Note 2 to the financial statements, the Authority's significant recurring losses, working capital deficiencies, credit downgrades, large non-discretionary capital expenditure requirement, uncertainty as to fully satisfy its obligations, fiscal oversight and lack of market access, raise substantial doubt about its ability to continue as a going concern. Management's plans in regards to these matters are also described in Note 2 to the financial statements. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information
Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 through 29 and the schedule of funding progress for postemployment healthcare benefits on page 86 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information, because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

GASB 68 Required Supplementary Information
The Authority did not include the Schedule of the Authority's Proportionate Share of the Net Pension Liability, and the Schedule of Authority's Contributions to the Employees' Pension Plan, information that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements, because the final audited pension information from the Employee Retirement System of the Government of the Commonwealth of Puerto Rico is not readily available. Such missing information, although not a part of the basic financial statements, is required to be an essential part of the financial reporting by the Governmental Accounting Standards Board, who considers it an essential part of the financial reporting for placing the basic financial statements is an appropriate operational, economic or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Supplementary Information
Our audit was conducted for the purpose of forming an opinion on the financial statements that comprise the Authority's basic financial statements. The supplemental schedule of financial results and debt coverage calculations per the 2012 amended and restated master agreement of trust ("schedule") on page 87 is presented as additional information and is not a required part of the basic financial statements. The schedule is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. 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 financial statements or to the basic financial statements themselves, and other additional procedures in accordance with the auditing standards generally accepted in the United States of America. In our opinion, the schedule is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

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Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 7, 2017, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

San Juan, Puerto Rico
March 7, 2017.

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CERTIFIED PUBLIC ACCOUNTANTS

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, 2016, 2015 and 2014. Please read it in conjunction with the Authority's financial statements, which follow this section. Numbers included are rounded to facilitate the readers' analysis.

Going Concern

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

The discussion in Note 2 to the financial statements provides information regarding the Authority's financial risks and uncertainties, including liquidity risk, which is the risk of not having sufficient liquid financial resources to meet obligations when they come due. The severity of the risks and uncertainties facing the Authority together with other factors further described in Note 2 to the financial statements and summarized below, have led to conclude that there is a substantial doubt as to the ability of the Authority to continue as a going concern.

The Authority is currently experiencing cash flows and financing difficulties. Net position for the years ended June 30, 2016 and 2015 decreased by $238.4 million and $86.1 million, respectively. In addition, the Authority working capital deficiencies as of June 30, 2016 and 2015 amounted to $347 million and $471 million, respectively. However, the Authority's restricted cash includes a portion for the payment of current debt of approximately $235.6 million and $250.9 million for 2016 and 2015, respectively. In addition, the Authority has not made the quarterly interest and principal payments of the term note payable with the Government Development Bank for Puerto Rico ("GDB"), since December 2015. As of the date of the issuance of the financial statements, the term note has not been declared in default by GBD.

On June 30, 2016 the Authority with the acknowledgment and support of the United States Environmental Protection Agency ("EPA"), executed a Forbearance Agreement (the "Forbearance Agreement") with the Puerto Rico Department of Health (DOH), administrator of the Drinking Water State Revolving Fund Programs, the Commonwealth's Environmental Quality Board (EQB), administrator of the Clean Water State Revolving Fund Programs (CW-SRF), and the Puerto Rico Infrastructure Financing Authority ("PRIFA"), a public corporation and instrumentality of the Commonwealth, as operating agent for the for the State Revolving Funds ("SRF"), authorized to assist the DOH and the EQB in the administration, financial and accounting activities of the SRFs. Under the Forbearance Agreement, the payments due on July 1, 2016 under the SRF Loans were deferred, for a period of six (6) months. On December 14, 2016, the Forbearance Agreement was amended to extend the forbearance period until June 30, 2017.

The Authority also requested that USDA Rural Development Program provide a short-term forbearance period, which included deferral of the payment due on July 1, 2016, during which they will refrain from exercising its rights and remedies under the Rural Development ("RD Bond") documents or grants or loan agreements. To this effect, the Authority and USDA Rural Development Program executed a forbearance document as of June 30, 2016 and granted a three (3) month forbearance period, which matured on September 30, 2016 and December 30, 2016. An additional forbearance period was granted until March 30, 2017.

Going Concern – (continued)

Historically, the Authority's Capital Improvement Program ("CIP") has been funded with external financing. Currently as a result of the economic crisis facing the Commonwealth of Puerto Rico and several of its components units, including the Authority, there is a lack of market access resulting in the suspension of its capital improvement program. Also, the Authority has been unable to pay certain outstanding contractor obligations. As a result of the suspension of certain construction projects, the Authority recognized an impairment loss of $72.6 million. As of June 30, 2016, unpaid CIP contractor obligations were approximately $144 million, including interest and penalties.

The Commonwealth, which serves as guarantor in certain debts of the Authority, and several of its component units face significant risks and uncertainties, including liquidity risk. The risks and uncertainties facing the Commonwealth, together with other factors, have led the Commonwealth's management to conclude that there is substantial doubt as to the ability of the primary government and various discretely presented component units, to continue as a going concern. In addition, the Commonwealth's management believes that the pension trust funds, included as part of the fiduciary funds, carry a substantial risk of insolvency, if measures are not taken to significantly increase contributions to such funds.

The Commonwealth currently faces a severe fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession (which commenced in 2006), high unemployment, population decline, and high levels of debt and pension obligations. Further stressing the Commonwealth's liquidity are the vulnerability of revenue streams during times of major economic downturns and large health care, education, pension and debt service costs. As the Commonwealth's tax base has decrease and its revenues affected by prevailing economic conditions, health care, pension and debt service costs have become an increasing portion of the General Fund budget, which has resulted in reduced funding available for other essential services. The Commonwealth's very high level of debt and unfunded pension liabilities and the resulting required allocation of revenues to service debt and pension obligations have contributed to significant budget deficits during the past several years, which deficits the Commonwealth has financed, further increasing the amount of its debt. More recently, these matters and the Commonwealth's liquidity constraints, among other factors, have adversely affected its credit ratings and its ability to obtain financing at reasonable interest rates, if at all. As a result, the Commonwealth had relied more heavily on short-term financings and interim loans from the GDB, and other instrumentalities of the Commonwealth, which reliance has constrained the liquidity of the Commonwealth in general and the GDB in particular, and increased near-term refinancing risk. These factors have also resulted in delays in the repayment by the Commonwealth and its instrumentalities of outstanding GDB lines of credit, which delays have limited the GDB's ability to continue providing liquidity to the Commonwealth and have caused the GDB to fail to make a principal payment on its debt obligations. These factors are reflected in the deterioration of the Commonwealth's credit ratings. Since June 30, 2014, the principal rating agencies have continued to lower their rating on the general obligation bonds of the Commonwealth, which had already been placed within non-investment grade ratings in February 2014. After the Commonwealth failed on its general obligation bonds and guaranteed bonds on July 1, 2016, the credit rating was lowered to "D", the lowest credit rating given to issuers that have defaulted on their obligations. They also lowered their credits ratings on the bonds of other component units of the Commonwealth, including the GDB and the Authority, all of which were lowered multiple notches in the grading levels. In addition, although neither the Commonwealth nor its component units, including the Authority, are eligible to seek relief under Chapter 9 of the United States Bankruptcy Code, on June 30, 2016, the U.S. President signed the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA"), which grants the Commonwealth and its component units access to an orderly mechanism to restructure their debts in exchange for significant federal oversight over the Commonwealth's finances. In broad terms, PROMESA seeks to provide Puerto

Going Concern – (continued)

Rico with fiscal and economic discipline through the creation of a control board, relief from creditor lawsuits through the enactment of a temporary stay on litigation, and two alternative methods to adjust unsustainable debt.

First, to ensure fiscal and economic discipline, PROMESA creates a federally appointed a fiscal oversight board that has plenary authority over Puerto Rico's finances. The board's primary function is to provide fiscal oversight through the development and approval of fiscal plans and budgets, and to enforce compliance with those plans and budgets through broad-based powers such as reducing non-debt expenditures and instituting certain hiring freezes. The board also has oversight over legislative processes because PROMESA requires the board to review new laws and deny their enforcement if they are inconsistent with the approved fiscal plans and budgets. The board also has authority to review contracts to ensure compliance with the fiscal plan, and to prevent the execution or enforcement of a contract, rule, executive order or regulation to the extent that it is inconsistent with the approved fiscal plan. Second, the enactment of PROMESA also operates as a broad-based stay on litigation, applicable to all entities, with respect to claims related to Puerto Rico's financial debt, as well as on enforcement of provisions in contracts that allow for termination and the exercise of remedies based on non-payment of financial obligations, among other conditions. Finally, PROMESA contains two methods to adjust Puerto Rico's debts. The first method is a streamlined process to achieve modifications of financial indebtedness with the consent of a supermajority of affected financial creditors. This method has benefits such as potential speed relative to a traditional restructuring through a formal in-court process. The second method is a court-supervised debt-adjustment process, which is modeled on Chapter 9 of the U.S. Bankruptcy Code. This process includes the so-called "cram-down" power, which may provide Puerto Rico with flexibility in debt adjustment, but it also gives the oversight board total control over the adjustment process and includes certain provisions designed to protect creditor interests.

On September 30, 2016, the Authority has been designated by the Oversight Board pursuant to section 101 of PROMESA as a covered territorial instrumentality, meaning it will be subject to the requirements of the Act. Therefore, the Authority is required to present a Fiscal Plan as well to submit to the Oversight Board such budgets and monthly or quarterly reports as are determined to be necessary. Also, the Authority is subject to the approval of the Oversight Board prior to enter into any new financing or debt restructuring process.

The GDB faces significant risks and uncertainties and it currently does not have sufficient liquid financial resources to meet obligations when they come due, as further described below. Pursuant to enacted legislation, the Governor of the Commonwealth has ordered the suspension of loan disbursements by the GDB, imposed restrictions on the withdrawal and transfer of deposits from the GDB, and imposed a moratorium on debt obligations of the GDB, among other measures.

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

Going Concern – (continued)

In addition on October 18, 2016, the Secretary of the Treasury issued circular Letter 13W-08-17 ("CC 13W-08-17") advising all agencies and public corporations of the Commonwealth about GDB liquidity issues and that management of GBD believes there is a substantial doubt about GDB ability to continue as a going concern. It also required that all agencies and public corporation with deposits at GDB perform an impairment analysis on the realization on the deposits at GDB, as it is probable that GDB will not be able to honor them.

As results, the Authority has recognized an impairment loss on deposits held with GDB of $9.8 million as of June 30, 2016. No impairment loss on deposits held with governmental banks was recognized as of June 30, 2015.

Implementation of New Accounting Standard for Pensions

As disclosed in Note 1 to the basic financial statements, the Authority was not able to implement the requirements of Statement No. 68 of the Governmental Accounting Standard Board, Accounting and Financial Reporting for Pensions, (GASB 68). The inability to implement the requirements of GASB 68 is because the Employee Retirement System of the Commonwealth of Puerto Rico (ERS), a pension trust fund of the Commonwealth, has not provided the final audited information. Therefore, the Authority has not recorded its proportionate share of net pension obligation, deferred inflow of resources and deferred outflow of resources related to pension cost, and the Authority has not recognized the effect of current period changes in net pension obligation, deferred outflow of resources and deferred inflow of resources as these relate to pension costs for the years ended June 30, 2016 and 2015.

The financial highlights presented below do not include any pension amounts that would have been required if GASB 68 would have implemented as of July 1, 2014.

June 30, 2016 and 2015 Financial Highlights

- The Authority's net position decreased by $238.4 million to $2,054.5 million, or 10.4%, which represents a decrease of $152.3 million when compared to the 2015 decrease in net position of $86.1 million. The decrease was primarily the net result of a decrease in operating revenues of $75.8 million, an increase of total operating expenses, including depreciation and amortization of $48.4 million, an increase in net non-operating expenses of $20.4 million, and a decrease in capital contributions of $7.8 million.

- Operating revenues decreased by $75.8 million to $978.7 million, or 7.2%, mainly due to a decrease of water consumption of 8.5% compared to fiscal year 2015, as a result of the severe drought that affected Puerto Rico during the months of May 2015 until November 2015. In order to control the situation and maintain the water supply and service to the population, the Authority implemented a rationing of water; performed water pressure adjustment to go through the difficult time due to the impact of the severe drought that affected Puerto Rico. In addition, during fiscal year 2016 continued the decrease in the numbers of clients served.

- Operating expenses, including depreciation and amortization, increased by $48.4 million to $987.8 million, or 5.1%, primarily as a result of an increase of cost of assets disposition of $63.1 million, increase in payroll and payroll related expenses of $4.3 million, an increase in depreciation expense of $4.1 million, netted by a decrease in electricity expense of $6.5 million, a decrease in professional services of $5.8 million, a decrease in other operating expense of $5.0 million, a decrease in materials and replacement expenses of $3.4 million, a decrease in repairs and maintenance expense of $3.1 million, respectively.

- Non-operating expenses increased by $20.4 million, or 9.0% to a net expense of $247.6 million, primarily as a result of an increase of $9.8 million in an impairment loss on deposits held with governmental bank, an increase in interest expense net of amortization of bond premium and discount, and deferred refunding losses of $3.1 million, a decrease of $9.8 million in commonwealth contributions for interest payments on bonds, a decrease in interest income of $1.1 million and an increase in other income of $3.4 million.

  Capital contributions decreased by $7.8 million, or 30.1% to $18.3 million, primarily as a result of a decrease of $4.8 million in contributions and grants received from the Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Fund, a decrease of $4.5 million in the USDA Rural Development contributions and an increase in other contributions of $1.9 million.

- Total assets and deferred outflows decreased by $337.4 million to $7,872.4 million or 4.1%, as result of a decrease in Authority's capital assets net of depreciation and amortization of $241.6 million, a decrease in restricted assets of $132 million, a decrease of $4.2 million in deferred outflow of resources on loss from debt refunding and, an increase in Authority's currents assets of $40.3 million. Total liabilities decreased by $99 million to $5,817.9 million or 1.7%, primarily as a result of a decrease of $117.2 million in long term debt, a decrease in accounts payable of $27.1 million and an increase of $32.1 in accrued interest, an increase of $3.9 million in accrued liabilities.

June 30, 2015 and 2014 Financial Highlights

- The Authority's net position decreased by $86.1 million to $2,292.9 million, or 3.6%, which represents a decrease of $45.1 million when compared to the 2014 decrease in net position of $41.0 million. The decrease was primarily the net result of a decrease in operating revenues of $72.9 million, a decrease of total operating expenses, including depreciation and amortization of $45.2 million, an increase in net non-operating expenses of $17.5 million, and an increase in capital contributions of $0.2 million.

- Operating revenues decreased by $72.9 million to $1,054.5 million, or 6.5%, mainly due to a reduction of water consumption and a decrease in the numbers of clients served. In addition, the decrease in operating revenues reflects the impact of the implementation of Act 66-2014, which adjusted government rates to the ones in place prior to the latest rate increase and a reduction in billed consumption required for certain governmental clients.

- Operating expenses, including depreciation and amortization, decreased by $45.2 million to $939.4 million, or 4.6%, primarily as a result of a decrease in payroll and payroll related expenses of $26.3, a decrease in other operating expense of $24.1 million, a decrease in electricity expense of $18.5 million, a decrease in repairs and maintenance expense of $5.9 million, netted by an increase in depreciation expense of $15.7 million, an increase in cost of assets disposition of $11 million, and increase in professional services and materials and replacement expenses of $2.6 million and $3.6 million, respectively.

- Non-operating expenses increased by $17.5 million, or 8.3% to a net expense of $227.3 million, primarily as a result of an increase of $20.4 million in interest expense, net of amortization of bond premium and discount, and deferred refunding losses, a decrease of $1.0 million in other income and an increase of $4.0 million from commonwealth contributions for interest payments on bonds.

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

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

Overview of the Financial Statements

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

Required Financial Statements

The financial statements report the financial position and operations of the Puerto Rico Aqueduct and Sewer Authority as of and for the year ended June 30, 2016 and 2015, which include a Balance Sheet, Statement of Revenues, Expenses and Changes in Net Position, Statement of Cash Flows and the notes to financial statements.

Financial Analysis of the Authority

The balance sheets and the statements 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, 2016	June 30, 2015	Change
Current and other assets	$ **584,117**	$ 675,783	$ (91,666)
Capital assets, net	**7,260,786**	7,502,348	(241,562)
Deferred outflows	**27,452**	31,638	(4,186)
Total assets and deferred outflows	**7,872,355**	8,209,769	(337,414)
Long-term debt outstanding	**5,096,138**	5,213,297	(117,159)
Other liabilities	**721,729**	703,568	18,161
Total liabilities	**5,817,867**	5,916,865	(98,998)
Net position:			
Investment in capital assets, net	**2,442,040**	2,638,506	(196,466)
Restricted	**5,364**	27,777	(22,413)
Unrestricted deficit	**(392,916)**	(373,379)	(19,537)
Total net position	$ **2,054,488**	$ 2,292,904	$ (238,416)

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

Net Position

June 30, 2016 and 2015

The Authority's net position as of June 30, 2016 was approximately $2,054.5 million. This is a decrease of $238.4 million from the net position as of June 30, 2015 of $2,292.9 million.

Total assets and deferred outflows decreased by $337.4 million during the fiscal year ended June 30, 2016.

Current and other assets decreased by $91.7 million, mainly due to the effect of a decrease of $132.0 million in restricted cash and cash equivalents, a decrease of $28.7 million in accounts receivable, a decrease of $1.0 million in materials and supplies inventory, and an increase of $70.4 million in cash and cash equivalents.

Restricted cash, unrestricted cash, cash equivalents and other deposits as of June 30, 2016, decreased by $61.6 million when compared with June 30, 2015. The decrease is primarily due to the usage of funds for debt service payments and the recognition of an impairment loss on deposits with governmental bank of $9.8 million.

Capital assets decreased by $241.6 million due to net current year additions of $119 million offset by current year depreciation and amortization of $278.7 million and cost of assets disposition of $85.2, which includes an impairment loss on discontinued CIP projects amounting to $72.6 million.

Deferred outflows of resources decreased by $4.2 million as a result of the amortization of losses resulting from debt refunding.

Total liabilities decreased by $99 million to $5,817.9 million, or 1.7%. Total current liabilities decreased by $83.1 million mainly due to a decrease of $92.5 million in the current portion of long-term debt, which included the payments of the outstanding principal of $90 million on the Banco Popular de Puerto Rico Credit Agreement and the outstanding balance of $7.4 million in the $70 million line of credit with Government Development Bank (GDB), (for more details, please refer to Notes Payable on the Debt Administration section of this Management's Discussion and Analysis and Note 11 to the financial statements). In addition, the Authority had a decrease of $27.1 million in accounts payable as a results of management's initiative to reduce CIP contractors' obligations due, an increase in accrued interest of $32.1 million and an increase of $3.9 million in accrued liabilities.

Total non-current liabilities decreased by $15.9 million, primarily as a result of the net effect of a decrease of $54.2 million of the noncurrent portion on bond payables as a result of payments of principal of outstanding bonds, a net increase of $29.6 million on the outstanding balance of the Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund. Also, compensated absence and postemployment benefits increased by $7.6 million, and customers' deposits increased by $ 1 million.

Net Position - (continued)

June 30, 2015 and 2014

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

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

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

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

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

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

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

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

Capital Assets

Capital assets as of June 30, 2016 and 2015 were as follows (in thousands):

	June 30, 2016	June 30, 2015	Change
Capital assets being depreciated	$ **10,848,712**	$ 10,432,316	$ 416,396
Accumulated depreciation and amortization	**(4,072,111)**	(3,799,439)	(272,672)
	6,776,601	6,632,877	143,724
Land and other nondepreciable assets	**74,831**	74,100	731
Construction in progress	**409,354**	795,371	(386,017)
Capital assets, net	$ **7,260,786**	$ 7,502,348	$ (241,562)

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

June 30, 2016 and 2015

The net decrease of $241.6 million in capital assets includes net additions of $119 million, reduced by $278.7 million in depreciation and amortization and $85.2 million in cost of assets disposition, which includes an impairment loss on discontinued CIP projects amounting to $72.6 million. The $151.7 million additions in capital investment are broken down as follows:

- $129 million in the Authority's capital improvement program;
- $22.7 million in renewal and replacement projects;

The Authority has approximately $409.4 million in construction in progress as of June 30, 2016, and has construction commitments of approximately $5.7 million.

Capital Assets - (continued)

June 30, 2015 and 2014

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

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

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

Debt Administration

Long-term debt for the years ended June 30, 2016 and 2015 was as follows (in thousands):

	June 30, 2016	June 30, 2015	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 (Superaqueduct)	**162,700**	162,700	-
2012 Series A PFC Commonwealth Appropriation Bonds	**56,247**	56,247	-
Revenue Bonds:			
2008 Series A Serial Bonds	**40,180**	54,410	(14,230)
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	**386,380**	418,455	(32,075)
2012 Series A Term Bonds	**1,381,995**	1,381,995	-
2012 Series B Serial Bonds	**157,095**	157,095	-
2012 Series B Term Bonds	**107,115**	107,115	-
Rural Development Serial Bonds	**394,211**	388,333	5,878
Plus premium on bonds refunding	**25,765**	26,306	(541)
Less: bond discounts	**(15,847)**	(16,038)	191
Total bonds	**$ 4,446,423**	$ 4,487,200	$ (40,777)

(Continued)

Debt Administration - (continued)

	June 30, 2016	June 30, 2015	Change
Bonds payable	$ **4,446,423**	$ 4,487,200	$ (40,777)
Notes payable:			
Water Pollution Control and Drinking Water Treatment Revolving Funds Loans	**580,012**	555,391	24,621
Notes with commercial banks	**4,153**	96,553	(92,400)
Notes with GDB	**65,550**	66,764	(1,215)
Total notes payable	**649,715**	718,708	(68,994)
Lines of credit	**-**	7,389	(7,389)
Long-term debt outstanding	**5,096,138**	5,213,297	(117,160)
Other long term liabilities:			
Accrued compensated absences	**43,434**	40,524	2,910
Net OPEB obligation	**40,535**	36,580	3,955
Customer deposits	**86,393**	84,823	1,570
Total other liabilities	**170,362**	161,927	8,435
Total – long-term obligations	**5,266,500**	5,375,224	(108,725)
Current portion	**134,965**	227,768	(92,803)
Long-term obligations, less current portion	$ **5,131,535**	$ 5,147,456	$ (15,922)

The Authority's long-term debt decreased by $117.2 million, or 2.2% from $5,213.3 million as of June 30, 2015, to $5,096.1 million as of June 30, 2016.

Bonds Payable

Bonds outstanding as of June 30, 2016 decreased by $40.8 million, mainly from the payment of principal on 2012 Series A of $32.1 million and on 2008 Series A Revenue Bonds of $14.2 million, and the payment of $4.7 million in principal on Rural Development Bonds. On September 15, 2015, the Authority issued $75 million of its 2015A Senior Bonds under the Master Trust Agreement, as supplemented by a Fifth Supplemental Agreement of Trust. The 2015 Series A Bond proceeds were used to repay part of the outstanding balance of a $90 million term loan extended by Banco Popular de Puerto Rico ("Banco Popular") under the Banco Popular Credit Agreement. The Banco Popular Credit Agreement balance was then reduced to $15 million. Both financings were due on November 30, 2015, date on which the maturities were extended until February 29, 2016. On February 29, 2016, the Authority paid the principal outstanding balance of $75 million on the Series 2015 A Bonds with collateralized escrow funds on the Rate Stabilization Account. On October 8, 2015, the Authority issued the Series JJ under the USDA Rural Development Bonds for $10.6 million.

Debt Administration - (continued)

June 30, 2016

On June 30, 2016, the Authority requested that USDA Rural Development Program to provide a short- term forbearance period, during which it would refrain from exercising its rights and remedies, including the enforcement of the Commonwealth Guaranty, under the Rural Development Bond ("RD Bond") documents or grants or loan agreements. To this effect, the Authority and USDA Rural Development Program executed a forbearance document, effective as of June 30, 2016 (the "USDA Forbearance Agreement"). The USDA Rural Development Program granted the Authority a three (3) month forbearance period, through September 30, 2016, subject to the terms and conditions set forth in the USDA Forbearance Agreement, in order to provide for additional time to examine all options available to correct the Authority deficiencies and restore loan repayments.

As pursuant to the USDA Forbearance Agreement, the payments due on July 1, 2016 under the RD Bond documents were also deferred for the duration of the forbearance period and USDA Rural Development Program agreed to forbear from exercising, or consenting to the exercise of, any enforcement of rights or remedies available to it under the RD Bond documents or any grant or loan document in relation thereto. As part of the forbearance agreements, USDA Rural Development Program required a payment of $1.4 million, on July 12, 2016 the Authority made the payment as part of the agreement. On September 30, 2016, the forbearance agreement matured, and an additional forbearance period was granted until December 31, 2016. As part of the extension agreement, the USDA Rural Development Program required an additional payment for $2.4 million. On October 06, 2016, the Authority made the requested payment $1.2 million payment and on the first business day of November and December made payments of $0.6 million each to be applied to overdue loan payments. On December 30, 2016, USDA Rural Development Program further extended the USDA Forbearance Agreement, through March 30, 2017.

<u>Notes Payable</u>

On May 29, 2015, the Authority entered into a Credit Agreement with Banco Popular (the "Banco Popular Credit Agreement") pursuant to which Banco Popular made a $90 million term loan (the "BPPR Loan") to the Authority for the purpose of refinancing the $75 million due to such bank under the CIP Credit Agreement and providing an additional $15 million to be applied by the Authority, together with Operating Revenues collected during May 2015, after making the required deposits to the Senior Bond Fund, to repay in full the outstanding $75 million of Oriental Bank's Commitment under the CIP Credit Agreement. The amounts due under the Banco Popular Credit Agreement were secured with an escrow deposit of $90 million of the Authority's funds then on deposit in the Rate Stabilization Account of the Surplus Fund created under the MAT and would be payable on the earlier of (i) August 31, 2015, (ii) upon the occurrence and continuation of an event of default under the Banco Popular Credit Agreement or (iii) the date of issuance of the 2015A Senior Bonds.

As explained in Note 10 to the financial statements, on September 15, 2015 the Authority issued $75 million of its Series 2015A Senior Bonds under the MAT, as supplemented by a Fifth Supplemental Agreement of Trust, dated as of September 15, 2015 setting the details of such bonds. The proceeds of the purchase of the Series 2015A Senior Bonds were used to repay part of the outstanding balance of a $90 million term loan extended by Banco Popular under the Banco Popular Credit Agreement. The outstanding balance of the BPPR Loan was then reduced to $15 million. Both financings were due on November 30, 2015.

Debt Administration - (continued)

June 30, 2016 – (continued)

Notes Payable – (continued)

On November 30, 2015, the Authority extended the maturity date of the Series 2015A Senior Bonds through February 29, 2016 and executed a third amendment to the Banco Popular Credit Agreement to also extend the credit facility's maturity date through February 29, 2016. As a condition to the latter the Authority agreed to make partial principal payments of $5 million and $10 million on January 31, 2016 and February 29, 2016, respectively, which were made.

On February 29, 2016, the principal and interest due under both financings were paid in full with the escrowed funds securing such facilities

As authorized by the Board's Resolution No. 2844, adopted on April 23, 2014, on November 3, 2014, the Authority entered into a credit agreement with Popular Auto, LLC, a limited liability company organized and existing under the laws of the Commonwealth, pursuant to the term of which such institution agreed to make borrowings available to the Authority in the aggregate principal amount of $7.5 million (the "Fleet Term Loan") to be repaid by November 2, 2017. The Fleet Term Loan was designated by the Authority as Senior Subordinate Indebtedness, Other System Indebtedness and a Refundable Principal Installment pursuant to the terms of the Master Trust Agreement. As of June 30, 2016, the outstanding balance of the Fleet Term Loan was $4.2 million.

The Authority finances the cost of design and construction of certain capital improvements projects with notes from the Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund programs that bear interest at 2%. As of June 30, 2016, the Authority's loans outstanding under these programs amounted to approximately $580 million, which are considered Commonwealth Guaranteed Indebtedness under the Master Agreement of Trust. These loans increased by $24.6 million due to the net effect of drawings of $50.4 million for payment of capital improvements projects and payments of principal outstanding of $25.7 million.

On June 30, 2016, the Authority executed a Forbearance Agreement (the "Forbearance Agreement") with the Puerto Rico Department of Health ("DOH"), administrator of the Drinking Water State Revolving Fund Programs, the Commonwealth's Environmental Quality Board ("EQB"), administrator of the Clean Water State Revolving Fund Programs ("CW-SRF"), and the Puerto Rico Infrastructure Financing Authority ("PRIFA"), a public corporation and instrumentality of the Commonwealth, as operating agent for the SRFs, authorized to assist the DOH and the EQB in the administration, financial and accounting activities of the SRFs. Under the Forbearance Agreement, the payments due on July 1, 2016 under the SRF Loans were deferred and the parties thereto agreed to forbear from exercising, or consenting to the exercise of, any enforcement of rights or remedies available to each under the SRF Loans.

Debt Administration - (continued)

June 30, 2016 – (continued)

Notes Payable – (continued)

PRIFA, DOH and EQB, with the acknowledgment and support of the United States Environmental Protection Agency ("EPA"), granted such forbearance, subject to the terms and conditions set forth in the Forbearance Agreement, for a period of six (6) months. On December 14, 2016, the Forbearance Agreement was amended to extend the forbearance period until June 30, 2017. During such forbearance period, the Commonwealth Guaranty will not be enforced either. PRIFA, EQB and DOH, with the support of EPA, contemplate that during the forbearance period the parties will negotiate new terms and conditions to the SRF Loans under a restructuring of such loans and a revision of underlying agreements between the Authority, PRIFA, EQB, DOH and, where applicable, EPA, understand that given current circumstances, such forbearance and possible restructuring protects the perpetuity of the DW-SRF and CW-SRF programs beyond the financially stressed scenario faced by both the Authority and the Commonwealth at this time. On December 14, 2016, PRIFA, EQB and PRDOH, with the support of EPA further extended the SRF's Forbearance Agreement, through June 30, 2017.

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

On December 30, 2015, the Authority gave notice to GDB that it would not be making the payment due GDB on December 31, 2015, under the Amended and Restated Loan Agreement, dated as of June 27, 2014, by and between the Authority and the GDB, as further amended. The Authority's payment obligations under the Loan Agreement were not designated as Other System Indebtedness and are therefore not payable on a parity basis with the Authority's Senior debt and have no rights under the MAT, as the parties expressly agreed, that such payment obligations would be junior and subordinate in all respects to the requirements of the MAT. In this respect, the nonpayment of the amounts due to GDB under the Loan Agreement do not constitute an Event Default under the MAT, inasmuch as the nonpayment defaults contemplated under Section 8.01(a) and Section 8.01(b) of the MAT relate to a default in payment of amounts due under the Bonds or Other System Indebtedness.

As of June 30, 2016, the term loan outstanding balance was $65.6 million. As of the date of the issuance of the financial statements, the term note has not been declared in default by GBD.

Debt Administration - (continued)

June 30, 2016

Lines of Credit

The outstanding balance of $7.4 million as of June 30, 2015 of the $70 million line of credit with GDB, which the Authority used to provide funding for the capital improvement program, was paid in full with the proceeds of the issuance of the Series JJ USDA Rural Development Bond. There was no outstanding balance on the $70 million line of credit as of June 30, 2016.

The $180 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. The maturity date of the line of credit was on June 30, 2016 and the Authority did not renew the credit facility. There was no outstanding balance as of June 30, 2016. Pursuant to the Master Agreement of Trust amended by the Sixth Supplemental Agreement of Trust, on July 2016, the Authority made the require monthly deposits into an operational fund reserve account with the Authority's trustee agent, in order to establish an operating reserve fund of $180 million at the end of thirty six (36) months.

Detailed information regarding long-term debt activity is included in Notes 10 through 14 to the financial statements.

June 30, 2015

Bonds Payable

Bonds outstanding as of June 30, 2015 decreased by $253.6 million, mainly from the payment of principal on 2012 Series B of $31.0 million and on 2008 Series A Revenue Bonds of $13.6 million, and the payment of $8.7 million in principal on Rural Development Bonds. During fiscal year 2015, the Authority did not issue additional bond debt.

Notes Payable

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

Debt Administration - (continued)

June 30, 2015 – (continued)

Notes Payable – (continued)

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

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

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

Debt Administration - (continued)

June 30, 2015 (continued)

Notes Payable – (continued)

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

Lines of Credit

The existing $70 million line of credit with GDB used to provide funding for the capital improvement program of the Authority had an outstanding balance as of June 30, 2015 of approximately $7.4 million.

The $180 million revolving line of credit with GDB for the purpose of financing the operating reserve, required by the Master Agreement of Trust securing its revenue bonds, had no outstanding balance as of June 30, 2015.

Detailed information regarding long-term debt activity is included in Notes 10 through 14 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, 2016 and June 30, 2015 (in thousands):

	June 30, 2016	June 30, 2015	Change
Operating revenue:			
Revenues from water and sewer services, net	$ **978,718**	$ 1,054,488	$ (75,770)
Operating expenses:			
Payroll and payroll related expenses	**269,589**	265,339	4,250
Service contract – Superaqueduct	**3,667**	3,495	172
Professional and consulting services	**29,158**	34,994	(5,836)
Chemicals	**27,766**	27,107	659
Materials and replacements	**18,328**	21,723	(3,395)
Repairs and maintenance of capital assets	**36,116**	39,254	(3,138)
Electricity	**141,743**	148,267	(6,524)
Insurance	**7,985**	8,058	(73)
Other operating expenses	**89,470**	94,423	(4,953)
Operating expenses (excluding depreciation and amortization)	**623,822**	642,660	(18,838)
Depreciation and amortization	**278,702**	274,573	4,129
Cost of assets disposed of	**85,238**	22,179	63,059
Total operating expenses	**987,762**	939,412	48,350
Operating (loss) income	**(9,044)**	115,076	(124,120)
Nonoperating expenses, net	**(247,629)**	(227,255)	(20,374)
Loss before capital contributions	**(256,673)**	(112,179)	(144,494)
Capital contributions	**18,257**	26,104	(7,847)
Change in net position	**(238,416)**	(86,075)	(152,341)
Net position at beginning of year	**2,292,904**	2,378,979	(86,075)
Net position at end of year	$ **2,054,488**	$ 2,292,904	$ (238,416)

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, 2015 and 2014 (in thousands):

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

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

June 30, 2016 and 2015

Net position decreased by $238.4 million or 10.4%, from $2,292.9 million in 2015 to $2,054.5 million in 2016, due to the results of current year operations.

Major fluctuations that resulted in a decrease in net position of $238.4 million when compared to 2015 operational results are broken down as follows (in thousands):

Decrease in operating revenues	$	(75,770)
Increase in operating expenses		(48,350)
Increase in nonoperating expenses, net		(20,374)
Decrease in capital contributions		(7,847)
2015 change in net position		(86,075)
Net change	$	(238,416)

Operating revenues decreased by $75.8 million or 7% for fiscal year ended June 30, 2016 when compared to fiscal year ended June 30, 2015. The decrease is mainly due to the impact of the severe drought that affected Puerto Rico, as result, the Authority confronted a reduction on the water consumption billed, and a continuing decrease in the numbers of clients.

Operating expenses increased by $48.4 million or 5% primarily due to the net effect of the following:

- Increase of $63.1 million in cost of assets disposition.
- Increase of $4.3 million in payroll and payroll related expenses.
- Increase of $4.1 million in depreciation and amortization expense.
- Decrease of $6.5 million in electricity expense.
- Decrease of $5.8 million in professional and consulting expense.
- Decrease of $5.0 million in other operating expense.
- Decrease of $3.4 million in materials and replacements expenses.
- Decrease of $3.1 million in repairs and maintenance of capital assets expenses.

Non-operating expenses increased by $20.4 million or 9% when compared to fiscal year 2015. This was mainly due to a decrease of $9.8 million in Commonwealth contributions for payments of PFC bonds, due to the nonpayment of interest by the Commonwealth of Puerto Rico; an increase of $9.8 million in an impairment loss on deposits as a result of the economic and fiscal crisis of the GBD, an increase of interest expenses as results of debt interest payments and the amortization of bond premium and discount, and deferred refunding losses by $3.1 million, and an increase in other income of $3.4 million.

Capital contributions decreased by $7.8 million or 30.1%, primarily as a result a decrease of $4.8 million in contributions and grants received from the Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Fund, a decrease of $4.5 million in the USDA Rural Development contributions and an increase in other contributions of $2 million.

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

June 30, 2015 and 2014

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

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

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

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

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

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

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

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

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

Next Year's Budget and Credits Ratings

On June 2016, the Authority adopted a balanced operational budget for fiscal year 2017. In addition, the Authority's Capital Improvement Program for the fiscal year 2017 is estimated in approximately $196.4 million.

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

Contacting the Authority's Financial Management

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

Puerto Rico Aqueduct and Sewer Authority

(A Component Unit of the Commonwealth of Puerto Rico)

Balance Sheets

June 30, 2016 and 2015

(In thousands)

	2016	2015
Assets		
Current assets:		
Cash and cash equivalents	$ 106,079	$ 35,686
Accounts receivable, net	193,752	222,471
Receivables from federal agencies	2,685	2,519
Receivables from Commonwealth	3,736	3,736
Materials and supplies inventory, net	27,800	28,733
Prepayments and other current assets	4,346	4,909
Total current assets	338,398	298,054
Restricted assets--		
Restricted cash, cash equivalents and other deposits	245,719	377,729
Capital assets:		
Capital assets being depreciated	10,848,712	10,432,316
Accumulated depreciation and amortization	(4,072,111)	(3,799,439)
	6,776,601	6,632,877
Land and other nondepreciable assets	74,831	74,100
Construction in progress	409,354	795,371
Total capital assets, net	7,260,786	7,502,348
Deferred outflows of resources--		
Deferred loss resulting from debt refunding	27,452	31,638
Total assets and deferred outflows of resources	$ 7,872,355	$ 8,209,769

(Continued)

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

Puerto Rico Aqueduct and Sewer Authority

(A Component Unit of the Commonwealth of Puerto Rico)

Balance Sheets

June 30, 2016 and 2015

(In thousands)

	2016	2015
Liabilities and net position		
Current liabilities:		
Bonds payable	$ 71,911	$ 58,519
Notes payable	37,037	135,611
Lines of credit	-	7,389
Accounts payable	256,197	283,250
Accrued liabilities	139,719	135,800
Accrued interest	135,252	103,164
Unearned revenue	20,199	19,427
Customers' deposits	7,586	7,053
Compensated absences and postemployment benefits	18,431	19,196
Total current liabilities	686,332	769,409
Noncurrent liabilities:		
Bonds payable	4,374,512	4,428,681
Notes payable	612,678	583,097
Customers' deposits	78,807	77,770
Compensated absences and postemployment benefits	65,538	57,908
Total noncurrent liabilities	5,131,535	5,147,456
Total liabilities	5,817,867	5,916,865
Net Position:		
Net investment in capital assets	2,442,040	2,638,506
Restricted for environmental compliance, capital activity and other	5,364	27,777
Unrestricted deficit	(392,916)	(373,379)
Total net position	2,054,488	2,292,904
Total liabilities and net position	$ 7,872,355	$ 8,209,769

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

Puerto Rico Aqueduct and Sewer Authority
(A Component Unit of the Commonwealth of Puerto Rico)
Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2016 and 2015

(In thousands)

	2016	2015
Operating revenues:		
Water	$ 674,758	$ 737,321
Sewer	345,130	379,737
Bad debt expense	(41,170)	(62,570)
Total net operating revenues	978,718	1,054,488
Operating expenses:		
Payroll and payroll related	269,589	265,339
Electricity	141,743	148,267
Repairs and maintenance of capital assets	36,116	39,254
Professional and consulting services	29,158	34,994
Chemicals	27,766	27,107
Materials and replacements	18,328	21,723
Insurance	7,985	8,058
Service contract – Superaqueduct	3,667	3,495
Other operating expenses	89,470	94,423
Operating expenses (excluding depreciation and amortization)	623,822	642,660
Depreciation and amortization	278,702	274,573
Cost of assets disposition	85,238	22,179
Total operating expenses	987,762	939,412
Operating (loss) income	(9,044)	115,076
Nonoperating revenues (expenses):		
Interest expense, net of amortization of debt issuance cost, bond premium and discount, and deferred refunding loss	(247,688)	(244,545)
Commonwealth contributions for interest payments on bonds and notes	-	9,817
Impairment loss on deposits with governmental bank	(9,795)	-
Interest income	3,372	4,435
Other income, net	6,482	3,038
Total non-operating expenses, net	(247,629)	(227,255)
Loss before capital contributions	(256,673)	(112,179)
Capital contributions:		
Federal grants and other contributions	18,257	26,054
Other Commonwealth contributions	-	50
Total capital contributions	18,257	26,104
Change in net position	(238,416)	(86,075)
Net position at beginning of year	2,292,904	2,378,979
Net position at end of year	$ 2,054,488	$ 2,292,904

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

Statements of Cash Flows
Years Ended June 30, 2016 and 2015

(In thousands)

	2016	2015
Cash flows from operating activities:		
Cash received from customers	**$ 1,016,505**	$ 1,078,416
Cash paid to suppliers	**(420,119)**	(244,206)
Cash paid to employees	**(250,065)**	(262,792)
Net cash provided by operating activities	**346,321**	571,418
Cash flows from noncapital financing activities:		
Payments of notes	**(1,214)**	(5,599)
Net cash from other income	**6,482**	3,038
Interest paid on notes and lines of credit	**(1,324)**	(4,550)
Net cash provided by (used in) noncapital financing activities	**3,944**	(7,111)
Cash flows from capital and related financing activities:		
Additions to utility plant and other capital assets	**(90,955)**	(335,326)
Proceeds from capital contributions	**11,531**	26,401
Proceeds from issuance of notes payable	**50,352**	187,801
Proceeds from borrowings from lines of credit	**-**	94,696
Payments of bonds and notes	**(158,557)**	(280,023)
Payment of lines of credit	**(7,389)**	(95,556)
Interest paid on bonds, notes and lines of credit	**(210,441)**	(216,265)
Net cash used in capital and related financing activities	**(405,459)**	(618,272)
Cash flows from investing activities		
Impairment loss on deposits with governmental bank	**(9,795)**	-
Interest received on investments	**3,372**	4,435
Net cash used in investing activities	**(6,423)**	4,435
Net change in cash and cash equivalents	**(61,617)**	(49,530)
Cash and cash equivalents, beginning of year	**413,415**	462,945
Cash and cash equivalents, end of year	**$ 351,798**	$ 413,415
For purposes of the statements of cash flows, cash and cash equivalents include:		
Unrestricted	**$ 106,079**	$ 35,686
Restricted	**245,719**	377,729
	$ 351,798	$ 413,415

(Continued)

Statements of Cash Flows
Years Ended June 30, 2016 and 2015

(In thousands)

	2016	2015
Reconciliation of operating (loss) income to net cash provided by operating activities:		
Operating (loss) income	$ (9,044)	$ 115,076
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	278,702	274,573
Cost of assets disposition	85,238	22,179
Bad debt expense	41,170	62,570
Change in assets and liabilities:		
Accounts receivable	(5,725)	(41,155)
Receivables from federal agencies	(166)	807
Materials and supplies inventory	933	1,482
Prepayments and other current assets	563	574
Accounts payable	(58,476)	146,390
Unearned revenue	772	844
Accrued compensated absences and post employment benefits	6,865	3,085
Accrued liabilities	3,919	(16,676)
Customers' deposits	1,570	1,669
Total adjustments	355,365	456,342
Net cash provided by operating activities	$ 346,321	$ 571,418

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

1. Reporting Entity and Summary of Significant Accounting Policies

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

Basis of Presentation – Blended Component Unit

The financial statements of the Authority as of June 30, 2016 and 2015 include the financial position and operations of PRASA Holdings, which is a limited liability company incorporated under the laws of the State of Delaware on March 6, 2014. PRASA Holdings, LLC engages in lawful activities, for which limited liability companies may be organized under the Delaware Limited Company Act, subject to the limitations contained in PRASA's enabling act.

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

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

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

PRASA Holdings LLC has total assets of $0.6 million for the year ended on June 30, 2016 and 2015 respectively, which include a construction in progress of $0.5 million and, a net position of $0.6 million as of June 30, 2016 and 2015, respectively.

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

Summary of Significant Accounting Policies

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

Measurement Focus and Basis of Accounting

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

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

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

Cash and Cash Equivalents

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

The Authority maintains some construction fund accounts related to past bond issuances invested. As of June 30, 2016 and 2015, the account balances amounted to approximately $0.9 million and $3.9 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 for Puerto Rico ("GDB") 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.

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

Cash and Cash Equivalents – (continued)

As a result of the critical fiscal and economic situation that faces the GDB, the Authority recognized an impairment loss on deposits held with governmental bank of $9.8 million as of June 30, 2016. See Note 3.

The Trust Fund values its investments on the basis of amortized cost. Although the Trust Fund's policies are designed to help maintain a stable net asset value per unit of $1.0, all money market instruments can change in value when interest rates or issuers' creditworthiness change, or if an issuer or guarantor of a security fails to pay interest or principal when due. As of June 30, 2016 and 2015, the net asset value per unit of the Trust Fund was $1.0.

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

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

Receivables

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

Materials and Supplies Inventory

Materials and supplies inventory is stated at average cost, not to exceed market. Inventory is presented net of a reserve for obsolescence totaling approximately $1.2 million and $1.1 million as of June 30, 2016 and 2015, respectively.

Unamortized Premiums, Discounts and Deferred Refunding Losses

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

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

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

Capital Assets

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

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, 2016 and 2015 amounted to approximately $17.7 million and $30.8 million, respectively.

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

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

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

The Authority performed an assessment of impairment on capital assets under the provisions of GASB No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes that, generally, an asset is considered impaired when its services utility has declined significantly and unexpectedly. This statement also clarifies and establishes accounting requirements for insurance recoveries.

Governments are required to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. Such events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage among others.

The Authority evaluated its capital assets as required by GASB 42 and an impairment of $72.6 million was identified in the construction in progress account, during the year ended June 30, 2016 and presented in cost of assets disposition in the accompanying Statements of Revenues, Expenses and Changes in Net Position. No impairment was identified during the year ended June 30, 2015.

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, including payroll related costs, as the benefits are earned by the employees and if the employees' rights to receive compensation are attributable to services already rendered and it is probable that the Authority will compensate the employees for the benefits through paid time off or some other means, such as cash payments at termination or retirement.

The cost of compensated absences expected to be paid in the next twelve (12) months is classified as a current liability while amounts expected to be paid after twelve (12) 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 18.

The total cost of healthcare benefits paid to retired employees amounted to approximately $2.9 million and $3.1 million for fiscal years 2016 and 2015, respectively.

Pension Benefits

As detailed in Note 17, the Authority's employees participate in the Employees Retirement System of the Government of Puerto Rico ("ERS"), a cost-sharing, multiple-employer defined benefit pension plan. The Authority recognizes annual pension expense equal to its required contribution to the Plan, which is not in accordance with GASB No. 68.

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

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

Net Position

Net position is reported in three categories:

- ***Net Investment in Capital Assets*** – This 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 Position*** – This results 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, 2016 and 2015, the Authority had no assets restricted by enabling legislation.

- ***Unrestricted Net Position*** – This consists of net assets, which do not meet the definition of the two preceding categories. Unrestricted net position could be designated to indicate that management does not consider certain amounts to be available for general operations. Unrestricted net position often has constraints on resources that are imposed by management that can be removed or modified.

Use of Estimates

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

Effects of New Pronouncements

The following GASB statements were effective for fiscal year 2016:

GASB No. 72 Fair Value Measurement and Application. This statement had no impact on the Authority.

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

The Authority is evaluating the impact that these statements will have on its financial statements.

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

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. Going Concern

The discussion in the following paragraphs regarding the Authority's financial and liquidity risks provides the necessary background and support for management's evaluation as to whether there is substantial doubt about the Authority's ability to continue as a going concern for 12 months beyond the date of the financial statements or for an extended period if there is currently known information that may raise substantial doubt shortly thereafter. GASB Statement No. 56, Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards, establishes that the continuation of a legally separate governmental entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. Information that may significantly contradict the going concern assumption would relate to a governmental entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of governmental operations, restructuring of debt, submission to the oversight of a separate fiscal assistance authority or financial review board, or similar actions. Indicators such as negative trends in operating losses and negative cash flows, possible financial difficulties such as nonpayment or default of debt and/or restructurings or noncompliance with capital or reserve requirements, and internal or external matters impacting the governmental entity's ability to meet its obligations as they become due, are factors that are considered in this evaluation. The Authority has had significant recurring losses, working capital deficiencies, credit downgrades, and large non-discretionary capital expenditure requirements as further discussed below. The Authority currently faces heightened liquidity and lack of market access and, as a result of the Authority's inability to obtain long-term financing, it has not been able to pay during the fiscal year 2016 certain contractor obligations related to its Capital Improvement Program and had recognize an impairment loss of certain ongoing projects currently suspended. The Authority's ability to obtain long term financing for its Capital Improvement Plan is uncertain. The risks and uncertainties facing the Authority together with other factors further described below, have led management to conclude that there is substantial doubt as to the ability to continue as a going concern in accordance with GASB Statement No. 56.

The Authority is currently experiencing cash flows and financing difficulties. Net position for the years ended June 30, 2016 and 2015 decreased by $238.4 million and $86.1 million, respectively. In addition, the Authority working capital deficiencies as of June 30, 2016 and 2015 amounted to $347 million and $471 million, respectively. However, the Authority's restricted cash includes a portion for the payment of current debt of approximately $235.6 million and $250.9 million for 2016 and 2015, respectively. In addition, the Authority has not made the quarterly interest and principal payments of the term note payable with the Government Development Bank for Puerto Rico ("GDB") since December 2015. As of the date of the issuance of the financial statements, the term note was not been declared in default by GBD.

2. Going Concern – (continued)

On June 30, 2016 the Authority with the acknowledgment and support of the United States Environmental Protection Agency ("EPA"), executed a Forbearance Agreement (the "Forbearance Agreement") with the Puerto Rico Department of Health (DOH), administrator of the Drinking Water State Revolving Fund Programs, the Commonwealth's Environmental Quality Board (EQB), administrator of the Clean Water State Revolving Fund Programs (CW-SRF), and the Puerto Rico Infrastructure Financing Authority ("PRIFA"), a public corporation and instrumentality of the Commonwealth, as operating agent for the for the State Revolving Funds ("SRF"), authorized to assist the DOH and the EQB in the administration, financial and accounting activities of the SRFs. Under the Forbearance Agreement, the payments due on July 1, 2016 under the SRF Loans were deferred, for a period of six (6) months. On December 14, 2016, the Forbearance Agreement was amended to extend the forbearance period until June 30, 2017.

The Authority also requested that USDA Rural Development Program provides a short-term forbearance period, which included deferral of the payment due on July 1, 2016, during which they will refrain from exercising its rights and remedies under the RD Bond documents or grants or loan agreements. To this effect, the Authority and USDA Rural Development Program executed a forbearance document as of June 30, 2016 and granted a three (3) month forbearance period, which matured on September 30, 2016 and December 30, 2016. An additional forbearance period was granted until March 30, 2017. For more information, refer to Note 11.

Historically, the Authority's Capital Improvement Program ("CIP") has been funded with external financing. Currently, as a result of the economic crisis facing the Commonwealth of Puerto Rico and several of its components units, including the Authority, there is a lack of market access resulting in the suspension of its capital improvement program. Also, the Authority had been unable to pay certain outstanding contractor obligations. As a result of the suspension of certain construction projects; the Authority recognized an impairment loss of $72.6 million. As of June 30, 2016 unpaid CIP contractor obligations were approximately $144 million, including interest and penalties.

The Commonwealth, which serves as guarantor in certain debts of the Authority, and several of its component units, including the Authority, face significant risks and uncertainties, including liquidity risk. The risks and uncertainties facing the Commonwealth, together with other factors, have led the Commonwealth's management to conclude that there is substantial doubt as to the ability of the primary government and of various discretely presented component units, to continue as a going concern. In addition, the Commonwealth's management believes that the pension trust funds, included as part of the fiduciary funds, carry a substantial risk of insolvency, if measures are not taken to significantly increase contributions to such funds.

The Commonwealth currently faces a severe fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession (which commenced in 2006), high unemployment, population decline, and high levels of debt and pension obligations. Further stressing the Commonwealth's liquidity are the vulnerability of revenue streams during times of major economic downturns and large health care, education, pension and debt service costs. As the Commonwealth's tax base has been reducing and its revenues affected by prevailing economic conditions, health care, pension and debt service costs have become an increasing portion of the General Fund budget, which has resulted in reduced funding available for other essential services. The Commonwealth's very high level of debt and unfunded pension liabilities and the resulting required allocation of revenues to service debt and pension obligations have contributed to significant budget

2. Going Concern – (continued)

deficits during the past several years, which deficits the Commonwealth has financed, further increasing the amount of its debt. More recently, these matters and the Commonwealth's liquidity constraints, among other factors, have adversely affected its credit ratings and its ability to obtain financing at reasonable interest rates, if at all. As a result, the Commonwealth had relied more heavily on short-term financings and interim loans from the GDB, and other instrumentalities of the Commonwealth, which reliance has constrained the liquidity of the Commonwealth in general and the GDB in particular, and increased near-term refinancing risk. These factors have also resulted in delays in the repayment by the Commonwealth and its instrumentalities of outstanding GDB lines of credit, which delays have limited the GDB's ability to continue providing liquidity to the Commonwealth and have caused the GDB to fail to make a principal and interest payment on its debt obligations. These factors are reflected in the deterioration of the Commonwealth's credit ratings. Since June 30, 2014, the principal rating agencies have continued to lower their credits rating on the general obligation bonds of the Commonwealth, which had already been placed within non-investment grade ratings in February 2014. After the Commonwealth failed on its general obligation bonds and guaranteed bonds on July 1, 2016, the Credit rating was lowered to "D", the lowest credit rating given to issuers that have defaulted on their obligations. They also lowered their ratings on the bonds of other component units of the Commonwealth, including the GDB and the Authority, all of which were lowered multiple notches in the grading levels. In addition, although neither the Commonwealth nor its component units, including the Authority, are eligible to seek relief under Chapter 9 of the United States Bankruptcy Code, on June 30, 2016, the U.S. President signed the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), which grants the Commonwealth and its component units access to an orderly mechanism to restructure their debts in exchange for significant federal oversight over the Commonwealth's finances. In broad terms, PROMESA seeks to provide Puerto Rico with fiscal and economic discipline through the creation of a control board, relief from creditor lawsuits through the enactment of a temporary stay on litigation, and two alternative methods to adjust unsustainable debt.

First, to ensure fiscal and economic discipline, PROMESA creates a federally appointed a fiscal oversight board that has plenary authority over Puerto Rico's finances. The board's primary function is to provide fiscal oversight through the development and approval of fiscal plans and budgets, and to enforce compliance with those plans and budgets through broad-based powers such as reducing non-debt expenditures and instituting certain hiring freezes. The board also has oversight over legislative processes because PROMESA requires the board to review new laws and deny their enforcement if they are inconsistent with the approved fiscal plans and budgets. The board also has authority to review contracts to ensure compliance with the fiscal plan, and to prevent the execution or enforcement of a contract, rule, executive order or regulation to the extent that it is inconsistent with the approved fiscal plan. Second, the enactment of PROMESA also operates as a broad-based stay on litigation, applicable to all entities, with respect to claims related to Puerto Rico's financial debt, as well as on enforcement of provisions in contracts that allow for termination and the exercise of remedies based on non-payment of financial obligations, among other conditions. Finally, PROMESA contains two methods to adjust Puerto Rico's debts. The first method is a streamlined process to achieve modifications of financial indebtedness with the consent of a supermajority of affected financial creditors. This method has benefits such as potential speed relative to a traditional restructuring through a formal in-court process. The second method is a court-supervised debt-adjustment process, which is modeled on Chapter 9 of the U.S. Bankruptcy Code. This process includes the so-called "cram-down" power, which may provide Puerto Rico with flexibility in debt adjustment, but it also gives the oversight board total control over the adjustment process and includes certain provisions designed to protect creditor interests.

2. Going Concern – (continued)

On September 30, 2016, the Authority has been designated by the Oversight Board pursuant to section 101 of PROMESA as a covered territorial instrumentality, meaning it will be subject to the requirements of the Act. Therefore, the Authority is required to present a Fiscal Plan as well to submit to the Oversight Board such budgets and monthly or quarterly reports as are determined to be necessary. Also, the Authority is subject to the approval of the Oversight Board prior to enter into any new financing or debt restructuring process.

The GDB faces significant risks and uncertainties and it currently does not have sufficient liquid financial resources to meet obligations when they come due, as further described below. Pursuant to enacted legislation, the Governor of the Commonwealth has ordered the suspension of loan disbursements by the GDB, imposed restrictions on the withdrawal and transfer of deposits from the GDB, and imposed a moratorium on debt obligations of the GDB, among other measures.

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

In addition, on October 18, 2016, the Secretary of the Treasury issued circular Letter 13W-08-17 ("CC 13W-08-17") advising all agencies and public corporations of the Commonwealth about GDB liquidity issues and that management of GBD believes there is a substantial doubt about GDB's ability to continue as a going concern. It also required that all agencies and public corporations with deposits at GDB perform an impairment analysis on the realization on the deposits at GDB, as it is probable that GDB will not be able to honor them.

As a result, the Authority has recognized an impairment loss on deposits held with GDB of $9.8 million as of June 30, 2016. No impairment loss on deposits held with governmental banks was recognized as of June 30, 2015.

The conditions stated above raise substantial doubt about the Authority's ability to continue as a going concern.

Among the alternatives evaluated by the Authority's management to overcome the current fiscal situation, is the creation of a new special purpose entity and governmental instrumentality that would be permitted to issue bonds payable from special charges imposed by such entity, the proceeds of which would be provided to the Authority to pay for approved expenses, including CIP costs. For that purposes, on July 12, 2016, the Governor of Puerto Rico signed into law Act 68 of 2016 ("Act 68"), providing for the creation of a new public corporation, to be known as the Puerto Rico Aqueduct and Sewer Authority Revitalization Corporation (the "Corporation"), as a single purpose, bankruptcy remote entity. The Corporation is authorized to fix and collect securitization charges for the purpose of issuing bonds the proceeds of which may be used by the Authority for its Capital Improvement Program ("CIP"), refinancing of bond anticipation notes and the cancelation, defeasance and refinancing of its Bonds, among other approved financing costs. Act 68 limits the securitization charge, which may be imposed by the Corporation to an amount equivalent to 20% of the Authority's revenues and provides

2. Going Concern – (continued)

that the Corporation may issue up to a maximum of $900 million in bonds for the purpose of financing the development of the Authority's CIP. The difference between the $900 million that may be used for the financing of the CIP and the maximum amount that can be financed with the 20% of Authority revenues may be used to retire, cancel (defease) or refinance Bonds of the Authority, subject to certain conditions.

Also the Authority's management is in the process of evaluating several operational initiatives to increase revenues and/or reduce expenses, the capital improvement program and its debt service. Based on the final outcome of the evaluation, and if the Authority is not able to obtain financing (through Act 68 or other mechanism), the Authority will be forced to re-evaluate the financing structure for its capital improvement program and may be required to implement reductions in its operating expenses, debt service and/or additional increases in its service rates.

3. Deposits

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

	June 30,					
	2016				2015	
	Carrying amount	Impairment Loss	Net Carrying amount	Bank balance	Carrying amount	Bank balance
Unrestricted deposits in commercial banks in Puerto Rico	$ 106,079	$ –	$ 106,079	$ 105,022	$ 35,686	$ 34,494
Restricted deposits in commercial banks in Puerto Rico	241,094	–	$ 241,094	241,094	345,654	345,654
Restricted deposits in governmental banks:						
GDB	14,420	(9,795)	$ 4,625	14,420	27,971	27,971
EDB	-			-	4,104	4,104
Total	$ 361,593	$ (9,795)	$ 351,798	$ 360,536	$ 413,415	$ 412,223

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

Custodial Credit Risks Related to Deposits and Impairment Loss on Deposits with Governmental Bank

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.

3. Deposits - (continued)

Custodial Credit Risks Related to Deposits and Impairment Loss on Deposits with Governmental Bank – (continued)

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

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,	
	2016	**2015**
Uninsured and uncollateralized:		
GDB	$ **14,420**	$ 27,971
EDB	**-**	4,104
Less: Impairment loss	**(9,795)**	-
	$ **4,625**	$ 32,075

On April 8, 2016, GDB was declared to be in state of emergency with the signature of executive order EO-2016-010 ("the Executive Order"), in accordance with the emergency powers provided for in Act No. 21, which was signed into law on April 6, 2016. The Executive Order implemented a regulatory framework governing GDB's operations and liquidity, including establishing a new procedure with respect to governmental withdrawals, payments, and transfer request in respect to funds held on deposit at GDB. The procedures implemented by the Executive Order may result in restrictions on the ability of the Authority to withdraw the funds held on deposit at GDB, which could result in an adverse impact on the Authority's financial condition, liquidity and results of operations.

In addition on October 18, 2016, the Secretary of the Treasury issued Circular Letter 13W-08-17 ("CC 13W-08-17") advising all agencies and public corporations of the Commonwealth about GDB liquidity issues and that management of GBD believes there is a substantial doubt about GDB ability to continue as a going concern. It also required that all agencies and public corporations with deposits at GDB perform an impairment analysis on the recoverability of the deposits at GDB as it was deemed probable that GDB will not be able to honor them.

As a result, the Authority has recognized an impairment loss on deposits held with GDB of $9.8 million as of June 30, 2016. No impairment loss on deposits held with governmental banks was recognized as of June 30, 2015. The balance of the deposits which was not impaired of $4.6 million as of June 30, 2016, are federal grants received under the USDA Rural Development Program to finance construction projects required by the federal program. Pursuant to the statutory requirements, the Authority is requesting the approval from the USDA Rural Development Program in order to request the funds to GBD.

4. 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,	
	2016	2015
Water and sewer services:		
Residential, industrial, and commercial	$ 653,792	$ 645,370
Government agencies and municipalities	109,640	113,624
	763,432	758,994
Other receivables:		
Government agencies and municipalities	3,410	3,410
Private entities	31,105	29,817
	34,515	33,227
	797,947	792,221
Less allowance for uncollectible accounts	(604,195)	(569,750)
Total	$ 193,752	$ 222,471

5. Other Receivables

Receivables from Federal Agencies

Receivables from federal agencies of approximately $2.7 million and $2.5 million as of June 30, 2016 and 2015, respectively, consisted primarily of amounts to be received from the U.S. Department of Homeland Security ("USDHS") as reimbursement for expenses incurred by the Authority's disaster recovery activities.

Receivables from Commonwealth

Receivables from Commonwealth are approximately $3.7 million as of June 30, 2016 and 2015, and consist of prepaid interest by the Authority on the PFC 2011 Series B Bonds to be reimbursed by the Commonwealth.

6. Materials and Supplies Inventory

As of June 30, 2016 and 2015, 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.

7. Capital Assets

Utility plant and other capital assets as of June 30, 2016 and 2015 and the changes therein for the years then ended are as follows (in thousands):

	June 30, 2016			
	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated:				
Land	$ 63,783	$ 529	$ (35)	$ 64,277
Easement	10,317	237	-	10,554
Construction in progress	795,371	118,259	(504,276)	409,354
Total capital assets not being depreciated	869,471	119,025	(504,311)	484,185
Capital assets being depreciated:				
Infrastructure (water and sewer facilities)	9,214,005	400,922	(40,267)	9,574,660
Wells, tanks and meters	736,792	46,313	(9,879)	773,226
Buildings and improvements	101,299	17,611	(10,844)	108,066
Equipment, furniture, fixtures and vehicles	380,220	55,663	(43,123)	392,760
Total capital assets being depreciated	10,432,316	520,509	(104,113)	10,848,712
Less: accumulated depreciation and amortization:				
Infrastructure (water and sewer facilities)	(3,277,142)	(220,089)	5,360	(3,491,871)
Wells, tanks and meters	(216,972)	(27,526)	670	(243,828)
Buildings and improvements	(38,923)	(1,327)	-	(40,250)
Equipment, furniture, fixtures and vehicles	(266,402)	(29,760)	-	(296,162)
Total accumulated depreciation and amortization	(3,799,439)	(278,702)	6,030	(4,072,111)
Total capital assets being depreciated, net	6,632,877	241,807	(98,083)	6,776,601
Total capital assets, net	$ 7,502,348	$ 360,832	$ (602,394)	$ 7,260,786

7. Capital Assets - (continued)

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

8. Restricted Assets

Restricted assets at June 30, 2016 and 2015 consisted of the following:

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

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

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

Restricted assets by category consist of (in thousands):

	June 30,	
	2016	2015
Construction funds	$ 8,797	$ 12,428
Capital activity funds	8,321	19,641
Debt service funds	238,396	345,660
Less: Impairment loss	(9,795)	-
	$ 245,719	$ 377,729

9. Accrued Liabilities

Accrued liabilities consisted of the following (in thousands):

	June 30,	
	2016	2015
Payroll and related accruals	$ 46,810	$ 33,543
Legal, labor related and environmental contingencies	70,755	77,739
Contract retentions	22,154	24,518
	$ 139,719	$ 135,800

10. Long-Term Liabilities

Long-term debt activity for the years ended June 30, 2016 and 2015 was as follows (in thousands):

	June 30, 2016					
	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	13,251	42,996
2008 Series A Revenue Bonds	1,305,510	-	(14,230)	1,291,280	14,940	1,276,340
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	-	(32,075)	1,768,375	-	1,768,375
2012 Series B Revenue Bonds	264,210	-	-	264,210	33,665	230,545
2015 Series A Revenue Bonds	-	75,000	(75,000)	-	-	-
Rural Development Serial Bonds	388,333	10,600	(4,722)	394,211	9,686	384,525
Sub total bonds	4,476,932	85,600	(126,027)	4,436,505	71,542	4,364,963
Add: bond premium	26,306	-	(541)	25,765	569	25,196
Less: bond discount	(16,038)	-	191	(15,847)	(200)	(15,647)
Total bonds	4,487,200	85,600	(126,377)	4,446,423	71,911	4,374,512
Notes payable:						
Water Pollution Control and Safe Drinking Water Treatment Revolving Funds Loans	555,391	50,352	(25,731)	580,012	25,985	554,027
Notes with commercial banks	96,553	-	(92,400)	4,153	2,555	1,598
Notes with GDB	66,764	-	(1,214)	65,550	8,497	57,053
Total notes	718,708	50,352	(119,345)	649,715	37,037	612,678
Lines of credit	7,389	-	(7,389)	-	-	-
Other long-term liabilities:						
Accrued compensated absences	40,524	16,991	(14,081)	43,434	11,548	31,886
Net OPEB obligation	36,580	6,883	(2,928)	40,535	6,883	33,652
Customers' deposits	84,823	10,176	(8,606)	86,393	7,586	78,807
Total other liabilities	161,927	34,050	(25,615)	170,362	26,017	144,345
Total – long-term obligations	$ 5,375,224	$ 170,002	$ (278,726)	$ 5,266,500	$ 134,965	$ 5,131,535

10. Long-Term Liabilities - (continued)

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

11. Bonds Payable

Bonds payable consisted of the following (in thousands):

	June 30, 2016	June 30, 2015
PFC Commonwealth Appropriation Bonds:		
Series 2011:		
Series A, 6.50%, due in semiannual interest payments through August 1, 2028 and annual principal installments from August 1, 2027 to 2028	**$ 90,099**	$ 90,099
Series B, 5.50% - 6.00% due in semiannual interest payments through August 1, 2031 and annual principal installments from August 1, 2024 to 2031	**102,183**	102,183
Series B - Superaqueduct, 5.50% - 6.00% due in semiannual interest payments through August 1, 2031 and annual principal installments from August 1, 2024 to 2031	**162,700**	162,700
Series 2012:		
Series A, 3.10% - 5.35%, due in monthly interest payments through August 1, 2031 and annual principal installments from August 1, 2015 to 2031	**56,247**	56,247
Revenue Refunding Bonds:		
Series 2008:		
Series A and B, Term Bonds, 5.80% – 6.10%, due in monthly interest payments through July 1, 2034 and annual principal payments from July 1, 2021 to 2034	**284,755**	284,755
Revenue bonds:		
Series 2008:		
Series A, Serial Bonds, 5.00%, due in semiannual interest payments through July 1, 2025 and annual principal payments from July 1, 2012 to July 1, 2025	**40,180**	54,410
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)

11. Bonds Payable - (continued)

	June 30, 2016	June 30, 2015
Series A, Term Bonds, 5.00% - 6.00%, due in semiannual interest payments through July 1, 2027 and annual principal payments from July 1, 2026 to 2047	$ **1,095,125**	$ 1,095,125
Series B, Serial Bonds, 6.15% due in monthly interest interest payments through July 1, 2038 and one principal payment on July 1, 2038	**22,445**	22,445
Series 2012:		
Series A, Serial Bonds, 4.00% - 5.55%, due in semiannual interest payments through July 1, 2030 and annual principal payments from July 1, 2015 to July 1, 2030	**386,380**	418,455
Series A, Term Bonds, 5.00% - 6.00%, due in semiannual interest payments through July 1, 2047 and annual principal payments from July 1, 2033 to July 1, 2047	**1,381,995**	1,381,995
Series B, Serial Bonds, 3.35% - 5.00%, due in semiannual interest payments through July 1, 2023 and annual principal payments from July 1, 2014 to July 1, 2023	**157,095**	157,095
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, 2055	**394,211**	388,333
Subtotal	**4,436,505**	4,476,932
Bond premium	**25,765**	26,306
Bond discount	**(15,847)**	(16,038)
Total	$ **4,446,423**	$ 4,487,200

11. Bonds Payable - (continued)

Act 164 PFC Bonds

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

Act 164 requires the Commonwealth's Office of Management and Budget ("OMB") to include the amounts required to pay debt service on the Notes in the proposed annual budget of the Commonwealth submitted by the Governor to the Legislature of Puerto Rico (the "Legislature"). However, the Legislature is not legally required to appropriate funds for such payments.

The Legislature did not appropriate any funds for payments on the Notes for fiscal year 2016, which resulted in the non-payment of the Notes and a concomitant failure to pay principal and interest due on the PFC Bonds. As previously stated, the Debt Service on the PFC Bonds is payable solely from payments received on the Notes, and the PFC Bonds are limited obligations of PFC and not of any Commonwealth entity, including the Authority. Therefore, in the event of a non-appropriation of funds and resulting lack of payment of the PFC Bond, bondholders have no recourse against the Legislature of Puerto Rico, the Commonwealth or other governmental agencies of the Commonwealth.

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

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

The Authority's share of 2011 Series A, 2011 Series B and 2012 Series A PFC Refunding Bonds is included in the Authority's balance sheets as of June 30, 2016 and 2015.

11. 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 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, following the issuance of the 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.

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

On August 18, 2011, December 8, 2011 and June 28, 2012 PFC issued 2011 Series A, 2011 Series B and 2012 Series A Refunding Bonds for the amount of $242.4 million, $437.6 million, and $410.6 million, respectively. The net proceeds from such refunding bonds, after payment of the cost of issuance and bond premium, were used to advance refund the Authority's share of the 2004 Series A PFC Bonds $326.8 million. The Authority's share on these previous bond issuances was removed from the balance sheets.

As of June 30, 2016, the Authority's share for the 2011 Series A, 2011 Series B, 2011 Series B Superaqueduct and 2012 Series A Refunding Bonds is approximately $90.1 million, $102.2 million, $162.7 million and $56.2 million, respectively.

Due to the non-appropriations of funds for the payments of the Notes in the Commonwealth's annual budget for fiscal year 2016, none of the payments on the Notes, or any corresponding payments on the PFC Bonds, that have come due and payable in fiscal year 2016 have been paid. As publically disclosed by GDB and PFC following the approval of the Commonwealth's annual budget for fiscal year 2016, the non-appropriation of the necessary funds to make the payments on PFC Bonds reflects the reality of the Commonwealth's current liquidity situation and fiscal challenges, in combinations with the balance of the Commonwealth's obligations to its creditors and the equally important obligations to the citizens of Puerto Rico to ensure the provisions of essential services.

The Commonwealth currently faces a severe fiscal and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession (which commenced in 2006), high unemployment, population decline, and high levels of debt and pension obligations. The risks and uncertainties facing the Commonwealth, together with other factors, have led the Commonwealth's management to conclude that there is substantial doubt as to their ability to continue as a going concern. As of the date hereof, GDB is unaware of any claims being asserted by holders of the PFC Bond or the PFC Bonds trustee under the governing agreements and/or the Notes in connection with the missed payments on the PFC Bonds obligations.

11. Bonds Payable – (continued)

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 "CIP").

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, 2016 and 2015, the outstanding balance for the 2008 Revenue Bonds Series A was approximately $1,291.3 million and $1,305.5 million, respectively, which included approximately $28.0 million of accreted value.

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

The 2008 Series A and B Revenue Bonds are considered senior debt. As of June 30, 2016 and 2015, the outstanding balance for the 2008 Revenue Bonds Series B was $22.4 million.

2008 Series A and B Revenue Refunding Bonds

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

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

11. Bonds Payable – (continued)

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

The 2008 Revenue Refunding Bonds are guaranteed by the Commonwealth and the Authority's net revenue, as defined in the corresponding trust indenture, is pledged toward the payment of debt service on these bonds. The 2008 Revenue Refunding Bonds are subordinated to all senior and senior subordinated debt. As of June 30, 2016 and 2015 the outstanding balance for the 2008 Series A and B refunding Bonds was $284.8 million.

2012 Series A and B Revenue Bonds

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

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

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

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

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

In connection with the 2012 Revenue Bond issuance, on January 24, 2012, the Authority's Board of Directors authorized the execution of an amended and restated Master Agreement of Trust (the "MAT"), dated as of February 15, 2012, by and between the Authority and Banco Popular de Puerto Rico as Trustee. The MAT as amended and restated changed from a net revenue pledge to a gross revenue pledge securing the repayment of the Authority's Senior, Senior Subordinated, and Subordinated debt, incurred by the Authority under the terms thereof, and changed the rate covenant requirements as explained in Note 14.

11. Bonds Payable – (continued)

2012 Series A and B Revenue Bonds – (continued)

The 2012 Revenue Bonds are issued as Senior Debt, pursuant to the terms of the MAT. As of June 30 2016 and 2015, the outstanding balance for 2012 Series A and B was $2,032.6 million and $2,064.7 million, respectively.

2015 Series A Revenue Bonds

On September 15, 2015 the Authority issued $75 million of its Revenue Bonds (Senior Lien) (the "Series 2015A Bonds") under the MAT, as further supplemented by a Fifth Supplemental Agreement of Trust, dated as of September 15, 2015 fixing the details of such bonds. As required by the Fifth Supplemental Agreement of Trust, the Series 2015A Bonds were secured by $75.5 million, which were deposited in an Escrow Account pursuant to the terms of the Escrow Deposit Agreement, dated September 15, 2015 among the Authority, Banco Popular de Puerto Rico, as Trustee and U.S. Bank National Association, as escrow agent.

The proceeds of the purchase of the Series 2015A Bonds were used to repay part of the outstanding balance of a $90 million term loan extended by Banco Popular de Puerto Rico (the "BPPR Loan") under a Credit Agreement, dated as of May 29, 2015, as amended, which was amended on the same date to reflect the new outstanding balance of such facility and an extension of its maturity date through November 30, 2015. On such date, both the Series 2015A Bonds and the BPPR Loan Agreement's maturity dates were extended through February 29, 2016. Both credit facilities were repaid on February 29, 2016 with the escrowed funds securing each facility.

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 provided interim financing for these projects through short-term lines of credit.

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

As of June 30, 2016 and 2015, the USDA Rural Development Program Bonds consisted of twenty-seven (27) separate series, issued from 1983 through 2016, bearing interest ranging from 2.0% to 5.00% due in semiannual installments through 2055. The outstanding balance of the USDA Rural Development Program Serial Bonds as of June 30, 2016 and 2015 was approximately $394.2 million and $388.3 million, respectively.

The USDA Rural Development Program Serial Bonds are guaranteed by the Commonwealth, pursuant Act No. 45 of the Legislative Assembly of Puerto Rico, approved on July 28, 1994, as amended ("Act No. 45"), and the Authority's net revenue is pledged toward the payment of debt service on the USDA Rural Development Program Bonds.

11. Bonds Payable – (continued)

Rural Development Serial Bonds – (continued)

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

On June 30, 2016, the Authority requested USDA Rural Development Program to provide a short- term forbearance period, during which it would refrain from exercising its rights and remedies, including the enforcement of the Commonwealth Guaranty, under the Rural Development Bond documents or grants or loan agreements. To this effect, the Authority and USDA Rural Development Program executed a forbearance document, effective as of June 30, 2016 (the "USDA Forbearance Agreement"). The USDA Rural Development Program granted the Authority a three (3) month forbearance period, through September 30, 2016, subject to the terms and conditions set forth in the USDA Forbearance Agreement, in order to provide for additional time to examine all options available to correct the Authority deficiencies and restore loan repayments.

Pursuant to the USDA Forbearance Agreement, the payments due on July 1, 2016 under the Rural Development Bond documents were also deferred for the duration of the forbearance period and USDA Rural Development Program agreed to forbear from exercising, or consenting to the exercise of, any enforcement of rights or remedies available to it under the Rural Development Bond documents or any grant or loan document in relation thereto. As part of the forbearance agreements, USDA Rural Development Program required a payment of $1.4 million, on July 12, 2016 the Authority made the payment as part of the agreement. On September 30, 2016, the forbearance agreement matured, and an additional forbearance period was granted until December 31, 2016. As part of the extension agreement, the USDA Rural Development Program required an additional payment for $2.4 million. On October 6, 2016, the Authority made the requested payment $1.2 million payment and on the first business day of November and December made payments of $0.6 million each to be applied to the overdue loan payments. On December 30, 2016, USDA Rural Development Program further extended the USDA Forbearance Agreement through March 30, 2017.

11. Bonds Payable - (continued)

Debt Service Payments

Future principal and interest payments on all bonds payable outstanding at June 30, 2016 are as follows (in thousands):

	Principal	Interest	Total
Fiscal year:			
2017	$ 71,542	$ 250,377	$ 321,919
2018	66,870	233,561	300,431
2019	70,156	230,209	300,365
2020	73,113	226,666	299,779
2021	75,642	222,906	298,548
2022-2026	495,240	1,043,599	1,538,839
2027-2031	909,091	860,441	1,769,532
2032-2036	789,675	617,700	1,407,375
2037-2041	827,188	402,730	1,229,918
2042-2046	766,915	170,231	937,146
2047-2051	285,549	17,480	303,029
2052-2056	5,524	204	5,728
Total	4,436,505	$ 4,276,104	$ 8,712,609
Plus: unamortized premium	25,765		
Less: unamortized discount	(15,847)		
Bonds payable, net	$ 4,446,423		

12. Notes Payable

Notes payable consisted of the following (in thousands):

	June 30, 2016	June 30, 2015
Puerto Rico Water Pollution Control Revolving Fund	$ **392,807**	$ 384,881
Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund	**187,205**	170,510
Notes with commercial banks	**4,153**	96,553
Note with GDB	**65,550**	66,764
	$ **649,715**	$ 718,708

12. Notes Payable – (continued)

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

The Authority also receives federal funds for its CIP through various loans (the "SRF Loans") granted by the Clean Water State Revolving Fund Programs ("CW-SRF") and the Drinking Water State Revolving Fund Programs ("DW-SRF") and together with the CW-SRF, the "SRFs"), created under the federal Clean Water Act of 1972 and Safe Drinking Water Act of 1974, as amended, administered by the Commonwealth's Environmental Quality Board ("EQB") and the Puerto Rico Department of Health ("PRDOH"), respectively. The SRF Loans are also secured by a Commonwealth guaranty under Act No. 45 of the Legislative Assembly of Puerto Rico, approved on July 28, 1994, as amended.

In this respect, EQB and PRDOH, on behalf of the Commonwealth, are authorized to enter into operating agreements and capitalization grant agreements with the U.S. Environmental Protection Agency ("EPA"). The Puerto Rico Infrastructure Financing Authority ("PRIFA"), a public corporation and instrumentality of the Commonwealth, as operating agent for the SRFs, is authorized to assist the PRDOH and the EQB in the administration, financial and accounting activities of the SRFs.

The Authority has entered into revolving loan agreements with PRIFA to finance certain capital improvements to the system. As of June 30, 2016 and 2015, the Authority had outstanding approximately $580 million and $555.4 million, respectively, under these loan agreements.

The SRF 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 outstanding bonds. If the Authority's pledged net revenues are not sufficient for the payment of principal and interest, the payments due under the SRF Loans are guaranteed by the Commonwealth under Act No. 45.

On June 30, 2016, the Authority executed a Forbearance Agreement (the "Forbearance Agreement") with PRDOH, administrator of the DW-SRF, EQB, CW-SRF, and PRIFA, as operating agent for the SRFs. Under the Forbearance Agreement, the payments due on July 1, 2016 under the SRF Loans were deferred and the parties thereto agreed to forbear from exercising, or consenting to the exercise of, any enforcement of rights or remedies available to each under the SRF Loans.

PRIFA, PRDOH and EQB, with the acknowledgment and support of the EPA granted such forbearance, subject to the terms and conditions set forth in the Forbearance Agreement, for a period of six (6) months, which could be extended for an additional six (6) months if conditions are met. During such forbearance period, the Commonwealth's guaranty under Act No. 45 would not be enforced. PRIFA, EQB and PRDOH, with the support of EPA, contemplate that during the forbearance period the parties will negotiate new terms and conditions to the SRF Loans and restructure of such loans and the underlying agreements between the Authority, PRIFA, EQB, PRDOH and, where applicable, EPA. On December 14, 2016, PRIFA, EQB and PRDOH, with the support of EPA further extended the SRF's Forbearance Agreement, through June 30, 2017.

12. Notes Payable – (continued)

Notes with commercial banks

As authorized by the Governing Board's Resolution No. 2796 adopted on July 3, 2013, on October 24, 2013, the Authority entered into a credit agreement (the "CIP Credit Agreement"), as amended with Oriental Bank, as Administrative Agent and Banco Popular de Puerto Rico ("Banco Popular") and the Lenders party thereto,, pursuant to the terms of which the Lenders agreed to make certain advances to the Authority in the aggregate principal amount of up to $350 million (the "CIP Line of Credit") to be repaid on the earliest to occur of (a) March 31, 2015 or (b) three (3) days after the issuance by the Authority of its revenue bonds under the Master Agreement of Trust.

As of June 30, 2014, the CIP Line of Credit had an outstanding balance of $200 million and was designated by the Authority as Senior Indebtedness pursuant to the terms of the MAT. On March 4, 2015, the Authority executed an amendment to the CIP Credit Agreement in which the local commercial bank syndicate agreed to extend the maturity date of the CIP Line of Credit through May 29, 2015. As a condition to such extension, the Authority agreed to make a principal payment in an aggregate amount of $50 million. Concurrently with the execution of the amendment, the Authority paid the Lenders $40 million, reducing the outstanding principal amount of the indebtedness to $160 million, and agreed to make two additional $5 million principal payments on April 1, 2015 and May 1, 2015, which were made on their respective due dates.

On May 29, 2015, the Authority entered into a Credit Agreement with Banco Popular (the "Banco Popular Credit Agreement") pursuant to which Banco Popular made a $90 million term loan (the "BPPR Loan") to the Authority for the purpose of refinancing the $75 million due to such bank under the CIP Credit Agreement and providing an additional $15 million to be applied by the Authority, together with Operating Revenues collected during May 2015, after making the required deposits to the Senior Bond Fund, to repay in full the outstanding $75 million of Oriental Bank's Commitment under the CIP Credit Agreement. The amounts due under the Banco Popular Credit Agreement were secured with an escrow deposit of $90 million of the Authority's funds then on deposit in the Rate Stabilization Account of the Surplus Fund created under the MAT and would be payable on the earlier of (i) August 31, 2015, (ii) upon the occurrence and continuation of an event of default under the Banco Popular Credit Agreement or (iii) the date of issuance of the 2015A Senior Bonds.

As explained in Note 10 herein, on September 15, 2015 the Authority issued $75 million of its Series 2015A Senior Bonds under the MAT, as supplemented by a Fifth Supplemental Agreement of Trust, dated as of September 15, 2015 setting the details of such bonds. The proceeds of the purchase of the Series 2015A Senior Bonds were used to repay part of the outstanding balance of a $90 million term loan extended by Banco Popular under the Banco Popular Credit Agreement. The outstanding balance of the BPPR Loan was then reduced to $15 million. Both financings were due on November 30, 2015.

12. Notes Payable – (continued)

Notes with commercial banks (continued)

On November 30, 2015, the Authority extended the maturity date of the Series 2015A Senior Bonds through February 29, 2016 and executed a third amendment to the Banco Popular Credit Agreement to also extend the credit facility's maturity date through February 29, 2016. As a condition to the latter the Authority agreed to make partial principal payments of $5 million and $10 million on January 31, 2016 and February 29, 2016, respectively, which were made.

On February 29, 2016, the principal and interest due under both financings were paid in full with the escrowed funds securing such facilities.

Fleet Term Loan

As authorized by the Board's Resolution No. 2844, adopted on April 23, 2014, on November 3, 2014, the Authority entered into a credit agreement with Popular Auto, LLC, a limited liability company organized and existing under the laws of the Commonwealth, pursuant to the term of which such institution agreed to make borrowings available to the Authority in the aggregate principal amount of $7.5 million (the "Fleet Term Loan") to be repaid by November 2, 2017. The Fleet Term Loan was designated by the Authority as Senior Subordinate Indebtedness, Other System Indebtedness and a Refundable Principal Installment pursuant to the terms of the Master Trust Agreement. As of June 30, 2016 and 2015, the outstanding balance of the Fleet Term Loan was $4.2 million and $6.6 million, respectively.

Notes with GDB

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

On December 30, 2015, the Authority gave notice to GDB that it would not be making the payment due GDB on December 31, 2015, under the Amended and Restated Loan Agreement, dated as of June 27, 2014, by and between the Authority and the GDB, as further amended. The Authority's payment obligations under the Loan Agreement were not designated as Other System Indebtedness and are therefore not payable on a parity basis with the Authority's Senior debt and have no rights under the MAT, as the parties expressly agreed, that such payment obligations would be junior and subordinate in all respects to the requirements of the MAT. In this respect, the nonpayment of the amounts due to GDB under the Loan Agreement do not constitute an Event Default under the MAT, inasmuch as the nonpayment defaults contemplated under Section 8.01(a) and Section 8.01(b) of the MAT relate to a default in payment of amounts due under the Bonds or Other System Indebtedness. As of June 30, 2016 and 2015, the term loan outstanding balance was $65.6 million and $66.8 million, respectively. As of the date of the issuance of the financial statements, the term note has not been declared in default by GBD.

12. Notes Payable – (continued)

Notes with GDB – (continued)

The combined future aggregate amount of debt service for these loans as of June 30, 2016 was as follows (in thousands):

	Principal	Interest	Total
2017	$ 37,037	$ 13,610	$ 50,647
2018	31,778	9,785	41,563
2019	76,227	8,237	84,464
2020	23,803	5,466	29,269
2021	24,281	4,988	29,269
2022-2026	118,562	17,810	136,372
2027-2031	87,723	6,665	94,388
2032-2036	24,858	914	25,772
	424,269	$ 67,475	$ 491,744
Interim construction loans:			
Puerto Rico Water Pollution Control Revolving Fund	176,442		
Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund	49,004		
Total	$ 649,715		

13. Lines of Credit

On March 18, 2008, the Authority entered into a revolving line of credit agreement with GDB. This agreement provides the Authority with an available maximum amount of $150 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 million. There was no outstanding balance as of June 30, 2016 and 2015. This line of credit matured on June 30, 2016 and was not renewed. Pursuant to the MAT, amended by the Sixth Supplemental Agreement of Trust, on July 2016 the Authority made the required monthly deposits into an operational fund reserve account with the Authority's trustee agent, in order to establish an operating reserve fund of $180 million at the end of thirty six (36) months.

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, the American Recovery Act ("ARRA"), and the USDA Rural Development Bonds. The Authority will pay this interim financing with moneys received from State Revolving Funds, as reimbursements on payments done by the Authority for the projects. On October 8 2016, with the proceeds of the issuance of the Series JJ of the USDA Rural Development Bonds, the Authority cancelled the outstanding balance of $7.4 million. As of June 30, 2016, there was not outstanding balance. As of June 30, 2015, the outstanding balance on this line of credit amounted to approximately $7.4 million.

14. Financial Covenants

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

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

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

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

As of June 30, 2016 and 2015, the Authority was in compliance with the senior annual debt service coverage requirements.

15. Capital Contributions

Capital contributions for the fiscal years ended June 30, 2016 and 2015 were as follows (in thousands):

	June 30,	
	2016	**2015**
Federal grants:		
USDA Rural Development Program	$ **4,547**	$ 9,055
Federal Emergency Management Agency	**213**	7
US EPA Clean Water State Revolving Funds	**3,349**	8,211
Developer contributions	**8,643**	6,630
Contributions from governmental agencies and municipalities	-	537
Other contributions from Commonwealth	-	50
Other contributions	**1,505**	1,614
	$ **18,257**	$ 26,104

16. Related Party Transactions

Operating revenues for services provided to the Commonwealth and its component units amounted to approximately $91 million and $104.1 million during the years ended June 30, 2016 and 2015, respectively. As of June 30, 2016 and 2015, the Authority's government account receivable is $109.6 million and $113.3 million, respectively, for which $73.2 and $69 million are considered uncollectible, in 2016 and 2015, respectively. Further, operating, administrative, and general expenses during the fiscal years ended June 30, 2016 and 2015 included approximately $141.7 million and $148.3 million, respectively, of charges from Puerto Rico Electric Power Authority (PREPA), a component unit of the Commonwealth.

As of June 30, 2016 and 2015, the Authority had approximately $3.7 million, respectively, of receivables from the Commonwealth and its component units, which are reported as receivables from the Commonwealth in the accompanying balance sheets.

The Authority had approximately $1.4 million and $1.1 million of excess of collections over billings from the Commonwealth, recorded as unearned revenue in the accompanying balance sheets as of June 30, 2016 and 2015, respectively.

As of June 30, 2016, the Commonwealth and its component units face significant uncertainties, including liquidity risks, which is the risk of not having sufficient liquid financial resources to meet their obligations when they become due. Because of these uncertainties, the amount due from Commonwealth and its component units may not be collected in the near future. This situation could result in an adverse impact on the Authority's financial condition, liquidity and results of operations.

Over the years, GDB, as fiscal agent and bank of the Commonwealth, had extended lines of credit and term loans to the Authority in order to finance capital improvement projects and operational needs. As of June 30, 2016 and 2015, the Authority had a term loan with an outstanding balance of approximately $65.6 million and $66.8 million, respectively, under this credit facility. The Authority has not made the quarterly principal and interest payments on this term loan since December 2015. As of the date of the issuance of the financial statements, the term note has not declared in default by GDB. In addition, the Authority has restricted deposits with the GDB and EDB as of June 30, 2016 and 2015 of $14.4 million and $32.1 million, respectively.

As a result of the fiscal crisis of the GDB and the lack of liquidity, the Authority has recognized an impairment loss in the amount of $9.8 million on deposits with governmental bank. This impairment is recognized as a non-operating loss for the year ended June 30, 2016, in the accompanying statements of revenues, expenses and changes in net position.

17. Pension Plan

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

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

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

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

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

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

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.

17. Pension Plan – (continued)

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

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

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

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

Effective July 1, 2013, all participants will contribute a minimum of 10% with no maximum restriction of their gross monthly salary to the program. Commencing in fiscal year 2014, the Authority will pay a contribution of 12.275% of the employee's gross monthly salary and will increase 1% per year until fiscal year 2016 and 1.25% per year until fiscal year 2021. The Authority's contributions during fiscal year 2016 were of 14.275% of the employee's gross salary.

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

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

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

Under Act 447 the Authority's contributions during fiscal years ended June 30, 2016, 2015 and 2014 amounted to approximately $9.1 million, $8.7 million and $8.5 million, respectively, which represented 100% of required contributions.

The Authority contributions under System 2000 plan during the fiscal years ended June 30, 2016, 2015 and 2014, amounted to approximately $8.8 million, $8.9 million and $8.2 million, respectively, which represented 100% of required contributions.

Under Act 3, the Authority contributions for the hybrid program during fiscal years ended on June 30, 2016, 2015 and 2014, amounted to approximately $1.4 million, $1.2 million and $0.7 million, respectively.

17. Pension Plan - (continued)

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

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

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

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, 2015 (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.

To improve the liquidity and solvency of the ERS, the Commonwealth enacted Act. No. 32 of June 25, 2013, which provides for incremental annual contributions from the Commonwealth's General Fund, public corporations and municipalities beginning on fiscal year 2013-2014 through fiscal year 2032-2033 . The additional contribution is determined annually based on actuarial studies. The ERS determined the portion attributed to the Authority based on the relationship of the Authority's employer contributions to the total of all participating employers for the current year. For the fiscal years ended June 30, 2016, 2015 and 2014, the Authority's additional uniform contribution was $ 5 million, $4.8 million and $4.4 million, respectively.

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

17. Pension Plan - (continued)

As of the date of the release of this report, the ERS has not provided the Authority with the required information to implement the requirements of Statement No. 68 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27* (GASB 68). Therefore, the accompanying financial statements do not have any adjustments that will be necessary for the Authority to account for its proportionate share of the net pension liability, deferred inflow of resources and deferred outflow of resources in the balance sheets as of June 30, 2016, and 2015, as well as the effect in the recorded pension expense in the statement of revenues, expenses and changes in net position for the years ended June 30, 2016 and 2015. Also, additional disclosures required by GASB 68 as well as required supplementary information were not included in the basic financial statements.

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

The actuarial valuation of the Basic System Benefits and System Administered Benefits as of June 30, 2015 (most recently available) reflects a fiduciary net position of $(579) million, total pension liability of $32.7 billion and a net pension liability of $33.3 billion.

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

18. Other Postemployment Benefits

Plan Description

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

Retirement age is as follows:

► For those employees employed by the Authority before March 30, 1990, normal retirement age will be at sixty-one (61) years old.

► For employees employed by the Authority on March 30, 1990 and before July 1, 2013, normal retirement age will be at sixty-five (65) years old.

► For the employees hired by the Authority after July 1, 2013, normal retirement age will be at sixty-seven (67) years old.

18. Other Postemployment Benefits – (continued)

Plan Description – (continued)

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

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

Funding Policy

The contribution requirements of the Authority are established and may be amended, by the Authority's Board of Directors. The benefits are paid directly by the Authority to the retirees at a rate of a maximum of $125 per month per retiree. The Plan is financed on a pay-as-you-go basis and the amount contributed during the fiscal years ended June 30, 2016 and 2015 was approximately $2.9 million and $3.1 million, respectively. There is no contribution requirement for plan members.

Annual OPEB costs and Net OPEB obligation

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

The annual required contribution estimated for the years ended June 30, 2016 and 2015 amounted to (in thousands):

	2016	2015
Annual Required Contribution (ARC):		
Normal costs	$ 2,252	$ 2,252
Amortization of initial UAAL	2,341	2,341
Amortization of loss	4,911	4,911
GASB Statement No. 45 Annual Required Contribution	$ 9,504	$ 9,504

OPEB costs components for the years ended June 30, 2016 and 2015 are as follows (in thousands):

	2016	2015
Annual OPEB costs		
ARC for fiscal year	$ 9,504	$ 9,504
Interest on net OPEB obligation	743	743
ARC amortization adjustment	(3,364)	(3,364)
Total annual OPEB costs	$ 6,883	$ 6,883

18. Other Postemployment Benefits – (continued)

Annual OPEB costs and Net OPEB obligation – (continued)

The net OPEB obligation change for the years ended June 30, 2016 and 2015 is as follows (in thousands):

	2016	2015
Change in net OPEB obligation		
Net OPEB obligation, beginning balance	$ 36,580	$ 32,330
Total annual OPEB costs	6,883	6,883
Actual benefit payments	(2,928)	(2,633)
Net OPEB obligation, ending balance	$ 40,535	$ 36,580

The net OPEB obligation is recorded as a component of compensated absences and postemployment benefits in the accompanying balance sheets as of June 30, 2016 and 2015.

Funded Status

Funded status of the plan as of June 30, 2016 and 2015, the most recent actuarial valuation date, is as follows (in thousands):

	2016	2015
Unfunded Actuarial Accrued Liability (UAAL):		
Active employees	$ 33,684	$ 33,287
Retirees	42,542	42,039
Actuarial accrued liability	76,226	75,326
Actuarial value of assets	-	-
UAAL	$ 76,226	$ 75,326

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

Actuarial Assumptions

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

18. Other Postemployment Benefits – (continued)

Economic Assumptions

Discount Rate

The discount rate considered for years ended June 30, 2016 and 2015 was 2.10%. For fiscal year 2015, a 3-year average of the U.S. Treasury Bond 10-year term investments represents the Authority's expected long-term return on internal assets used to finance the payment of plan benefits.

Medical Increase Rate

As the retirement healthcare benefit is fixed, such that it will not increase the obligation under the plan (regardless of the claim experience) without negotiation of a new contract with the unions or an express Board of Directors' approval, the medical increase rate was zero percent for the years ended June 30, 2016 and 2015. 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, 2016 and 2015, the turnover table used for the valuation was the Standard Hewitt Withdrawal Table for Hourly Union Employees – five (5) years of service select period.

Healthy Mortality

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

Disability Table

The Hunter disability table was used for the valuation.

Actuarial Cost Method

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

Amortization of Initial UAAL

Period

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

Method

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

19. Labor Union Contracts

The collective bargaining agreement with the HIEPAAA union, which covers approximately 149 professional employees, was signed effective May 31, 2012 until June 30, 2016.

The collective bargaining agreement with the UIA union, which covers approximately 3,302 blue-collar and clerical employees, was signed effective January 1, 2012 until December 31, 2015.

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

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

The Authority developed the Superaqueduct, as part of the infrastructure of the water intakes and the interconnections tanks in the distribution system, along the PR North Coast route, from Arecibo to Bayamón. During fiscal year 2012, the Authority signed an agreement with Caribbean Water Specialist Corp. and paid a management fee for the operation, security, and for the environmental and regulatory compliance (water quality) for all the operations under the contract of the North Coast Aqueduct. On October 1, 2013, the Authority signed a contract agreement with CH2 Hill Puerto Rico for the operation and maintenance of the Superaqueduct for a 12-month period, the contract may be renewed on an annual basis up to five years. In October 2014 the contract was renewed. The cost incurred under the contract is reported under the caption of *Service Contract – Superaqueduct* ($3.5 million and $3.7 million for the years ended June 30, 2016 and 2015, respectively). All other operational costs associated with the operation of the Superaqueduct system are captioned in their respective expense category and are presented in the statements of revenues, expenses and changes in net position as part of the financial statements.

21. Commitments and Contingencies

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 completion dates established in the Agreement.

21. 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 the Authority's service. The agreement also required the implementation of the Preventive Maintenance Program ("PMP") for all of Authority's WWPSs. This was fully completed in December of 2010, and is still in place.

As part of the agreement, the Authority pays stipulated penalties for pump station bypass events on a quarterly basis. The penalty calculations are based on the pumping capacity of the pump station and the time taken to correct the deficiency causing the bypass event. The amount of penalties paid during fiscal years 2016 and 2015 was approximately $0.1 million and $0.6 million, respectively.

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

As part of the agreement, the Authority 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 accrued for period from January 2015 to February 29, 2016 were approximately $0.6 million and the amount paid during 2015 (corresponding to penalties incurred in 2014) were $0.4 million. These penalty payments were deposited into an escrow account from which a fraction of the deposited amount can be reimbursed to the Authority based on completion of specific projects and initiatives, being 2015 the last deposit done to the escrow account. The Authority recognized the contingencies penalties accrued as accrued liabilities in the financial statements, the penalties amount for June 30, 2016 is $0.6 million, which was paid on September 2016 to the U. S. Department of Treasury.

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

21. Commitments and Contingencies – (continued)

Environmental Matters – (continued)

Government on June 22, 2006. The plea agreement also stipulated penalties for violation of any of the deadlines or performance standards set forth in the agreement. As of today, the Authority is in compliance with the deadlines and requirements of this Consent Order and no penalties have been paid. The probation period expired on April 2012.

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

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. The Authority is in compliance with these SEP.

During fiscal years ended June 30, 2016 and 2015, the penalties paid amounted approximately $0.5 million and $0.1 million, respectively. The Authority deposited $0.1 million in an escrow account. The deposit in the escrow account is for parameters exceedances, and will be used for compliance projects with the approval of the Department of Health.

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

21. 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 in November 2012.

During the fiscal year 2016, no penalties were paid under this agreement. Penalties paid for the fiscal year 2015 were approximately $0.2 million. Stipulated penalties must be paid by the Authority for failing to comply with remedial measures deadlines, permit limit exceedances or fail to submit deliverables or Discharge Monitoring Reports.

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

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

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

21. Commitments and Contingencies (continued)

Environmental Matters – (continued)

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

On December 2016, the Authority requested a time extension to EPA pursuant to Section XIII-Modification/Prioritization of Remedial Measures for certain projects of the Consent Decree which include the remedial measures to address Washwater Discharges at Water and Wastewater Treatment Plants.

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.

21. Commitments and Contingencies (continued)

Risk Management – (continued)

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

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	$ 0	$1 million per occurrence
Comprehensive general liabilities	$100 thousand per occurrence	$1 million per occurrence $2 million per aggregate
Umbrella liability		
First excess general liability and automobile	Retention $1 million	In excess of $20 million up to $20 million
Second excess general liability and automobile	$ 0	From $20 million to $40 million
Pollution liability	$250 thousand per occurrence	$5 million per occurrence $10 million per aggregate
Crime	$10 thousand per occurrence	From $500 thousand up to $1 million

21. 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	$ 0	Additional $10 million
Travel and accident	$ 0	$500 thousand per occurrence $2.5 million aggregate
Accident and health divers	$ 0	$250 thousand per occurrence $1.7 million aggregate
EPLI	$100 thousand per occurrence	$5.0 million
Excess EPLI	$ 0	Additional $5.0 million

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

21. Commitments and Contingencies (continued)

Risk Management (continued)

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

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

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

Construction Projects

The Authority enters in construction projects for the replacements or expansion of its facilities. As of June 30, 2016 and 2015, there were outstanding commitments for projects in process for approximately $5.6 million and $90.7 million, respectively.

Operating Leases

Certain commercial offices and warehouse facilities of the Authority are leased under operating lease agreements. During the fiscal years ended June 30, 2016 and 2015, the Authority incurred approximately $5.1 million and $3.6 million, respectively, in rent expense.

21. Commitments and Contingencies (continued)

Operating Leases – (continued)

Future minimum noncancelable lease payments on existing operating leases at June 30, 2016, which have an initial term of one year or more, are as follows (in thousands):

Year ending June 30,	Amount
2017	$ 3,452
2018	2,709
2019	1,480
2020	1,342
2021	855
2022 - 2026	2,102
2027 - 2031	1,721
	$ 13,661

Litigation

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

The Authority is the defendant or codefendant in various other lawsuits arising out of the normal course of business. The ultimate outcome of the lawsuits cannot presently be determined. However, management, based on discussion with legal counsel, has accrued a liability to cover litigation claims and contingencies. See Note 9.

22. Subsequent events

Subsequent events were evaluated through March 7, 2017, the date the financial statements were available to be issued to determine if such events should be recognized or disclosed in the 2016 financial statements.

On July 12, 2016, the Governor of Puerto Rico signed into law Act 68 of 2016 ("Act 68"), providing for the creation of a new public corporation, to be known as the Puerto Rico Aqueduct and Sewer Authority Revitalization Corporation (the "Corporation"), as a single purpose, bankruptcy remote entity. The Corporation is authorized to fix and collect securitization charges for the purpose of issuing bonds the proceeds of which may be used by the Authority for its Capital Improvement Program ("CIP"), refinancing of bond anticipation notes and the cancelation, defeasance and refinancing of its Bonds, among other approved financing costs. Act 68 limits the securitization charge which may be imposed by the Corporation to an amount equivalent to 20% of the Authority's revenues and provides that the Corporation may issue up to a maximum of $900 million in bonds for the purpose of financing the development of the Authority's CIP. The difference between the $900 million that may be used for the financing of the CIP and the maximum amount that can be financed with the 20% of Authority's revenues may be used to retire, cancel (defease) or refinance Bonds of the Authority, subject to certain conditions. As of the date of the issuance of the financial statements this Corporation has not commenced operations.

On June 30, 2016, the President of the United States signed into law the Puerto Rico Oversight, Management and Economic Stability Act, Public Law 114-187 ("PROMESA"), providing the creation of a Financial and Management Board (the "Fiscal Oversight Board").

On September 30, 2016, the Fiscal Oversight Board designated the Authority as a "Covered Governmental Entity" under section 101 of PROMESA, and thus the Authority is subject to section 201(b), which requires the Authority to provide the Fiscal Oversight Board with a Fiscal Plan.

On January 28, 2017, the Fiscal Oversight Board requested the Authority to submit the Fiscal Plan by February 21, 2017. On that date, the Authority submitted a draft of its Fiscal Plan.

On December 14, 2016, the existing Forbearance Agreement with the Authority and the Puerto Rico Department of Health (DOH), administrator of the Drinking Water State Revolving Fund Programs, the Commonwealth's Environmental Quality Board (EQB), administrator of the Clean Water State Revolving Fund Programs (CW-SRF), and the Puerto Rico Infrastructure Financing Authority ("PRIFA"), was extended until June 30, 2017.

On December 30, 2016, the existing Forbearance Agreement with the United States Department of Agriculture, Rural Development and Rural Utilities Service was extended for an additional ninety (90) days period until March 30, 2017.

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, 2016	$ -	$ 76,226	$ 76,226	0%	$ 149,209	51%
June 30, 2015	$ -	$ 75,326	$ 75,326	0%	$ 135,965	55%
June 30, 2014	$ -	$ 72,027	$ 72,027	0%	$ 148,131	49%
June 30, 2013	$ -	$ 73,044	$ 73,044	0%	$ 149,613	49%
June 30, 2012	$ -	$ 71,703	$ 71,703	0%	$ 163,753	44%

Supplemental Schedule

Puerto Rico Aqueduct and Sewer Authority
(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, 2016 and 2015

(In thousands)

	2016	2015
Revenues		
Service revenues (cash basis)	$ 1,007,858	$ 1,072,407
Other income	5,933	4,365
Developers contributions	4,092	3,555
Transfer from rate stabilization account	90,000	-
Operating revenues (cash basis)	1,107,883	1,080,327
Budgetary reserve fund	-	-
Total authority revenues	1,107,883	1,080,327
Operating expenses:		
Payroll and payroll related	269,589	265,339
Electricity	141,743	148,267
Other operating expenses	212,490	229,054
Total net operating expenses	623,822	642,660
Non cash reserve adjustments	10,008	9,005
Adjusted operating expenses	613,814	633,655
Total net revenues per MAT	$ 494,069	$ 446,672
Debt service coverage calculation:		
Operating revenues	$ 1,107,883	$ 1,080,327
Senior debt (net of funds available in the Senior Bond Fund of $43.6 million)	325,961	355,477
Accumulated coverage ratio (Min 2.5x) - Section 7.01 (i) MAT	*3.40*	*3.04*
Senior subordinated debt	2,721	1,170
Accumulated coverage ratio (Min 2.0x) - Section 7.01 (ii) MAT	*3.37*	*3.03*
All bonds and other system indebtedness	328,682	356,647
Accumulated coverage ratio (Min 1.5x) - Section 7.01 (iii) MAT	*3.37*	*3.03*
Rate covenants:		
Authority revenues	$ 1,107,883	$ 1,080,327
All debt plus current expenses	1,039,794	1,082,288
Accumulated coverage ratio (Min 1.0x) - Section 7.01 (iv) MAT	*1.07*	*1.00*

Other Reports

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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*

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

We have audited, in accordance with the auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Puerto Rico Aqueduct and Sewer Authority (the Authority) as of and for the years ended June 30 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Authority 's basic financial statements and have issued our report thereon dated March 7, 2017. Our report includes an emphasis of a matter paragraph which states, along with other matters that the Authority's significant recurring operating losses, working capital deficiencies, credit downgrades, large non-discretionary capital expenditure requirement, uncertainty as to fully satisfy its obligations, fiscal oversight and market access risk raises substantial doubt about its ability to continue as a going concern. Management's plans in regards to these matters are also described in Note 2 to the financial statements. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter. In addition, our report was qualified because the Authority has not implemented the requirements of Statement No. 68 of the Governmental Accounting Standard Board, *Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27* and Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of GASB Statement No. 68,* because the final audited pension information is not readily available.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether 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 statements' amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Authority's Responses to the Findings

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the Authority'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 Authority's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

San Juan, Puerto Rico
March 7, 2017.

Kevane Grant Thornton LLP

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