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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, 2017

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

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Report of Independent Certified Public Accountants

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

Report on the Financial Statements

We have audited the accompanying financial statements of Puerto Rico Aqueduct and Sewer Authority (a component unit of the Commonwealth of Puerto Rico) ("the Authority"), which comprise the balance sheet as of June 30, 2017, and the related statements of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Puerto Rico Aqueduct and Sewer Authority as of June 30, 2017 and the respective changes in financial position, and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter Regarding Going Concern

The accompanying financial statements have been prepared assuming that the Authority will continue as a going concern. As discussed in Note 2 to the financial statements, the Authority's relation with the Government of Puerto Rico, credit downgrades, large non-discretionary capital expenditure requirement, and lack of market access raise substantial doubt about its ability to continue as a going concern. Management's plans in regards to these matters are also described in Note 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

Restatement of Prior Period Financial Statements
As discussed in Note 21 to the financial statements, as of July 1, 2016, the net position of the Authority has been restated to correct prior period misstatements related to the adoption of the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement No. 27*, and GASB Statement No. 71, *Pension Transitions for Contributions Made Subsequent to the Measurement Date – an amendment of GASB statement No. 68*, which were effective on July 1, 2014. Our opinion is not modified with respect to this matter.

Change in Accounting for Postretirement Benefits Other than Pensions
As discussed in Note 21 to the financial statements, the Authority adopted the provisions under GASB Statement No. 75, *Accounting and Financial Reporting for Postretirement Benefits Other than Pensions*, as of July 1, 2016. Our opinion is not modified with respect to this matter.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 18, the schedule of the Authority's proportionate share of the net pension liability on page 74 and, the schedules of contributions on pages 75 - 76 and the schedule of changes in the Authority's total Other Post Employment Benefits ("OPEB") liability and related ratios on page 77, be presented to supplement the financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries to management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic 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.

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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 78 is presented as additional information and is not a required part of the basic financial statements. The schedule is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements and certain additional procedures, including comparing and reconciling financial statements or to the basic financial statements themselves, and other additional procedures in accordance with the auditing standards generally accepted in the United States. In our opinion, the schedule is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 30, 2019, 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
September 30, 2019.

Kevane Grant Thornton LLP

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COLEGIO DE CONTADORES PUBLICOS AUTORIZADOS DE PUERTO RICO

KEVANE GRANT THORNTON LLP
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 year ended on June 30, 2017. 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 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, 2017 and 2016 decreased by $1,426 million (mainly as a result of the adoption of the provisions under GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* and GASB Statement No. 75, *Accounting and Financial Reporting for Postretirement Benefits Other than Pensions*, as of July 1,2016) and $238.4 million, respectively. In addition, the Authority working capital deficiencies as of June 30, 2017 and 2016 amounted to $426 million and $347 million, respectively. However, the Authority's restricted cash includes a portion for the payment of current debt of approximately $232.8 million and $235.6 million for 2017 and 2016, 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.

Historically, the Authority's Capital Improvement Program ("CIP") has been funded with external financing. As a result of the economic crisis facing the Commonwealth of Puerto Rico and several of its components units, including the Authority, lack of market access resulted in the suspension of its capital improvement program. The Authority had managed its liquidity to be able to pay certain outstanding contractor obligations. As of June 30, 2017, unpaid CIP contractor obligations were approximately $95 million, including interest and penalties, which has been completely paid as of the date of the issuance of these financial statements.

On June 30, 2016, the Authority, with the acknowledgment and support of the United States Environmental Protection Agency ("EPA"), executed Forbearance Agreements (the "EPA Forbearance Agreements") with the Puerto Rico Department of Health (DOH), administrator of the Drinking Water State Revolving Fund Programs ("DW-SRF") and with the Commonwealth's Environmental Quality Board ("EQB"), administrator of the Clean Water State Revolving Fund Programs ("CW-SRF" and collectively with the DW-SRF, the "SRFs"), both also agreed by the Puerto Rico Infrastructure Financing Authority ("PRIFA"), a public corporation and instrumentality of the Commonwealth, as operating agent for the for the SRFs, authorized to assist the DOH and the EQB in the administration, financial and accounting activities of the SRFs. Under the Forbearance Agreements and its extensions thereof, the payments due on July 1, 2016, January 1, 2017, July 1, 2017, January 1, 2018, July 1, 2018, January 1, 2019 and July 1, 2019 under the SRF Loans were deferred, subject to certain conditions and partial payments. The Forbearance Agreements were amended and extended in multiples occasions until July 31, 2019.

Going Concern – (continued)

The Authority also requested that United Stated Department of Agriculture ("USDA") Rural Development Program provide a short-term forbearance period, which included deferral of the payments due on July 1, 2016, January 1, 2017, July 1, 2017, January 1, 2018, July 1, 2018, January 1, 2019 and July 1, 2019 during which they would refrain from exercising its rights and remedies under the Rural Development ("RD Bond") documents or grants or loan agreements related to the Authority's USDA Rural Development, Rural Utilities Service program bonds (the "RD Bonds"), subject to certain conditions and partial payments. To this effect, the Authority and USDA Rural Development Program executed a forbearance document as of June 30, 2016. Subsequently, the forbearance period was further extended in several occasions until July 31, 2019.

On July 26, 2019, the Authority and the Puerto Rico Fiscal Agency and Financial Advisory Authority ("AAFAF", by its Spanish acronym) consummated definitive agreements (the "Agreements") restructuring the Authority's debt obligations under SRF loans and RD Bonds totaling almost $1 billion (the SRF loans and RD Bonds are collectively referred to as the "Federal Debt").

The Agreements were approved by the Financial Oversight and Management Board for Puerto Rico (the "Oversight Board") pursuant to Section 207 of PROMESA. The Agreements include the termination of existing Commonwealth guarantees of the Federal Debt, thus reducing overall Government contingent liabilities by approximately $1 billion and the consolidation of all the restructured debt into two SRF loans and one RD loan to replace the existing SRF loans and RD Bonds with extended maturities and lower interest rates as follows:

- RD loans: 40-year term at 2% interest rate, with $10 million annual debt service from years 1 to 10 and $17 million annual debt service thereafter
- SRF loans: 30-year term at 0% interest rate and $10 million annual principal-only payment from years 1 to 10 and 1% interest rate and $27 million annual debt service thereafter.

The restructured Federal Debt was designated as Other System Indebtedness in parity with other senior debt under PRASA's Master Agreement of Trust.

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.

On June 30, 2016, the President of the United States enacted 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 an oversight board, relief from creditor lawsuits through the enactment of a temporary stay on litigation, and alternative methods to adjust unsustainable debt. To ensure fiscal and economic discipline, PROMESA created a federally appointed 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.

Going Concern – (continued)

On September 30, 2016, the Authority was designated by the Oversight Board pursuant to section 101 of PROMESA as a covered territorial instrumentality, meaning it is 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 entering any new financing or debt restructuring process.

As a result of the fiscal difficulties faced by the Commonwealth, on May 3, 2017 the Financial Oversight and Management Board for Puerto Rico (Oversight Board), at the request of the Governor, commenced a Title III case for the Commonwealth by filing a petition for relief under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) in the United States District Court for the District of Puerto Rico.

On September 6, 2017 and September 20, 2017, Hurricanes Irma and Maria, respectively, hit Puerto Rico resulting in island-wide catastrophic damages to Puerto Rico's infrastructure, homes and business. As a result of the impact of these Hurricanes, most of the island's population was left without electrical power and there was significant disruption to the water distribution system among other basic utility and infrastructure services. These factors caused significant disruption to the island's economic activity. The entire island will need and is in the process of an immense infrastructure rebuilding program.

The President of the United States of America issued a state of emergency declaration for Puerto Rico, as a U.S. territory. The order mandates federal assistance through the Department of Homeland Security and the Federal Emergency Management Agency (FEMA) be made available to assist in local and territorial recovery efforts.

The Authority suffered damages to water treatment facilities and structures across the island which may result in a material adverse change in the financial condition of the Authority and the Commonwealth. Significant emergency work was made after hurricanes and significant projects to restore the damaged facilities will be made. As of the date of issuance of the financial statements the Authority estimates that the property damages sustained by the hurricanes could range from $770 million to $4,500 million if resiliency projects are included. Part of these costs are expected to be covered by insurance funds and disaster –relief funds granted by FEMA. Presently, the Authority has received $300 million from insurance proceeds to cover for property damages and business interruption losses.

On May 15, 2017, the Puerto Rico Fiscal Agency, AAFAF and GDB entered into a Restructuring Support Agreement (the "RSA") with a significant portion of GDB's creditors. The parties to the RSA agreed to undertake a financial restructuring of GDB pursuant to a Qualifying Modification under Title VI of PROMESA (the "Qualifying Modification"). On August 9, 2018, GDB commenced the solicitation of votes on the Qualifying Modification and on August 10, 2018 commenced an action to obtain court approval of the Qualifying Modification. Following the conclusion of voting on September 12, 2018, GDB announced it received the necessary votes from holders of claims subject to the Qualifying Modification (the "Participating Bond Claims") to approve the Qualifying Modification, as required under PROMESA. On November 6, 2018, the Qualifying Modification was approved by the Federal Court. On November 29, 2019, the AAFAF and the GDB announced the consummation of the Qualifying Modification.

Under the Qualifying Modification, holders of certain bond and deposit claims exchanged their claims for bonds issued by a newly created public instrumentality—the GDB Debt Recovery Authority (the "Debt Recovery Authority")—and GDB transferred to such entity its municipal loan portfolio, a portion of its public entity loan portfolio, its real estate owned assets and its unencumbered cash. As a result of the Qualifying Modification, loans totaling approximately $57.7 million, after giving effect to Closing Date adjustments, owed by the Authority to GDB were transferred to the Debt Recovery Authority.

Going Concern – (continued)

In addition, pursuant to Act No. 109-2017, also known as the Government Development Bank for Puerto Rico Debt Restructuring Act (the "GDB Restructuring Act"), the balance of liabilities owed between the Commonwealth and its agents, instrumentalities and affiliates, including the Authority (each a "Non-Municipal Government Entity") and GDB were determined by applying the outstanding balance of any deposits held at GDB in a Non-Municipal Government Entity's name against the outstanding balance of any loan of such Non-Municipal Government Entity owed to GDB or of any bond or note of such Non-Municipal Government Entity held by GDB as of such date. As a result of this foregoing adjustment, all of the Authority's deposits, excluding deposits of federal funds, at GDB were extinguished as a result of the Qualifying Modification.

As a result, the Authority has recognized an impairment loss on deposits held with GDB of $9.8 million as of June 30, 2016.

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

As presented on the latest Fiscal Plan, certified by the Oversight Board on June 25, 2019, the Authority's management is in the process of evaluating and implementing 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 initiatives, and if the Authority is not able to obtain financing, 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.

Implementation of New Accounting Standard for Pensions and Other Postemployment Benefits

As disclosed in Note 13 and 14 to the basic financial statements, the Authority implemented the requirements of Statement No. 68 of the Governmental Accounting Standard Board, Accounting and Financial Reporting for Pensions, (GASB 68) and Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (GASB 75). Following the adoption of GASB 68 and GASB 75, the Authority has recorded its proportionate share of net pension obligation, deferred inflow of resources and deferred outflow of resources related to pension and other post-employment benefits costs, and the Authority has recognized the cumulative effect of prior period adjustments in net pension obligation, deferred outflows of resources and deferred inflows of resources.

Financial Highlights (using 2016 as previously reported)

- On fiscal year 2017, the Authority implemented the GASB Statements No. 68 "Accounting and Financial Reporting for Pensions" and No. 75 "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions" which caused the Authority to recognize a prior period adjustment of $1,221.5 million, being this the most significant fluctuation of the Authority's net position of $1,426.1 million or 69%. Also, decrease in net position is due to the net effect of increase in operating revenues by $53.3 million, operating expenses by $6.0 million (including depreciation and amortization), decrease in net non-operating expenses by $0.8 million, and decrease in capital contributions by $14.2 million.

- Operating revenues increased by $53.3 million to $1,032 million, or 5.2%. During fiscal year 2016, the Authority suffered the impact of a severe drought that affected Puerto Rico and the billings were reduced by the water rationing program the Authority was forced to implement. The average water service consumption increased by 4%, however, the number of clients served decreased during fiscal year 2017.

Financial Highlights (using 2016 as previously reported) – (continued)

- Operating expenses, including depreciation and amortization, increased by $6.0 million to $993.7 million, or 1%, primarily as a result of an increase in payroll and payroll related expenses of $83.3 million mainly to the implementation of GASBs 68 and 75, an increase in depreciation expense of $6.5 million, an increase in chemicals of $4.3 million, and an increase in professional and consulting services of $2.6 million, offset by a decrease in cost of assets disposition of $70 million, a decrease in electricity expense of $15.1 million, a decrease in other operating expense of $4.1 million, and a decrease in repairs and maintenance expense of $1.7 million, respectively.

- Non-operating expenses decreased by $0.8 million, or 0.3% to a net expense of $246.8 million. In fiscal year 2016, the Authority recognized an impairment loss on deposits held with governmental bank of $9.8 million. During fiscal year 2017, the Authority experienced an increase in interest expense net of amortization of bond premium and discount, and deferred refunding losses of $6.1 million, a decrease in interest income of $1 million, and a decrease in other income of $1.8 million.

- Capital contributions decreased by $14.2 million, or 78% to $4 million, primarily as a result of a decrease of $6.6 million in the USDA Rural Development contributions, a decrease of $3.3 million in contributions and grants received from the Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Fund, and a decrease of $4.5 million in developers' contributions.

- Total assets and deferred outflow of resources increased by $134.2 million to $8,006.6 million or 1.7% when compared to fiscal year 2016 as previously reported of $7,872.4 million, as result of the cumulative effect of the adoption of GASB 68 and GASB 75, reflecting an increase of $345.1 million in deferred outflow of resources, an increase in restricted cash of $75.2 million, a decrease in capital assets net of depreciation and amortization of $262.2 million, and a decrease in currents assets of $20 million.

- Total liabilities increased by $1,560.4 million to $7,378.2 million or 26.8%, which reflect an increase in pension liability of $1,525.7 million related to the implementation of GASB 68 and an increase of $33.9 million in compensated absences and postemployment benefits as a result of the early adoption of GASB 75. Accrued interest increased by $50.9 million, accounts payable decreased by $75.9 million, long term debt decreased by $51.8 million, accrued liabilities decreased by $15.2 million

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, 2017, 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 sheet and the statement of revenues, expenses, and changes in net position, report the net position of the Authority and the changes therein. The Authority's net position – the difference between assets and liabilities – can be used to measure its financial health or financial position. Increases or decreases in the Authority's net position are one indicator of whether its financial health is improving or deteriorating. However, other nonfinancial factors need to be considered such as changes in economic conditions and new or changed government regulations or accounting regulations.

Analysis of Financial Results

The following table provides a summary of the Authority's net position as of June 30, 2017 (in thousands):

	June 30, 2017	June 30, 2016 *As previously reported*[1]	Change
Current and other assets	**$ 639,324**	$ 584,117	$ 55,207
Capital assets, net	**6,998,570**	7,260,786	(262,216)
Deferred outflows of resources	**368,710**	27,452	341,258
Total assets and deferred outflows of resources	**8,006,604**	7,872,355	134,249
Long-term debt outstanding	**5,044,321**	5,096,138	(51,817)
Other liabilities	**2,295,968**	721,729	1,574,239
Deferred inflows of resources	**37,956**	-	37,956
Total liabilities and deferred inflows of resources	**7,378,245**	5,817,867	1,560,378
Net position:			
Investment in capital assets, net	**2,195,602**	2,442,040	(246,438)
Restricted	**79,606**	5,364	74,242
Unrestricted deficit	**(1,646,845)**	(392,916)	(1,253,929)
Total net position	**$ 628,363**	$ 2,054,488	$ (1,426,125)

Note:

[1] The net position of the Authority has been restated to correct prior period misstatements related to the adoption of GASB Statement No. 68 and 71, and due to the adoption of GASB Statement No. 75. See Note 21 for net position reconciliation. The amounts presented for 2016 are those previously reported in the 2016 audited financial statements and have not been adjusted to reflect these prior period misstatements.

Net Position

June 30, 2017

The Authority's net position for fiscal year ended June 30, 2017 was approximately $628.4 million. This is a decrease of $1,426.1 million from the net position as of June 30, 2016 of $2,054.5 million, as previously reported. The main reason for the significant decrease in the net position was the cumulative effect of a change in accounting for pension and other postemployment benefits cost recorded in the beginning net position due to the adoption of GASB 68 "Accounting and Financial Reporting for Pensions" and the early implementation of GASB 75 "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (OPEB)", resulting in a net position decrease of $1,187.6 million and $33.9 million, respectively. The adoption of GASB 68 became effective in fiscal year 2015, but had not been implemented because financial information of pensions was not available.

Total assets and deferred outflows increased by $134.2 million during the fiscal year ended June 30, 2017, also mainly as a result of the implementation of GASB 68 and GASB 75, which increased deferred outflows of resources.

Current and other assets increased by $55.2 million, driven by an increase of $75.2 million in restricted cash and cash equivalents, an increase of $2.4 million in accounts receivable, a decrease of $20.4 million in cash and cash equivalents, and a decrease of $2.4 million in accounts receivable from federal agencies.

Restricted cash, unrestricted cash, cash equivalents and other deposits as of June 30, 2017, increased by $54.9 million when compared with fiscal year ended June 30, 2016. The increase is primary due to the monthly deposits made by the Authority into an operational fund reserve account held by the Authority's trustee agent. Pursuant to the MAT, amended by the Sixth Supplemental Agreement of Trust, on July 2016 the Authority started depositing the monthly requirement into an operating reserve fund account in order to establish an operating reserve of three month of current expenses at the end of a sixty-month (60) period, which represented an increase of $36 million in restricted cash for fiscal year 2017. In addition, the Authority deposited $20 million in a construction fund account to finance its capital improvement program.

Capital assets decreased by $262.2 million, or 4% to $6,998.6 million due to net current year additions of $145.7 million offset by current year depreciation and amortization of $285.2 million and cost of assets disposition of $15.2 million. For the fiscal year 2017, the Authority did not recognize any impairment of capital assets.

Deferred outflow of resources increased by $341.3 million as a result of the implementation of GASB 68 by $338.9 million and GASB 75 by $6.8 million, net from a decrease of $4.4 million for the amortization of losses resulting from debt refunding.

Total liabilities increased by $1,560.4 million to $7,378.2 million, or 26.8% when compared with fiscal year 2016 total liabilities of $5,817.9 million, as previously presented. Total current liabilities increased by $55 million, driven by an increase of $53 million in pension liability, an increase of $50.9 million in the accrued interest, and an increase of $45.7 million in the current portion of long-term debt, net of a decrease of $75.9 million in accounts payable as part of the initiative to reduce CIP contractors' obligations due, and a decrease of $46.4 million in accrued liabilities.

Total non-current liabilities increased by $1,467.5 million, mainly due to the implementation of GASB 68, increasing pension liability by $1,525.7 million and GASB 75, increasing postemployment benefits liability by $ 37.5 million. The decrease of $67.3 million of the noncurrent portion on bond payables is related to the payments of principal of outstanding bonds, and a decrease of $30.3 million in the noncurrent portion of the note payables reclassified to current liabilities.

Capital Assets

Capital assets as of June 30, 2017 and 2016 were as follows (in thousands):

	June 30,		
	2017	**2016** *As previously reported*	**Change**
Capital assets being depreciated	$ **10,935,871**	$ 10,848,712	$ 87,159
Accumulated depreciation and amortization	**(4,345,624)**	(4,072,111)	(273,513)
	6,590,247	6,776,601	(186,354)
Land and other nondepreciable assets	**74,913**	74,831	82
Construction in progress	**333,410**	409,354	(75,944)
Capital assets, net	$ **6,998,570**	$ 7,260,786	$ (262,216)

June 30, 2017 and 2016

The net decrease of $262.2 million in capital assets includes net additions of $37.4 million, reduced by $285.2 million in depreciation and amortization, and $15.2 million in cost of assets disposition. The $47.0 million additions in capital investment are broken down as follows:

- $18.9 million in the Authority's capital improvement program;
- $28.1 million in renewal and replacement projects;

The Authority has $333.4 million in construction in progress as of June 30, 2017. Currently, the capital improvements program is on stoppage and some projects were prioritized in order to comply with regulatory agencies and other projects were rescheduled for the following years.

Debt Administration

Long-term debt for the years ended June 30, 2017 and 2016 was as follows (in thousands):

	June 30,		
	2017	**2016** *As previously reported*	**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	**25,240**	40,180	(14,940)
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**	386,380	-
2012 Series A Term Bonds	**1,381,995**	1,381,995	-
2012 Series B Serial Bonds	**123,430**	157,095	(33,665)
2012 Series B Term Bonds	**107,115**	107,115	-
Rural Development Serial Bonds	**392,646**	394,211	(1,565)
Plus premium on bonds refunding	**25,196**	25,765	(569)
Less: bond discounts	**(15,647)**	(15,847)	200
Total bonds	$ **4,395,884**	$ 4,446,423	$ (50,539)

(Continued)

Debt Administration - (continued)

	June 30, 2017	June 30, 2016 *As previously reported*	Change
Bonds payable	**$ 4,395,884**	$ 4,446,423	$ (50,539)
Notes payable:			
Water Pollution Control and Drinking Water Treatment Revolving Funds Loans	**581,276**	580,012	1,264
Notes with commercial banks	**1,611**	4,153	(2,542)
Notes with GDB	**65,550**	65,550	-
Total notes payable	**648,437**	649,715	(1,278)
Lines of credit	**-**	-	-
Long-term debt outstanding	**5,044,321**	5,096,138	(51,817)
Other long term liabilities:			
Accrued compensated absences	**43,300**	43,434	(134)
Net OPEB obligation	**74,549**	40,535	34,014
Customer deposits	**88,372**	86,393	1,979
Total other liabilities	**206,221**	170,362	35,859
Total – long-term obligations	**5,250,542**	5,266,500	(15,958)
Current portion	**230,233**	134,965	95,268
Long-term obligations, less current portion	**$ 5,020,309**	$ 5,131,535	$ (111,226)

The Authority's long-term debt decreased by $51.8 million, or 1% from $5,096.1 million as of June 30, 2016, to $5,044.3 million as of June 30, 2017.

Bonds Payable

Bonds outstanding as of June 30, 2017 decreased by $50.5 million, mainly from the payments of principal on 2012 Series B of $33.7 million and on 2008 Series A Revenue Bonds of $14.9 million and the payment of $1.7 million in principal on Rural Development Bonds, under the terms of the extensions of the USDA Forbearance Agreement. USDA Rural Development Program approved to amend and further extend in various occasions the USDA Forbearance Agreement until July 31, 2019. As part of the forbearance agreement requirements, the Authority made subsequent payments after June 30, 2017 for a total of $22 million. During fiscal year 2017, the Authority did not issue additional bond debt.

On July 26, 2019, the Authority and AAFAF consummated a definitive agreement restructuring the Authority's debt obligations under RD Bonds totaling $403 million, including accrued interest as of that date.

Debt Administration - (continued)

June 30, 2017

Bonds Payable – (continued)

The agreement consolidating and restructuring all RD Bonds into one loan with a 40-year maturity and 2% interest rate, with a $10 million annual debt service requirement from years 1 to 10 and $17 million annual debt service thereafter. The restructured RD loan was designated as Other System Indebtedness in parity with other senior debt under PRASA's Master Agreement of Trust.

Notes Payable

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 Subordinated Indebtedness, Other System Indebtedness and a Refundable Principal Installment pursuant to the terms of the Master Trust Agreement. As of June 30, 2017, the outstanding balance of the Fleet Term Loan was $1.6 million. The Authority subsequently paid the Fleet Term Loan in full.

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 bore interest at 2%. As of June 30, 2017, the Authority's loans outstanding under these programs amounted to approximately $581.3 million, which were considered Commonwealth Guaranteed Indebtedness under the Master Agreement of Trust.

On June 30, 2016, the Authority executed the SRF Forbearance Agreement DOH, EQB and PRIFA. Under the SRF Forbearance Agreement, as further amended in several occasions, the payments due through July 1, 2019, inclusive, 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 subject to certain conditions and partial payments.

The SRF Forbearance Agreement as further extended until July 31, 2019 required payments during the extension periods, for a total of $12.1 million which have been timely paid by the Authority.

On July 26, 2019, the Authority and AAFAF consummated definitive agreements restructuring the Authority's debt obligations under the SRF loans including the outstanding $570 million loans plus $26 million of funds for ongoing projects.

The Agreements were approved by the Financial Oversight and Management Board for Puerto Rico (the "Oversight Board") pursuant to Section 207 of PROMESA and consolidated all the restructured debt into two SRF loans with a 30-year maturity term at 0% interest rate and $10 million annual principal-only payment from years 1 to 10 and 1% interest rate and $27 million annual debt service thereafter.

The restructured SRF loans were designated as Other System Indebtedness in parity with other senior debt under the Authority's Master Agreement of Trust.

Debt Administration - (continued)

June 30, 2017 – *(*continued)

Notes Payable – (continued)

On February 29, 2012, the Authority entered into a line of credit agreement with GDB. This agreement provides an available maximum amount of $150 million for the purpose of assisting with the Authority's cash flows needs during the transition period after amending and restating the Master Agreement of Trust as a result of the issuance of 2012 Revenue Bonds Series A and B. On June 27, 2014, the Authority and GDB executed an Amended and Restated Loan Agreement (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 of 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, 2017, the term loan outstanding balance was $65.6 million. On November 2018, after the liquidation of GDB the loan was transferred to the GDB Debt Recovery Authority for the balance, offset against deposits of the Authority at GDB not provided by the federal program.

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, 2017 and June 30, 2016 (in thousands):

	June 30, 2017	June 30, 2016 *As previously reported*	Change
Operating revenue:			
Revenues from water and sewer services, net	$ 1,032,003	$ 978,718	$ 53,285
Operating expenses:			
Payroll and payroll related expenses	352,889	269,589	83,300
Service contract – Superaqueduct	3,852	3,667	185
Professional and consulting services	31,715	29,158	2,557
Chemicals	32,023	27,766	4,257
Materials and replacements	18,565	18,328	237
Repairs and maintenance of capital assets	34,433	36,116	(1,683)
Electricity	126,650	141,743	(15,093)
Insurance	7,890	7,985	(95)
Other operating expenses	85,334	89,470	(4,136)
Operating expenses (excluding depreciation and amortization)	693,351	623,822	69,529
Depreciation and amortization	285,228	278,702	6,526
Cost of assets disposed of	15,218	85,238	(70,020)
Total operating expenses	993,797	987,762	6,035
Operating (loss) income	38,206	(9,044)	47,250
Nonoperating expenses, net	(246,802)	(247,629)	827
Loss before capital contributions	(208,596)	(256,673)	48,077
Capital contributions	4,016	18,257	(14,241)
Change in net position	(204,580)	(238,416)	33,836
Net position at beginning of year	2,054,488	2,292,904	(238,416)
Cumulative effect of a change in accounting principle for pension and OPEB cost	(1,221,545)	-	(1,221,545)
Net position at beginning of year (as restated). See Note 21	832,943	2,292,904	(1,459,961)
Net position at end of year	$ 628,363	$ 2,054,488	$ (1,426,125)

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

June 30, 2017

Net position decreased by $1,426.2 million or 69.4%, from $2,054.5 million in 2016 *(as previously reported)* to $628.3 million in 2017, driven by the results of current year operations and the implementation of GASB 68 and GASB 75.

Major fluctuations that resulted in a decrease in net position of $1,426.1 million when compared to 2016 operational results *(as previously reported)* are broken down as follows (in thousands):

Increase in operating revenues	$	53,285
Increase in operating expenses		(6,035)
Decrease in nonoperating expenses, net		827
Decrease in capital contributions		(14,241)
2016 change in net position *as restated*		(1,459,961)
Net change	$	(1,426,125)

Operating revenues increased by $53.3 million or 5.4% for fiscal year ended June 30, 2017 when compared to fiscal year ended June 30, 2016. The change is due to the increase on government's clients billing, which were adjusted after the expiration of Act 66-2014 disposition granting them a "preferential" rate and the fact that the Authority did not have the impact of the drought that affected Puerto Rico during fiscal year 2016.

Operating expenses increased by $6 million or 6.1% primarily due to the net effect of the following:

- Increase of $83.3 million in payroll and payroll-related expenses.
- Increase of $6.5 million in depreciation and amortization expense.
- Increase of $4.3 million in chemicals expense.
- Increase of $2.6 million in professional and consulting expenses.
- Decrease of $70 million in cost of assets disposition.
- Decrease of $15.1 million in electricity expense.
- Decrease of $4.1 million in other operating expense.
- Decrease of $1.7 million in repairs and maintenance of capital assets expenses.

Non-operating expenses decreased by $0.8 million or 0.3% when compared to fiscal year 2016. This was mainly due to the Authority impairment loss on deposits held in GBD recognized during fiscal year 2016, netted by an increase of interest expense, the amortization of bond premium and discount, and deferred refunding losses by $6.1 million.

Capital contributions decreased by $14.2 million or 78%, primarily as a result a decrease of $6.6 million in the USDA Rural Development contributions, a decrease of $4.5 million in contributions and grants received from the Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Fund, and a decrease in other contributions of $4.2 million.

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

***June 30, 2017 and 2016** - (continued)*

Next Year's Budget and Credits Ratings

In June 2018, the Authority's Government Board adopted a balanced operational budget for fiscal year 2019. In addition, the approved operational budget included the amount of $181.4 million for the Authority's Capital Improvement Program. The budget included a line for creditor's relief of $221.5 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 "Ca" by Moody's Investor Services, and "C" by Fitch Ratings. On August 2018, Standard and Poor's withdrew its credit ratings on the Authority.

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 Sheet
June 30, 2017

(In thousands)

Assets	
Current assets:	
Cash and cash equivalents	$ 85,718
Accounts receivable, net	199,875
Receivables from federal agencies	279
Materials and supplies inventory, net	27,842
Prepayments and other current assets	4,652
Total current assets	318,366
Restricted assets--	
Restricted cash, cash equivalents and other deposits	320,958
Capital assets:	
Capital assets being depreciated	10,935,871
Accumulated depreciation and amortization	(4,345,624)
	6,590,247
Land and other nondepreciable assets	74,913
Construction in progress	333,410
Total capital assets, net	6,998,570
Deferred outflows of resources:	
Deferred loss resulting from debt refunding	23,027
Deferred outflows of resources of GASB 68	338,868
Deferred outflows of resources of GASB 75	6,815
Total deferred outflows of resources	368,710
Total assets and deferred outflows of resources	$ 8,006,604

The accompanying notes are an integral part of this balance sheet.

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

Balance Sheet
June 30, 2017

(In thousands)

Liabilities and Net Position		
Current liabilities:		
Bonds payable	$	88,630
Notes payable		66,019
Pension liability		52,970
Accounts payable		180,287
Accrued liabilities		127,258
Accrued interest		186,151
Unearned revenue		20,123
Customers' deposits		7,820
Compensated absences and postemployment benefits		14,793
Total current liabilities		744,051
Noncurrent liabilities:		
Bonds payable		4,307,254
Notes payable		582,417
Pension liability		1,522,956
Customers' deposits		80,551
Compensated absences and postemployment benefits		103,056
Total noncurrent liabilities		6,596,234
Deferred inflows of resources:		
Deferred inflows of resources GASB 68		30,162
Deferred inflows of resources GASB 75		7,794
Total deferred inflows of resources		37,956
Total liabilities and deferred inflows of resources		7,378,241
Net position:		
Net investment in capital assets		2,195,602
Restricted for environmental compliance, capital activity and other		79,606
Unrestricted deficit		(1,646,845)
Total net position		628,363
Total liabilities and net position	$	8,006,604

The accompanying notes are an integral part of this balance sheet.

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

Statement of Revenues, Expenses and Changes in Net Position
Year Ended June 30, 2017

(In thousands)		
Operating revenues:		
Water	$	705,448
Sewer		359,923
Bad debt expense		(33,368)
Total net operating revenues		1,032,003
Operating expenses:		
Payroll and payroll related		352,889
Electricity		126,650
Repairs and maintenance of capital assets		34,433
Professional and consulting services		31,715
Chemicals		32,023
Materials and replacements		18,565
Insurance		7,890
Service contract – Superaqueduct		3,852
Other operating expenses		85,334
Operating expenses (excluding depreciation and amortization):		693,351
Depreciation and amortization		285,228
Cost of assets disposition		15,218
Total operating expenses		993,797
Operating income		38,206
Non-operating revenues (expenses):		
Interest expense, net of amortization of bond premium and discount, and deferred refunding loss		(253,792)
Interest income		2,329
Other income, net		4,661
Total non-operating expenses, net		(246,802)
Loss before capital contributions		(208,596)
Capital contributions:		
Federal grants and other contributions		3,894
Other Commonwealth contributions		122
Total capital contributions		4,016
Change in net position		(204,580)
Net position at beginning of year, ***as restated***		832,943
Net position at end of year	$	628,363

The accompanying notes are an integral part of this statement.

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

Statement of Cash Flows
Year Ended June 30, 2017

(In thousands)	
Cash flows from operating activities:	
Cash received from customers	$ 1,028,662
Cash paid to suppliers	(426,967)
Cash paid to employees	(280,826)
Net cash provided by operating activities	320,869
Cash flows from noncapital financing activities--	
Net cash from other income	4,661
Cash flows from capital and related financing activities:	
Additions to utility plant and other capital assets	(29,571)
Proceeds from capital contributions	6,873
Proceeds from issuance of notes payable	1,517
Payments of bonds and notes	(52,966)
Interest paid on bonds, notes and lines of credit	(198,834)
Net cash used in capital and related financing activities	(272,981)
Cash flows from investing activities--	
Interest received on investments	2,329
Net change in cash and cash equivalents	54,878
Cash and cash equivalents, beginning of year	351,798
Cash and cash equivalents, end of year	$ 406,676
For purposes of the statement of cash flows, cash and cash equivalents include:	
Unrestricted	$ 85,718
Restricted	320,958
	$ 406,676

The accompanying notes are an integral part of this statement.

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

Statement of Cash Flows
Year Ended June 30, 2017

(In thousands)

Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$	38,206
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization		285,228
Cost of assets disposition		15,219
Bad debt expense		33,368
Change in assets and liabilities:		
Accounts receivable		(38,612)
Receivables from federal agencies		2,406
Materials and supplies inventory		(42)
Prepayments and other current assets		(306)
Accounts payable		(84,571)
Unearned revenue		(76)
Accrued compensated absences and post employment benefits		917
Accrued liabilities		(2,615)
Customers' deposits		1,979
Pension liability		69,768
Total adjustments		282,663
Net cash provided by operating activities	$	320,869

The accompanying notes are an integral part of this statement.

(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 "System"). 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, 2017 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 was created to engage 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 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.

During fiscal year ended June 30, 2017 PRASA Holdings, LLC did not have operational activities. However, it has total assets and net position of $0.6 million as of June 30, 2017.

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 Governmental Account Standards Board ("GASB") pronouncements under the hierarchy established by GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments,* in the preparation of its financial statements. 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.

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

Measurement Focus and Basis of Accounting

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

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

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 statement of cash flows.

The Authority maintains some construction fund accounts related to past bond issuances invested. As of June 30, 2017, the account balances amounted to approximately $0.9 million. 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 90 days, including, but not limited to, obligations of the U.S. Government, the Puerto Rico Government, their respective agencies and instrumentalities, repurchase agreements with respect to obligations of the U.S. Government, certificates of deposit, time deposits, bank notes and banker's acceptances issued by the U.S. or Puerto Rico regulated banks, commercial paper and corporate obligations. The Authority can invest, reinvest or redeem units acquired at any time without charge or penalty.

The Trust Fund values its investments on the basis of amortized cost. Although the Trust Fund's policies are designed to help maintain a stable net asset value per unit of $1.0, all money market instruments can change in value when interest rates or issuers' creditworthiness change, or if an issuer or guarantor of a security fails to pay interest or principal when due. As of June 30, 2017, 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.

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

Receivables

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

Materials and Supplies Inventory

Materials and supplies inventory are stated at average cost, not to exceed market. Inventory is presented net of a reserve for obsolescence for approximately $1.5 million as of June 30, 2017.

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 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 sheet.

Capital Assets

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

Utility plant and other capital assets are carried at historical cost or estimated historical cost, which includes capitalized labor, materials, administrative costs, and interest on debt financed construction. Due to the lack of access to the market and the inability to issue debt to finance the Capital Improvements Programs (CIP), the Authority's management decided to stop its construction in progress, as a result the Authority did not recognize capitalized interest for the year ended June 30, 2017.

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.

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

Capital Assets – (continued)

Depreciation and amortization expense are 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 no impairment was identified during the year ended June 30, 2017.

Unearned Revenue

Unearned revenue arises from water and sewer services paid in advance by government, residential, commercial or industrial.

Deferred Outflows and Inflows of Resources

In addition to assets, the Balance Sheet reports a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources,* represents an increase in net position (a consumption of assets) applicable to a future period(s) and so will *not* be recognized as an outflow of resources (expense) until then. Similarly, the Authority reports deferred inflows of resources in the Balance Sheet in a separate section following liabilities. This separate financial statement element, *deferred inflows of resources,* represents a reduction of net position and resources (an acquisition of assets) applicable to a future period(s) and so will *not* be recognized as an inflow of resources (revenue) until that time. Deferred outflows and inflows of resources mainly affect the unrestricted (deficit) net position.

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

Deferred Outflows and Inflows of Resources– (continued)

The Authority has the following deferred outflow/inflow of resources:

Deferred outflows

- Difference between expected and actual experience, changes in assumptions and employer's contribution to the pension plan subsequent to the measurement date of the net pension liability. See Note 13.
- Unamortized deferred loss from debt refunding. See Note 11.
- Difference between actual and expected experience related to other post employment benefits obligation. See Note 14.

Deferred inflows

- Changes in assumptions about future economic and demographic factors related to other post employment benefits obligation. See Note 14.
- Difference between actual and expected experience. See Note 13.
- Difference between projected and actual investment earnings on pension plan investments. See Note 13.

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 per month per retired employee for medical plan coverage. For fiscal year 2017, the Authority adopted GASB statement No. 75 "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions" to account for its postretirement healthcare benefits, resulting in the recognition of a cumulative effect due to the change in accounting principle of $30.1 million. See Note 14.

The total cost of healthcare benefits paid to retired employees amounted to approximately $2.9 million for fiscal year 2017.

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

Pension Benefits

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. Effective on fiscal year ended June 30, 2017, the Authority adopted GASB Statement No. 68, *"Accounting and Financial Reporting for Pensions- an amendment of GASB Statement No. 27", as* detailed in Note 13.

GASB No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, was issued in 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. Effective July 1, 2017, it was implemented a pay as you go mechanism for the ERS, therefore, the Authority will follow GASB 73. GASB No. 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".

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 result when constraints on the use of net assets are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation. At June 30, 2017 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 considers 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 several estimates and assumptions relating to the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

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

Effects of New Pronouncements

The following GASB statements were adopted for fiscal year 2017:

GASB Statement No. 68 "Accounting and Financial Reporting for Pensions" – an amendment of GASB Statement No. 27 – This statement was issued to improve accounting and financial reporting by state and local governments for pensions. This statement replaces requirements of GASB Statement No. 27. GASB Statement No. 68 and GASB Statement No. 67 (applicable for Pensions Plans) establish a definition of a pension plan that reflects the primary activities associated with the pension arrangement, determining pensions, accumulating and managing assets dedicated for pensions and paying benefits to plan members as they become due. This Statement was effective for the fiscal year ended June 30, 2015 but it was not until fiscal year ended June 30, 2017 that the financial information needed to adopt this statement was available, and was implemented by the Authority. See Note 13.

GASB Statement No. 71, Pension Transition for Contributions Made Subsequently to the Measurement Date – an amendment of GASB Statement No.68 – The objective of this statement is to address an issue regarding application of the transition provision of GASB Statement No. 68. The issue relates to amounts associated with contributions, if any, made by state of local government employer or non-employer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The statement requires that, at transition, a government recognizes a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. This statement became effective for fiscal year ended June 30, 2015, but it was not until fiscal year ended June 30, 2017 that was implemented by the Authority.

GASB Statement No. 73 establishes requirements for defined benefit pension plans and defined contribution plans that are not within the scope of GASB Statement No. 68, Accounting and Financial Reporting for Pensions (GASB Statement No. 68). This Statement extends the approach to accounting and financial reporting established in GASB Statement No. 68 to all pensions to reflect that for accounting and financial reporting purposes, any assets accumulated for pensions that are provided through pension plans that are not administered through trusts that meet the criteria specified in GASB Statement No. 68, should not be considered pension plan assets. It also requires that information similar to that required by GASB Statement No. 68 be included in the notes to financial statements and required supplementary information by all similarly situated employers and non-employer contributing entities. This statement will be adopted during fiscal year 2018 due to the implementation of the pay-as-you-go mechanism in the ERS.

GASB Statement No. 75 "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions"- This statement replaces the requirements of Statements No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, as amended, and No. 57, OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans, for OPEB. Statement No. 74, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, establishes new accounting and financial reporting requirements for OPEB plans. The objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions. This Statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense. The statement is effective for fiscal years beginning after June 15, 2017, but the Authority decided to early adopt this statement in fiscal year ended June 30, 2017. For more details refer to Note 14.

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

Effects of New Pronouncements – (continued)

GASB Statement No. 77 establishes financial reporting standards for tax abatement agreements entered into by state and local governments. The disclosures required by this Statement encompass tax abatements resulting from both (a) agreements that are entered into by the reporting government and (b) agreements that are entered into by other governments and that reduce the reporting government's tax revenues. The provisions of this Statement should be applied to all state and local governments subject to such tax abatement agreements. For financial reporting purposes, a tax abatement is defined as a reduction in tax revenues that results from an agreement between one or more governments and an individual or entity in which (a) one or more governments promise to forgo tax revenues to which they are otherwise entitled and (b) the individual or entity promises to take a specific action after the agreement has been entered into that contributes to economic development or otherwise benefits the governments or the citizens of those governments. A transaction's substance, not its form or title, is a key factor in determining whether the transaction meets the definition of a tax abatement for the purpose of this Statement. The adoption of this statement had no impact on the Authority's financial statements.

GASB Statement No. 80 amends the blending requirements for the financial statements presentation of component units of all state and local governments by providing an additional criterion. A component unit should be included in the reporting entity financial statements using the blending method, if the component unit is organized as a not-for-profit corporation, in which the primary government is the sole corporate member as identified in the component unit's articles of incorporation or bylaws. The adoption of this statement had no material impact on the Authority's financial statements.

Future Adoption of Accounting Standards

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

GASB Statement No.	Name	Adoption required in fiscal year
81	Irrevocable Split-Interest Agreements	2018
82	Pension Issues – an Amendment of GASB Statements No. 67, No. 68 and No. 73	2019
83	Certain Assets Retirement Obligations	2019
84	Fiduciary Activities	2020
85	Omnibus 2017	2018
86	Certain Debt Extinguishment Issues	2019
87	Leases	2021
88	Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements	2019
89	Accounting for Interest Cost Incurred Before a Construction Period	2021

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

Future Adoption of Accounting Standards – (continued)

GASB Statement No.	Name	Adoption required in fiscal year
90	Majority Equity Interests – an amendment of GASB Statements No. 14 and No. 61	2020
91	Conduit Debt Obligations	2021

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

Commonwealth Appropriations

The Authority receives appropriations from the Commonwealth. Appropriations are classified as operating revenue, non-operating revenue or 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. During fiscal year 2017, Authority did not receive Commonwealth Appropriations.

(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. Although subsequent to June 30, 2017, several measures have been taken to improve its liquidity, 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 2017 certain contractor obligations related to its Capital Improvement Program. The Authority's ability to obtain long term financing for its Capital Improvement Plan is uncertain. In addition, on September 30, 2016, the Authority was designated by the Oversight Board pursuant to section 101 of PROMESA as a covered territorial instrumentality, meaning it is subject to the requirements of PROMESA. 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 entering any new financing or debt restructuring process.

(2) Going Concern – (continued)

The risks and uncertainties facing the Authority together with other factors further described below, have led 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, exacerbated by the impact of Hurricanes Irma and María during September 2017. Net position for the year ended June 30, 2017 decreased by $204 million, mainly as a result of the adoption of the provisions under GASB Statement No. 75, *Accounting and Financial Reporting for Postretirement Benefits Other than Pensions*, as of July 1,2016. In addition, the Authority working capital deficiency as of June 30, 2017 amounted to $426 million. However, the Authority's restricted cash includes a portion for the payment of current debt of approximately $232.8 million. In addition, the Authority has not made the quarterly interest and principal payments of the term note payable with the GDB since December 2015.

Historically, the Authority's Capital Improvement Program ("CIP") has been funded with external financing. As a result of the economic crisis facing the Commonwealth of Puerto Rico and several of its components units, including the Authority, lack of market access resulted in the suspension of its capital improvement program. The Authority had managed its liquidity to be able to pay certain outstanding contractor obligations. As of June 30, 2017, unpaid CIP contractor obligations were approximately $95 million, including interest and penalties, which has been completely paid as of the date of the issuance of these financial statements.

On June 30, 2016 the Authority, with the acknowledgment and support of the United States Environmental Protection Agency ("EPA"), executed Forbearance Agreements (the "EPA Forbearance Agreements") with the Puerto Rico Department of Health (DOH), administrator of the Drinking Water State Revolving Fund Programs ("DW-SRF") and with the Commonwealth's Environmental Quality Board ("EQB"), administrator of the Clean Water State Revolving Fund Programs ("CW-SRF" and collectively with the DW-SRF, the "SRFs"), both also agreed by the Puerto Rico Infrastructure Financing Authority ("PRIFA"), a public corporation and instrumentality of the Commonwealth, as operating agent for the for the SRFs, authorized to assist the DOH and the EQB in the administration, financial and accounting activities of the SRFs. Under the Forbearance Agreements and its extensions thereof, the payments due on July 1, 2016, January 1, 2017, July 1, 2017, January 1, 2018, July 1, 2018, January 1, 2019 and July 1, 2019 under the SRF Loans were deferred, subject to certain conditions and partial payments. The Forbearance Agreements were amended and extended in multiple occasions until July 31, 2019.

The Authority also requested that the United Stated Department of Agriculture ("USDA") Rural Development Program provides a short-term forbearance period, which included deferral of the payments due on July 1, 2016, January 1, 2017, July 1, 2017, January 1, 2018, July 1, 2018, January 1, 2019 and July 1, 2019 during which they would refrain from exercising its rights and remedies under the Rural Development ("RD Bond") documents or grants or loan agreements related to the Authority's USDA Rural Development, Rural Utilities Service program bonds (the "RD Bonds"), subject to certain conditions and partial payments. To this effect, the Authority and USDA Rural Development Program executed a forbearance document as of June 30, 2016. Subsequently, the forbearance period was further extended in several occasions until July 31, 2019.

On July 26, 2019, the Authority and the Puerto Rico Fiscal Agency and Financial Advisory Authority ("AAFAF", by its Spanish acronym) consummated definitive agreements (the "Agreements") restructuring the Authority's debt obligations under SRF loans and RD Bonds totaling almost $1 billion (the SRF loans and RD Bonds are collectively referred to as the "Federal Debt").

(2) Going Concern – (continued)

The Agreements were approved by the Financial Oversight and Management Board for Puerto Rico (the "Oversight Board") pursuant to Section 207 of PROMESA. The Agreements include the termination of existing Commonwealth guarantees of the Federal Debt, thus reducing overall Government contingent liabilities by approximately $1 billion and the consolidation of all the restructured debt into two SRF loans and one RD loan to replace the existing SRF loans and RD Bonds with extended maturities and lower interest rates as follows:

- RD loans: 40-year term at 2% interest rate, with $10 million annual debt service from years 1 to 10 and $17 million annual debt service thereafter
- SRF loans: 30-year term at 0% interest rate and $10 million annual principal-only payments from years 1 to 10 and 1% interest rate and $27 million annual debt service thereafter.

The restructured Federal Debt was designated as Other System Indebtedness in parity with other senior debt under PRASA's Master Agreement of Trust.

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.

On June 30, 2016, the President of the United States enacted 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 an oversight board, relief from creditor lawsuits through the enactment of a temporary stay on litigation, and alternative methods to adjust unsustainable debt. To ensure fiscal and economic discipline, PROMESA created a federally appointed 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.

On September 30, 2016, the Authority was designated by the Oversight Board pursuant to section 101 of PROMESA as a covered territorial instrumentality, meaning it is 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 entering any new financing or debt restructuring process.

As a result of the fiscal difficulties faced by the Commonwealth, on May 3, 2017 the Financial Oversight and Management Board for Puerto Rico (Oversight Board), at the request of the Governor, commenced a Title III case for the Commonwealth by filing a petition for relief under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) in the United States District Court for the District of Puerto Rico.

(2) Going Concern – (continued)

On September 6, 2017 and September 20, 2017, Hurricanes Irma and María, respectively, hit Puerto Rico resulting in island-wide catastrophic damages to Puerto Rico's infrastructure, homes and business. As a result of the impact of these Hurricanes, most of the island's population was left without electrical power and there was significant disruption to the water distribution system among other basic utility and infrastructure services. These factors caused significant disruption to the island's economic activity. The entire island will need and is in the process of an immense infrastructure rebuilding program.

The President of the United States of America issued a state of emergency declaration for Puerto Rico, as a U.S. territory. The order mandates federal assistance through the Department of Homeland Security and the Federal Emergency Management Agency (FEMA) be made available to assist in local and territorial recovery efforts.

The Authority suffered damages to water treatment facilities and structures across the island which may result in a material adverse change in the financial condition of the Authority and the Commonwealth. Significant emergency work was made after hurricanes and significant projects to restore the damaged facilities will be made. As of the date of issuance of the financial statements the Authority estimates that the property damages sustained by the hurricanes could range from $770 million to $4,500 million if resiliency projects are included. Part of these costs are expected to be covered by insurance funds and disaster –relief funds granted by FEMA. Presently, the Authority has received $300 million from insurance proceeds to cover for property damages and business interruption losses.

On May 15, 2017, the Puerto Rico Fiscal Agency and Financial Advisory Authority (AAFAF) and GDB entered into a Restructuring Support Agreement (the "RSA") with a significant portion of GDB's creditors. The parties to the RSA agreed to undertake a financial restructuring of GDB pursuant to a Qualifying Modification under Title VI of PROMESA (the "Qualifying Modification"). On August 9, 2018, GDB commenced the solicitation of votes on the Qualifying Modification and on August 10, 2018 commenced an action to obtain court approval of the Qualifying Modification. Following the conclusion of voting on September 12, 2018, GDB announced it received the necessary votes from holders of claims subject to the Qualifying Modification (the "Participating Bond Claims") to approve the Qualifying Modification, as required under PROMESA. On November 6, 2018, the Qualifying Modification was approved by the Federal Court. On November 29, 2019, the AAFAF and the GDB announced the consummation of the Qualifying Modification.

Under the Qualifying Modification, holders of certain bond and deposit claims exchanged their claims for bonds issued by a newly created public instrumentality—the GDB Debt Recovery Authority (the "Debt Recovery Authority")—and GDB transferred to such entity its municipal loan portfolio, a portion of its public entity loan portfolio, its real estate owned assets and its unencumbered cash. As a result of the Qualifying Modification, loans totaling approximately $57.7 million, after giving effect to Closing Date adjustments, owed by the Authority to GDB were transferred to the Debt Recovery Authority.

In addition, pursuant to Act No. 109-2017, also known as the Government Development Bank for Puerto Rico Debt Restructuring Act (the "GDB Restructuring Act"), the balance of liabilities owed between the Commonwealth and its agents, instrumentalities and affiliates, including the Authority (each a "Non-Municipal Government Entity") and GDB were determined by applying the outstanding balance of any deposits held at GDB in a Non-Municipal Government Entity's name against the outstanding balance of any loan of such Non-Municipal Government Entity owed to GDB or of any bond or note of such Non-Municipal Government Entity held by GDB as of such date. As a result of this foregoing adjustment, all of the Authority's deposits, excluding deposits of federal funds, at GDB were extinguished as a result of the Qualifying Modification.

(2) Going Concern – (continued)

As a result, the Authority has recognized an impairment loss on deposits held with GDB of $9.8 million as of June 30, 2016.

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

As presented on the latest Fiscal Plan, as certified by the Oversight Board on June 25, 2019, the Authority's management is in the process of evaluating and implementing 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 initiatives, and if the Authority is not able to obtain financing, 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

As of June 30, 2017, the carrying amount of deposits with financial institutions of the Authority consisted of the following (in thousands):

	Carrying Amount	Impairment Loss	Net Carrying Amount	Bank Balance
Unrestricted deposits in commercial banks in Puerto Rico	$ 85,718	$ –	$ 85,718	$ 84,948
Restricted deposits in commercial banks in Puerto Rico	316,322	–	316,322	316,322
Restricted deposits in GDB	14,431	(9,795)	4,636	14,431
Total	$ 416,471	$ (9,795)	$ 406,676	$ 415,701

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.

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 are exempt from the collateral requirements established by the Commonwealth and thus represent a custodial credit risk in the event of GDB's failure, the Authority may not be able to recover these deposits. GDB is a component unit of the Commonwealth.

(3) Deposits – (continued)

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

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

		Amount
Uninsured and uncollateralized:		
GDB	$	14,431
Less: Impairment loss		(9,795) [1]
Total	$	4,636

Note:

1 The impairment loss was recognized in fiscal year 2016.

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 resulted in restrictions on the ability of the Authority to withdraw the funds held on deposit at GDB, which had 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 GDB believed there was 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 would not be able to honor them.

As a result, the Authority recognized an impairment loss on deposits held with GDB of $9.8 million during the year ended June 30, 2016. No impairment loss on deposits held with governmental banks was recognized during the year ended June 30, 2017. 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. The Authority requested the restoration of USDA Rural Development Program funds that were previously deposited at GDB. The Authority expects such funds will be restored by the Commonwealth during fiscal year 2020.

(4) Accounts Receivable

Accounts receivable are primarily for water and sewer services provided to residential, industrial, commercial and government customers, and as of June 30, 2017 consisted of the following (in thousands):

	Amount
Water and sewer services:	
Residential, industrial, and commercial	$ 675,221
Government agencies and municipalities	125,531
	800,752
Other receivables:	
Government agencies and municipalities	3,410
Private entities	32,396
	35,806
	836,558
Less: allowance for uncollectible accounts	(636,683)
Total	$ 199,875

(5) Other Receivables

Receivables from Federal Agencies

Receivables from federal agencies of approximately $0.3 million as of June 30, 2017, 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, 2017, and consisted of prepaid interest by the Authority on the PFC 2011 Series B Bonds to be reimbursed by the Commonwealth. The receivables from Commonwealth are fully reserved.

(6) Materials and Supplies Inventory

Material and supplies inventory was approximately $27.8 million as of June 30, 2017 and 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, 2017 were as follows (in thousands):

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated:				
Land	$ 64,277	$ 84	$ (3)	$ 64,358
Easement	10,554	1	-	10,555
Construction in progress	409,354	37,332	(113,276)	333,410
Total capital assets not being depreciated	484,185	37,417	(113,279)	408,323
Capital assets being depreciated:				
Infrastructure (water and sewer facilities)	9,574,660	153,592	(68,495)	9,659,757
Wells, tanks and meters	773,226	11,964	(12,425)	772,765
Buildings and improvements	108,066	13,204	(10,201)	111,069
Equipment, furniture, fixtures and vehicles	392,760	40,355	(40,835)	392,280
Total capital assets being depreciated	10,848,712	219,115	(131,956)	10,935,871
Less: accumulated depreciation and amortization:				
Infrastructure (water and sewer facilities)	(3,491,871)	(227,885)	11,486	(3,708,270)
Wells, tanks and meters	(243,828)	(28,774)	4	(272,598)
Buildings and improvements	(40,250)	(2,397)	6	(42,641)
Equipment, furniture, fixtures and vehicles	(296,162)	(26,172)	219	(322,115)
Total accumulated depreciation and amortization	(4,072,111)	(285,228)	11,715	(4,345,624)
Total capital assets being depreciated, net	6,776,601	(66,113)	(120,241)	6,590,247
Total capital assets, net	$ 7,260,786	$ (28,696)	$ (233,520)	$ 6,998,570

(8) Restricted Assets

Restricted assets consist 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 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 as of June 30, 2017 consisted of the following (in thousands):

	Amount
Construction funds	$ 55,769
Capital activity funds	42,125
Debt service funds	232,859
	330,753
Less: Impairment loss	(9,795) [1]
Total	$ 320,958

Note:

1 The impairment loss was recognized during fiscal year 2016

(9) Accrued Liabilities

Accrued liabilities as of June 30, 2017 consisted of the following (in thousands):

	Amount
Payroll and related accruals	$ 40,413
Legal, labor related and environmental contingencies	70,815
Contract retentions	16,030
Total	$ 127,258

(10) Long-Term Debt

Long-term debt activity for the year ended June 30, 2017 was as follows (in thousands):

	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	19,390	36,857
2008 Series A Revenue Bonds	1,291,280	-	(14,940)	1,276,340	15,690	1,260,650
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	1,768,375	-	-	1,768,375	34,980	1,733,395
2012 Series B Revenue Bonds	264,210	-	(33,665)	230,545	-	230,545
Rural Development Serial Bonds	394,211	-	(1,565)	392,646	18,182	374,464
Sub total bonds	4,436,505	-	(50,170)	4,386,335	88,242	4,298,093
Add: bond premium	25,765	-	(569)	25,196	600	24,596
Less: bond discount	(15,847)	-	200	(15,647)	(212)	(15,435)
Total bonds	4,446,423	-	(50,539)	4,395,884	88,630	4,307,254
Notes payable:						
Water Pollution Control and Safe Drinking Water Treatment Revolving Funds Loans	580,012	1,518	(254)	581,276	51,056	530,220
Notes with commercial banks	4,153	-	(2,543)	1,610	1,610	-
Notes with GDB	65,550	-	-	65,550	13,353	52,197
Total notes	649,715	1,518	(2,797)	648,436	66,019	582,417
Total – long-term obligations	$ 5,096,138	$ 1,518	$ (53,336)	$ 5,044,320	$ 154,649	$ 4,889,671

(11) Bonds Payable

Bonds payable as of June 30, 2017, consisted of the following (in thousands):

		Amount
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
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
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
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
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
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		25,240
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

11. Bonds Payable – (continued)

	Amount
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
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
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
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
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	123,430
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
Rural development serial bonds:	
Serial Bonds, 2.00% - 5.00%, due semiannually through July 1, 2055	392,646
Subtotal	4,386,335
Bond premium	25,196
Bond discount	(15,647)
Total	$ 4,395,884

(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 stipulates the Commonwealth's Office of Management and Budget ("OMB") should 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 2017, 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.

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 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 sheet.

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 sheet as of June 30, 2017.

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.

(11) Bonds Payable – (continued)

Act 164 PFC Bonds – (continued)

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 sheet.

As of June 30, 2017, the Authority's share for the 2011 Series A, 2011 Series B, 2011 Series B Superaqueduct and 2012 Series A Refunding Bonds was 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 2017, none of the payments on the Notes, or any corresponding payments on the PFC Bonds, that have come due and payable in fiscal year 2017 have been paid. As publicly disclosed by GDB and PFC following the approval of the Commonwealth's annual budget for fiscal year 2017, 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 combination 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.

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, 2017, the outstanding balance for the 2008 Revenue Bonds Series A was approximately $1,276.3 million, 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, 2017, the outstanding balance for the 2008 Revenue Bonds Series B was $22.4 million.

(11) Bonds Payable – (continued)

2008 Series A and B Revenue Refunding Bonds

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

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

The 2008 Revenue Refunding Bonds are guaranteed by the Commonwealth and the Authority's net revenue, as defined in the corresponding trust indenture, is pledged toward the payment of debt service on these bonds. The 2008 Revenue Refunding Bonds are subordinated to all senior and senior subordinated debt. As of June 30, 2017, 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 GDB 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.

(11) Bonds Payable – (continued)

2012 Series A and B Revenue Bonds – (continued)

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's outstanding indebtedness, (2) provide funds to repay certain lines of credit provided by GDB 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 15.

The 2012 Revenue Bonds are issued as Senior Debt, pursuant to the terms of the MAT. As of June, 30 2017, the outstanding balance for 2012 Series A and B was $1,998.9 million.

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.

As of June 30, 2017, 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 5.0% due in semiannual installments through 2055. The outstanding balance of the USDA Rural Development Program Serial Bonds as of June 30, 2017 was approximately $392.6 million.

The USDA Rural Development Program Serial Bonds were 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.

As of June 30, 2017, the USDA Rural Development Program Bonds were subordinate to all senior and senior subordinated debt as well as to Operating Expenses, the Operating Reserve Fund and the Capital Improvement Fund.

(11) Bonds Payable – (continued)

Rural Development Serial Bonds – (continued)

The USDA Rural Development Program and PRASA agreed to several forbearance agreements, starting on July 1, 2016 and, as amended, until July 31, 2019. As part of the forbearance agreements requirements, the Authority made payments for a total of $25.8 million.

On July 26, 2019, the Authority and AAFAF consummated a definitive agreement restructuring PRASA's debt obligations under the USDA Rural Development, Rural Utilities Service program totaling $403 million, including accrued interest as of that date.

The agreement consolidated all the restructured USDA debt into one loan with a 40-year maturity and 2% interest rate, with a $10 million annual debt service requirement from years 1 to 10 and $17 million annual debt service thereafter. The restructured USDA debt was designated as Other System Indebtedness in parity with other senior debt under PRASA's Master Agreement of Trust, not guaranteed by the Commonwealth.

(11) Bonds Payable – (continued)

Debt Service Payments

Future principal and interest payments on all bonds payable outstanding as of June 30, 2017 are as follows (in thousands):

Fiscal Year	Principal	Interest	Total
2018	$ 88,242	$ 294,558	$ 382,800
2019	70,156	230,209	300,365
2020	73,113	226,666	299,779
2021	75,642	222,906	298,548
2022	87,268	218,682	305,950
2023-2027	532,767	1,017,135	1,549,902
2028-2032	959,912	809,681	1,769,593
2033-2037	763,248	574,400	1,337,648
2038-2042	868,420	356,713	1,225,133
2043-2047	709,353	129,607	838,960
2048-2052	155,123	6,110	161,233
2053-2057	3,091	80	3,171
Total	4,386,335	$ 4,086,747	$ 8,473,082
Plus: unamortized premium	25,196		
Less: unamortized discount	(15,647)		
Bonds payable, net	$ 4,395,884		

As previously mentioned in this note, on July 26, 2019, the Authority restructured its debt obligations under the USDA Rural Development, Rural utilities program. The future principal and interest payments on bonds payable presented above are based on the original debt agreement.

(12) Notes Payable

Notes payable as of June 30, 2017, consisted of the following (in thousands):

	Amount
Puerto Rico Water Pollution Control Revolving Fund	$ 392,553
Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund	188,722
Notes with commercial banks	1,611
Note with GDB	65,550
	$ 648,436

(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 were 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.

On December 18, 2018, a Deed of Trust was entered into, by and among PRIFA, EQB, and Banco Popular de Puerto Rico, as trustee (the "CWSRF Deed of Trust"); and on the same date a Deed of Trust was entered into, by and among PRIFA, DOH, and Banco Popular de Puerto Rico, as trustee (the "DWSRF Deed of Trust").

The Authority has entered into revolving loan agreements with PRIFA to finance certain capital improvements to the system. As of June 30, 2017, the Authority had an outstanding balance of approximately $581.3 million 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 "SRF 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 SRF Forbearance Agreement, as further amended in several occasions, the payments due until July 1, 2019, inclusive, 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 subject to certain conditions and partial payments.

On July 26, 2019, PRASA and AAFAF consummated definitive agreements restructuring PRASA's debt obligations under the SRFs in the amount of $570 million plus $26 million of funds for ongoing projects. The Agreements were approved by the Financial Oversight and Management Board for Puerto Rico (the "Oversight Board") pursuant to Section 207 of PROMESA and consolidated all the restructured debt into two SRF loans with a 30-year maturity term at 0% interest rate and $10 million annual principal-only payment from years 1 to 10 and 1% interest rate and $27 million annual debt service thereafter.

(12) Notes Payable – (continued)

Puerto Rico Water Pollution Control Revolving Fund and Safe Drinking Water Treatment Revolving Loans – (continued)

The restructured SRF loan was designated as Other System Indebtedness in parity with other senior debt under PRASA's Master Agreement of Trust.

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, 2017, the outstanding balance of the Fleet Term Loan was $1.6 million. The Fleet Term Loan was subsequently paid in full.

Note 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 the date of the issuance of the financial statements, AAFAF was in initial discussions with the Debt Recovery Authority to restructure the terms and conditions of the term note.

As of June 30, 2017, the term loan outstanding balance was $65.6 million.

On November 29, 2018, GDB completed the restructuring of certain of its indebtedness pursuant to a Qualifying Modification under Title VI of PROMESA. GDB Qualifying Modification and pursuant to the GDB Restructuring Act, on the Authority's credit facility with GDB was reduced on a dollar-for-dollar basis by deposits held at GDB, for which an impairment loss of $9.8 million was recognized during fiscal year 2016, reducing the debt balance to $58 million.

(12) Notes Payable – (continued)

The combined future aggregate amount of debt service for these notes as of June 30, 2017 was as follows (in thousands):

	Principal	Interest	Total
2018	$ 66,019	$ 23,228	$ 89,247
2019	76,227	8,237	84,464
2020	23,803	5,466	29,269
2021	24,281	4,988	29,269
2022	23,371	4,507	27,878
2023-2027	117,927	15,439	133,366
2028-2032	73,893	4,982	78,875
2033-2037	15,952	461	16,413
	421,473	$ 67,308	$ 488,781
Interim construction loans:			
Puerto Rico Water Pollution Control Revolving Fund	176,442		
Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund	50,521		
Total	$ 648,436		

As previously mentioned in this note, on July 26, 2019, the Authority restructured its debt obligations under SRF loans. The combined future aggregated amount of debt service presented above is based on the original debt agreement.

(13) Pension Plan

General Information of Pension Plan

The Employees Retirement System of the Commonwealth of Puerto Rico (ERS) is a multiple-employer cost-sharing hybrid defined benefit and defined contribution pension plan sponsored by, and reported as a component unit of the Commonwealth. The ERS is a statutory trust created by Act No. 447 of May 15, 1951 as amended ("Act 447"). All regular employees of the Authority become members of the ERS as a benefit of their employment.

On April 4, 2013, the Governor of Puerto Rico, signed into law Act No. 3 of 2013, which represents a comprehensive reform of the ERS, Act No. 3 became effective on July 1, 2013 and amended the provisions of the different benefit structures under the ERS as further discussed below.

Members who had entered the Employees Retirement System before January 1, 2000 participated in a defined benefit program. Members who began to participate prior to April 1, 1990 ("Act 447 Participants") were entitled to the highest benefits structure, while those who began to participate on or after April 1, 1990 ("Act 1 Participants") were subject to a longer vesting period and a reduced level of benefits, as provided by Act No. 1 of February 16, 1990 ("Act 1 of 1990").

(13) Pension Plan – (continued)

In 1999, Act 447 was amended to close the defined benefit program for new participants and, prospectively, establish a new benefit structure similar to a cash balance plan (this new benefit structure is referred to as System 2000). Members who entered the ERS on or after January 1, 2000 (System 2000 Participants) participate solely in System 2000. Act 3-2013 amended the law to eliminate the lump sum distribution alternative and substitute it for a life annuity payable to the System 2000 Participant. System 2000 Participants do not benefit from any employer contributions. Instead, employer contributions made on account of System 2000 Participants are used to reduce the accumulated unfunded pension benefit obligation of the ERS. System 2000 is not a separate plan as there are no separate accounts for System 2000 Participants. Contributions received from System 2000 Participants are pooled and invested by the ERS together with the assets corresponding to the defined benefit structure of Act 447 and Act 1 of 1990 and the defined contribution structure of System 2000, as amended by Act 3-2013, will be paid from the same pool of assets of the ERS.

Retirement and related benefits provided by the ERS and required contributions to the ERS by employers and employees, are determined by law rather than by actuarial requirements. As of July 1, 2011, after the adoption of Act 116 of July 6, 2011 ("Act 116"), the statutory employer contribution for the ERS increased from a minimum of 9.275% to a minimum of 10.275% of covered payroll and will continue to increase annually until fiscal year 2021. The employer contribution rate for fiscal year 2017 is 15.525%.

Required employee contributions for the ERS vary according to how the individual employee's retirement benefits are coordinated with social security benefits. Act 3-2013 increased the employee contribution from 8.275% to 10% of covered payroll.

The ERS provides basic benefits under the defined benefit program principally consisting of a retirement annuity and death and disability benefits (collectively referred to herein as Basic System Pension Benefits). The ERS also administers benefits granted under various special laws that have provided additional benefits for the retirees and beneficiaries (collectively referred to herein as System Administered Pension Benefits). The System Administered Pension Benefits include, among others, additional minimum pension, death and disability benefits, ad-hoc cost-of-living adjustments and summer and Christmas bonuses. Act 3-2013 and Act 160-2013 amended the various laws providing some of these System Administered Pension Benefits to reduce some of the amounts payable to existing retirees while eliminating the benefits for all future retirees (those retiring after June 30, 2013 and July 31, 2014).

Going Concern – Retirements System

The ERS is severely underfunded, its funded ratio (fiduciary net position as a % of total pension liability) as of June 30, 2016 was negative 3.47% and the net pension liability was approximately $37,699 billion.

On May 22, 2017, the Oversight Board, at the request of the Commonwealth, filed a petition for ERS in the United States District Court for the District of Puerto Rico, commencing a Title III case for ERS.

On June 27, 2017, the Treasury Department of the Commonwealth of Puerto Rico, issued Circular Letter no. 1300 46 17 in order to convey to central government agencies, public corporations and municipalities the new implementation procedures to adopt, effective July1, 2017, the new "pay as you go" ("PayGo") mechanism for all the Commonwealth Retirements Systems. Beginning on July 1, 2017, employer's contributions, contributions ordered by special laws and Additional Uniform Contributions were all eliminated. After July 1, 2017 covered employers pay a monthly PayGo charge to cover their current retirees and beneficiaries, excluding employees recruited after July 1, 2017 (Act 106-2017), which are under a defined contribution plan.

(13) Pension Plan – (continued)

Net Pension Liability, Pension Expenses and Deferred Outflow/Inflows of Resources Related to Pension

For fiscal year ended June 30, 2017, the Authority implemented Statement No. 68 of the *Governmental Accounting Standards Board, Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27 (GASB 68),* which became effective for the year ended June 30, 2015. The Authority could not implement this statement earlier because financial information related to pensions was not available. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers,* as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria, as is the case of the ERS.

As of fiscal year ended June 30, 2017, the cumulative effect on the Authority's net pension liability for the adoption of GASB 68 is $1,187.6 million, which was determined by an actuarial valuation as of June 30, 2016. The Authority's proportion of the net pension liability was 4.18031% at measurement date of June 30, 2016 (4.46859% for June 30, 2015). The Authority's proportion of the ERS collective net pension liability was based on the actual required contribution of each participating employers that reflect each employers' projected long-term contribution effort. The contribution that reflect each employers' contribution effort in the proportionate share calculation are: Act No. 116 of 2010 statutory payroll-based contribution, Act No. 3 of 2013 supplemental contribution, and other special law contributions.

For the year ended June 30, 2017, the Authority recognized pension expense of approximately $126.6 million. As of June 30, 2017, the Authority reported deferred outflows of resources and deferred inflows of resources related to pension from the following sources (expressed in thousands):

	Pension Related Deferred Outflows of Resources	Pension Related Deferred Inflows of Resources
Difference between actual and expected experience	$ 1,288	$ (21,635)
Changes in assumptions	240,377	-
Difference between projected and actual investment earnings on pension plan investments	-	(8,527)
Employer contributions subsequent to the measurement date (June 30, 2016)	97,203	-
	$ 338,868	$ (30,162)

(13) Pension Plan – (continued)

Net Pension Liability, Pension Expenses and Deferred Outflow/Inflows of Resources Related to Pension – (continued)

The $97.2 million reported as deferred outflows of resources related to pension resulting from contributions subsequent to the measurement date is recognized as a reduction of the net pension liability in the year ended June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in the pension expense as follows (in thousands):

Year Ending June 30,	Amount
2018	$ 90,952
2019	47,466
2020	47,977
2021	25,108
	$ 211,503

Actuarial methods and assumptions

The following is a description of the actuarial methods and assumptions used for the computation of the net pension liability as of June 30, 2016 (measurement date):

Valuation date	June 30, 2015
Measurement date	June 30, 2016
Actuarial cost method	Entry age normal cost
Asset -valuation method	Market value of assets
Actuarial assumptions:	
Discount rate	2.85%
Inflation	2.50%
Salary increases	3.00% per year. No compensation increases are assumed until July 1, 2021 as a result of Act No. 66 and the current general economy.
Investment rate of return	6.55%
Mortality tables	(see below)

(13) Pension Plan – (continued)

Actuarial methods and assumptions – (continued)

The mortality tables used in the June 30, 2016 actuarial valuation were as follows:

- *Pre-retirement Mortality* – For general employees not covered under Act No. 127, RP-2014 Employee Mortality Rates for males and females adjusted to reflect Mortality Improvement Scale MP-2016 from the 2006 base year, and projected forward using MP-2016 on generational basis. For members covered under Act No. 127, RP-2014 Employee Mortality Rates are assumed with blue collar adjustments for males and females adjusted to reflect Mortality Improvement Scale MP-2016 from the 2006 base year, and, projected forward using MP-2016 on generational basis. As generational tables, they reflect mortality improvements both before and after the measurement date. 100% of deaths while in active service are assumed to be occupational only for members covered under Act No. 127.

- *Post-retirement Healthy Mortality* – Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of the ERS Plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 92% of the rates from the UP-1994 Mortality Table for Males and 95% of the rates from the UP-1994 Mortality Table for Females, both projected from 1994 to 2010 using Scale AA. The base rates are projected using Mortality Improvement Scale MP-2016 on a generational basis. As a generational basis, it reflects mortality improvements both before and after the measurement date.

- *Post-retirement Disable Mortality* – Rates which vary by gender are assumed for disable retirees based on a study of the ERS Plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 105% of the rates from the UP-1994 Mortality Table for Males and 115% of the rates from the UP-1994 Mortality Table for Females. The base rates are projected using Mortality Improvement Scale MP-2016 on a generational basis. As a generational table, it reflects Mortality improvements both before and after the measurement date.

The long-term expected rate of return on pension benefits investments was determined in accordance with the asset allocation of the portfolio that was adopted by the ERS's Board during December 2013 and the actuary's capital market assumption as of June 30, 2016. In addition, the assumption reflects that loans to members comprise approximately 50% of the portfolio and have an approximate return of 9.1% with no volatility. The long-term expected rate of return on pension benefits investments of 6.55% as of June 30, 2016 is equal to the highest debt service of the senior pension funding bonds payable, which range from 5.85% per annum to 6.55% per year.

(13) Pension Plan – (continued)

Actuarial methods and assumptions – (continued)

The pension plan's policy in regard to allocation of invested assets is established and may be amended by the ERS's Board. Plan assets are managed on a total return basis with long-term objective of achieving and maintaining a positive impact on the ERS's financial condition for the benefits provided through the pension programs. The following was the ERS's Board adopted asset allocation policy as of June 30, 2016 (the measurement date):

	Target Allocation	Long-term expected rate of return
Asset class:		
Domestic equity	25%	6.40%
International equity	10%	6.70%
Fixed income	64%	6.30%
Cash	1%	3.00%
Total	100%	

The long-term expected rate of return on pension benefits investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The asset basis for the date of depletion projection in the ERS's fiduciary net position (the gross assets plus deferred outflows of resources less the gross liabilities, including the senior pension funding bonds payable, less deferred inflows of resources). On this basis, the ERS's fiduciary net position became negative in the fiscal year 2015 and accordingly no projection of date of depletion is needed.

Changes in actuarial methods and assumptions

There have not been any changes in methods since the prior valuation.

In fiscal years 2016 and 2015, the census data collection date is as of beginning-of-year. The total pension liability at end of year was determined by actuarial valuation as of the census data collection date at beginning-of-year and was then projected forward to end-of-year, using roll-forward methods and assuming no liability gains or losses.

The ERS's fiduciary net position was not projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the tax-free municipal bond index (Bond Buyer General Obligation 20-Bond Municipal Bond Index) was applied to all periods of projected benefits payments to determine the total pension liability. The discount rate was 2.85% and 3.80% as of June 30, 2016 and July 1, 2015, respectively, resulting in an increase in the net pension liability.

The date of depletion projection of the actuarial report does not include any amounts from the additional uniform contribution required by Act No. 32 because of actual fiscal and budgetary financial difficulties, continued budget deficits and liquidity risks of the Commonwealth of Puerto Rico and the municipalities, and in the event that their financial condition does not improve in the near term.

(13) Pension Plan – (continued)

Sensitivity of the Authority's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability as of June 30, 2016, calculated using the discount rate of 2.85%, as well as what the net pension liability would be if it was calculated using a discount rate that is 1 percent-point level lower (1.85%) or 1 percent-point higher (3.85%) than the current rate (in thousands):

	1% Decrease (1.85%)	Current Discount Rate (2.85%)	1% Increase (3.85%)
Net pension liability	$ 1,807,524	$ 1,575,924	$ 1,387,537

Detailed information about the ERS's fiduciary net position is available in its Annual Financial Report which can be found on the ERS's website at www.retiro.pr.gov.

(14) 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 the Collective Labor Agreement with "Unión Independiente Auténtica" ("UIA"), employees under the Collective Labor Agreement with "Hermandad Independiente de Empleados Profesionales de la Autoridad de Acueductos y Alcantarillados" ("HIEPAAA") and employees under the Managers' Regulation, all of which are Authority's employees. All employees with more than twenty (20) years of rendered service within the Authority are eligible for the healthcare benefit upon retirement age. Act No.3 of April 4, 2013, an amendment to Act No. 447, established a new retirement age.

Retirement age is as follows:

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

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

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

For more details in the retirement age, refer to Note 13.

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.

(14) Other Postemployment Benefits – (continued)

Early Adoption of GASB No. 75 *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions.*

For the fiscal year ended June 30, 2017, the Authority early adopted GASB No. 75, which replaces GASB No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, as amended, and No. 57, OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans, for OPEB. Statement No. 74, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, establishes new accounting and financial reporting requirements for OPEB plans. GASB No. 75 establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to 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.

As a result of the early implementation of GASB No. 75 the Authority recognized an adjustment to the beginning net position of $33.9 million.

Funding Policy

The contribution requirements of the Authority are established and may be amended, by the Authority's Governing Board. 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 year ended June 30, 2017 was approximately $2.9 million. There is no contribution requirement for plan members.

Annual OPEB costs and Net OPEB liability

The Annual Pension Cost ("APC") and the Annual Required Contribution ("ARC") were computed as part of an actuarial valuation performed as of June 30, 2017, in accordance with parameters of GASB No. 75 and based on current years' demographic data.

The following table illustrates the Net OPEB Liability under GASB No. 75 for the year ended June 30, 2017 (in thousands):

OPEB liability		
Retired participants and beneficiaries receiving payments	$	39,500
Active participants		35,049
Total		74,549
Plan fiduciary net position		-
Net OPEB liability	$	74,549
Plan fiduciary net position as a percentage of the Total OPEB liability		0%
Deferred outflows of resources for contributions made after measurement date		-

(14) Other Postemployment Benefits – (continued)

Annual OPEB costs and Net OPEB liability – (continued)

The following table illustrates the OPEB costs components for the year ended June 30, 2017 (in thousands):

OPEB expense:		
Service cost	$	1,842
Interest cost		2,134
Amortization change (gain)/loss:		
Liability loss		358
Assumption change		(409)
Total expense	$	3,925

OPEB deferred outflows of resources and deferred inflows of resources

The implementation of GASB No. 75 required to determine deferred outflows of resources and deferred inflows of resources in order to be amortized and recognized in the annual OPEB expense.

The following table illustrates the OPEB deferred outflows of resources and deferred inflows of resources under GASB 75 for the year ended June 30, 2017 (in thousands):

	Deferred outflows of resources	Deferred inflows of resources
Difference between actual and expected experience	$ 6,815	$ -
Net difference between expected and actual earnings on OPEB plan investment	-	-
Assumption changes	-	7,794
Total	$ 6,815	$ 7,794

The following table illustrates the list of amortization for the OPEB deferred outflows of resources and deferred inflows of resources under GASB No. 75 for the year ended June 30, 2017:

		Period		Balance		
Date Established	Type of Base	Original	Remaining	Original	Remaining	Annual Payment
6/30/2016	Liability (gain)/loss	20.03	19.03	$ 7,173,294	$ 6,815,167	$ 358,127
6/30/2016	Assumptions	20.03	19.03	(8,204,074)	(7,794,485)	(409,589)
	Total charges				$ (979,318)	$ (51,462)

OPEB deferred outflows of resources and deferred inflows of resources – (continued)

OPEB deferred outflows of resources and deferred inflows of resources to be register in the OPEB expenses are as follows:

Year Ending June 30,		Amount
2018	$	(51,462)
2019		(51,462)
2020		(51,462)
2021		(51,462)
2022		(51,462)
2023 and thereafter		(722,008)
	$	(979,318)

Actuarial Assumptions

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

Economic Assumptions

Discount Rate

The discount rate considered for year ended June 30, 2017 was 3.60%. In order to comply with GASB No.75, 20-year Municipal Bond Rate term investments were used to represent 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 Governing Board approval, the medical increase rate was zero percent for the year ended June 30, 2017. 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 year ended June 30, 2017, the turnover table used for the valuation was the Standard Hewitt Withdrawal Table for Hourly Union Employees – five (5) years of service select period.

Mortality Table

The RP-2014 with Scale MP2014 was used for the valuation of the benefit granted by the plan.

(14) Other Postemployment Benefits – (continued)

Disability Table

The Hunter disability table was used for the valuation.

Actuarial Cost Method

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

(15) 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, 2017, the Authority was in compliance with the senior annual debt service coverage requirement.

(16) Capital Contributions

Capital contributions for the fiscal year ended June 30, 2017 were as follows (in thousands):

	Amount
Developer contributions	$ 4,138
Contributions from governmental agencies and municipalities	664
Other contributions from Commonwealth	122
Other contributions	1,571
	6,495
Less return of federal grants:	
USDA Rural Development Program	(2,101)
Federal Emergency Management Agency	(378)
	$ 4,016

(17) Related Party Transactions

Operating revenues for services provided to the Commonwealth and its component units amounted to approximately $152.4 million during the year ended June 30, 2017. As of June 30, 2017, the Authority's government account receivable for water and sewer services was $125.5 million, for which $80.5 are considered uncollectible. Further, operating, administrative, and general expenses during the fiscal year ended June 30, 2017 included approximately $126.7 million of charges from Puerto Rico Electric Power Authority (PREPA), a component unit of the Commonwealth.

As of June 30, 2017, the Authority had approximately $7.1 million of receivables, from the Commonwealth and its component units, of which $3.7 million are fully reserved. Such receivable is reported as accounts receivable net in the accompanying balance sheet.

The Authority had approximately $1.2 million of excess of collections over billings from the Commonwealth, recorded as unearned revenue in the accompanying balance sheet as of June 30, 2017.

Since fiscal year 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, 2017, the Authority had a term loan with an outstanding principal balance of approximately $65.6 million, under this credit facility. The Authority has not made the quarterly principal and interest payments on this term loan since December 2015.

The GDB's fiscal and liquidity situation is on a critical period and has significantly declined the ability to operate. On March 23, 2018, GDB ceased its operations and wound down in an orderly manner under Title VI of PROMESA.

(18) Labor Union Contracts

The collective bargaining agreement with the UIA union, which covers approximately 3,155 blue-collar and clerical employees, was signed effective January 1, 2012 until December 31, 2015.

The collective bargaining agreement with the HIEPAAA union, which covers approximately 141 professional employees, was signed effective May 31, 2012 until June 30, 2016.

Under Act 66-2014 known as the "Fiscal Sustainability for the Government of Puerto Rico Act", both collective agreements effective terms were extended until December 31, 2017. However, on January 23, 2017, under Act 3-2017 known as the "Law to Address the Economic, Fiscal and Budgetary Crisis to Guarantee the Operation of the Government of Puerto Rico" both collective agreements effective terms were extended until June 30, 2021 for Non-economic clauses and clauses not effected by the Act. Economic clauses and Non-economic clauses with economic impact are suspended during the Act's applicability.

(19) 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. The Authority had signed an agreement with CH2M 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. In October 2017 the contract was renewed. The next renewal is schedule for October 2019. The cost incurred under the contract is reported under the caption of *Service Contract – Superaqueduct,* which amounted to $3.9 million for the year ended June 30, 2017. All other operational costs associated with the operation of the Superaqueduct system are captioned in their respective expense category and are presented in the Authority's statements of revenues, expenses and changes in net position as part of the financial statements.

(20) Commitments and Contingencies

Environmental Matters

Facilities and operations of the Authority's water and sewer systems are subject to regulations under Federal and Commonwealth environmental laws. The Authority is subject to two (2) court approved agreements to enforce compliance with such environmental laws, one with the Department of Health of the Government of Puerto Rico ("DOH") related to violations of the Safe Drinking Water Act ("SDWA") and the other with the United States Government, acting on behalf of EPA, related to violations of the Clean Water Act ("CWA").

DOH Agreement

On December 15, 2006, an Agreement (Civil Case No. KPE 2006-0858) was signed between the Authority and DOH to address SDWA compliance. The Agreement was preliminarily approved by the court on March 15, 2007, amended, and finally approved by the court on June 20, 2008. The Authority agreed to implement a work plan to remediate SDWA violations and a procedure to address future violations that may arise, 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 at the Authority water systems. As part of the Agreement, the Authority paid a civil penalty of $1 million during fiscal year ended June 30, 2007 for alleged non-compliances with the SDWA. The Agreement requires that the Authority self-assess and pay stipulated penalties for failing to comply with remedial measures deadlines, failing to submit deliverables, or exceedances to maximum contaminant levels.

(20) Commitments and Contingencies – (continued)

Environmental Matters – (continued)

As part of the Agreement, the Authority paid stipulated penalties during calendar year 2017 of $346,850. Stipulated penalties were paid by the Authority for failing to comply with remedial measures deadlines and parameters exceedances. The Authority deposited $247,100 in an escrow account for parameters exceedances. The escrow account is to be used for compliance projects with the approval of the DOH.

During the calendar year ended December 2016, the Authority accrued approximately $563,700 for penalties for noncompliance with the remedial measures of the Agreement, corresponding to the Progress Reports 31 to 35. On July 7, 2017, $563,700 were deposited in an escrow account to be used for a Second SEP that involves the chemical monitoring of 130 Non-Authority systems. The Authority is in compliance with the Second SEP.

In addition, in accordance with the Agreement, the Authority invoked force majeure protection for delays and non-compliances incurred attributable to the devastating impacts of Hurricanes Irma and María that struck Puerto Rico in September 2017. The DOH has provided the relief requested by the Authority on a case-by-case basis.

EPA Consent Decree

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

Concurrently with the filing of the Complaint, DOJ filed on September 15, 2015 a Consent Decree executed among the EPA, Authority and Government of Puerto Rico settling the matters addressed in the Complaint, under the terms agreed upon by the Authority, DOJ and EPA. The 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 a system-wide NPDES permit compliance plan, continuing 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 CWA occurring within the Authority's wastewater collection system of the Puerto Nuevo Wastewater Treatment Plant ("WWTP") in the Municipality of San Juan.

Negotiations leading to the execution of the EPA Consent Decree were commenced by the Authority in order to mitigate and consolidate in one consent decree the high capital improvement program ("CIP") costs mandated by existing consent decrees. Despite being in material compliance with the capital improvement project requirements of the existing consent decrees, the Authority began discussions with DOJ, on behalf of EPA, EPA and DOH seeking that a CIP prioritization system be recognized 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 a consent decree, and (iii) include the operation, maintenance and capital improvement program requirements related to the wastewater collection system of the Puerto Nuevo WWTP, including alleged combined sewer overflows.

(20) Commitments and Contingencies – (continued)

Environmental Matters – (continued)

On May 23, 2016, the District Court entered judgement approving the consolidated EPA Consent Decree. The Complaint was dismissed with prejudice and civil case number 15-2283 was closed.

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. In addition, in accordance with the EPA Consent Decree, the Authority invoked force majeure protection for delays and non-compliances incurred attributable to the impact of Hurricanes Irma and María in September 2017. The EPA, DOJ and Authority are currently working towards filing a motion to address the Authority's December 2016 extension and force majeure protection requests.

During the calendar year 2017, a total of $84,300 in stipulated penalties were paid under the Consent Decree covering reporting period from March 1st, 2017 to August 31, 2017. These stipulated penalties paid were associated with NPDES effluent limitations and unanticipated sanitary sewer overflows compliance events.

Risk Management

The Authority has commercial insurance to mitigate its exposure to certain losses involving real and personal property (including windstorm, flood and earthquake damages) and comprehensive general and automobile claims. Each commercial insurance policy maintained by the Authority contains specific policy limits and deductibles.

A summary of the commercial insurance maintained by the Authority is as follows:

Coverage	Deductible	Policy Limit
Real and personal property:		
Windstorm	$25 million combined for Property Damage and Business Interruption, except for the perils of Boiler and Machinery Breakdown, where a $25,000 applies.	$150 million per occurence
Flood	$25 million combined for Property Damage and Business Interruption, except for the perils of Boiler and Machinery Breakdown, where a $25,000 applies.	$300 million Combined Single Limit for Property Damage and Business Interruption, excess of applicable deductibles.
Earthquake	$25 million combined for Property Damage and Business Interruption, except for the perils of Boiler and Machinery Breakdown, where a $25,000 applies.	$300 million Combined Single Limit for Property Damage and Business Interruption, excess of applicable deductibles.
Business Interruption	$25 million combined for Property Damage and Business Interruption, except for the perils of Boiler and Machinery Breakdown, where a $25,000 applies.	Included in $150 million Property for all other perils, including Winds, and $300 million Earthquake and Flood Coverage, subject to a $35 million sublimit.

(20) Commitments and Contingencies – (continued)

Risk Management – (continued)

Coverage	Deductible	Policy Limit
Extra Expense	$25 million combined for Property Damage and Business Interruption, except for the perils of Boiler and Machinery Breakdown, where a $25,000 applies.	Included in $150 million Property for all other perils, including Winds, and $300 million Earthquake and Flood Coverage, subject to a $35 million sublimit.
Newly Acquired Locations	$25 million combined for Property Damage and Business Interruption, except for the perils of Boiler and Machinery Breakdown, where a $25,000 applies.	Included in $150 million Property for all other perils, including Winds, and $300 million Earthquake and Flood Coverage, subject to a $35 million sublimit.
Boiler and Machinery	$25,000 each and every occurence	Included in $150 million property coverage
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 $2.5 million aggregate
Accident and health divers	$ 0	$250 thousand per occurrence $1.7 million aggregate
EPLI Excess EPLI	$100 thousand per occurrence $ 0	$5.0 million Additional $5.0 million

(20) Commitments and Contingencies – (continued)

Risk Management – (continued)

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.

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 during the fiscal year 2017.

(20) Commitments and Contingencies – (continued)

Operating Leases

Certain commercial offices and warehouse facilities of the Authority are leased under operating lease agreements. During the fiscal year ended June 30, 2017, the Authority incurred approximately $3.8 million in rent expense.

Future minimum non-cancelable lease payments on existing operating leases at June 30, 2017, which have an initial term of one year or more, are as follows (in thousands):

Year Ending June 30,		Amount
2018	$	3,078
2019		1,761
2020		1,566
2021		996
2022		638
2023 - 2027		1,852
2028 - 2038		1,601
	$	11,492

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.

(21) Adoption of GASB No. 68 and GASB No. 75 and Prior Period Adjustment

GASB No. 68 "Accounting and Financial Reporting for Pensions" became effective on July 1, 2014 and, requires measurement and recognition of net pension liability, deferred outflows and inflows of resources and expense related to the Authority's share of the ERS pension liability. This statement had not been adopted since financial information related to pensions was not available until fiscal year 2017. As a result of the implementation of GASB 68, the Authority recognized a $1,187.6 million prior period adjustment on the beginning net position as of July 1, 2016.

GASB No. 75 "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (OPEB)" which replace GASB No. 45 "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions", is effective for fiscal years beginning after June 15, 2017, however, the Authority elected an early implementation. GASB 75 Statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to 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. As a result of the implementation of GASB 75, the Authority recognized a $33.9 million adjustment on the beginning net position as of July 1, 2016.

The impact of the adoption is as follows:

				Net Position			
	Net Pension/OPEB Liability	Deferred outflows of resources	Deferred inflows of resources	Net Investment in capital assets	Restricted for enviromental compliance, capital activity and other	Unrestricted	Total
As original reported	$ -	$ -	$ -	$ 2,442,040	$ 5,364	$ (392,916)	$ 2,054,488
Adjustment GASB 68 - Cumulative effect of a change in principle for pension cost	(1,483,777)	322,012	(25,840)	-	-	(1,187,605)	(1,187,605)
Adjustment GASB 75 - Cumulative effect of a change in benefits (OPEB) principle for other postemployment	(33,940)	-	-	-	-	(33,940)	(33,940)
As restated	$ (1,517,717)	$ 322,012	$ (25,840)	$ 2,442,040	$ 5,364	$ (1,614,461)	$ 832,943

(22) Subsequent events

Subsequent events were evaluated through September 30, 2019, the date the financial statements were available to be issued, to determine if such events should be recognized or disclosed in the 2017 financial statements.

Hurricanes

On September 6, 2017, Puerto Rico was affected by Category 5 Hurricane Irma, one of the strongest storms ever recorded in the Atlantic, with winds of up to 185 miles an hour. As a result of its passing through the north of Puerto Rico, PRASA suffered damages to water treatment facilities and structures across the Island.

On September 20, 2017, Hurricane María—an extremely destructive category 4 hurricane—made landfall in Puerto Rico, bringing sustained winds of 155 miles per hour and significant rainfall over a 30-hour period. Hurricane María crossed Puerto Rico diagonally, entering through the Southeast and exiting through the Northwestern region. The hurricane caused catastrophic destruction in Puerto Rico, including severe damages. Hurricanes Irma and María caused widespread destruction throughout Puerto Rico, knocking out power to the entire island, damaging PRASA's Systems and leaving most of the population of Puerto Rico without water service just after Hurricane María. Immediately after the landfall of the Hurricane María in Puerto Rico, the President of the United States of America issued a state of emergency declaration for Puerto Rico, as a U.S territory. The order mandates federal assistance through the Department of Homeland Security and the Federal Emergency Management Agency (FEMA) be made available to assist in local and territorial recovery efforts.

The Authority suffered damages to water treatment facilities and structures across the island which may result in a material adverse change in the financial condition of the Authority and the Commonwealth. Significant emergency work was made after the hurricanes struck Puerto Rico and significant projects to restore the damaged facilities will be made. As of the date of issuance of the financial statements the Authority estimates that the property damages sustained by the hurricanes could range from $770 million to $3,600 million if resiliency projects are included. Part of these costs are expected to be covered by insurance funds and disaster –relief funds granted by FEMA. Presently, the Authority has received $300 million from insurance proceeds to cover for property damages and business interruption losses.

Forbearance Agreements

On several occasions being the last one on May 28, 2019, 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 July 31, 2019.

The existing Forbearance Agreement with the United States Department of Agriculture, Rural Development and Rural Utilities Service was extended in several occasions, which was due on July 31, 2019.

(22) Subsequent events – (continued)

USDA and SRF Debt Modification [All these defined terms need to be conformed - defined once and then use the same defined terms]

On July 26, 2019, the Authority and the Puerto Rico Fiscal Agency and Financial Advisory Authority ("AAFAF", by its Spanish acronym) consummated definitive agreements (the "Agreements") restructuring PRASA's debt obligations under the Environmental Protection Agency's ("EPA") Clean Water and Drinking Water State Revolving Fund programs ("SRF") and the United States Department of Agriculture's ("USDA") Rural Development, Rural Utilities Service program ("RD/RUS" and together with the EPA, the "Federal Parties") totaling almost $1 billion (the "Federal Debt").

The Agreements were approved by the Financial Oversight and Management Board for Puerto Rico (the "Oversight Board") pursuant to Section 207 of PROMESA. The Agreements include the termination of existing Commonwealth guarantees of the Federal Debt, thus reducing overall Government contingent liabilities by approximately $1 billion and the consolidation of all the restructured debt into two SRF loans and one RD loan with extended maturities and/or lower interest rates as follows:

- RD loans: 40-year term at 2% interest rate, with $10 million annual debt service from years 1 to 10 and $17 million annual debt service thereafter
- SRF loans: 30-year term at 0% interest rate and $10 million annual principal-only payment from years 1 to 10 and 1% interest rate and $27 million annual debt service thereafter.

The restructured Federal Debt was designated as Other System Indebtedness in parity with other senior debt under PRASA's Master Agreement of Trust and is not guaranteed by the Commonwealth.

Retirement System

On August 23, 2017, in addition to the establishment of the Pay-Go mechanism, the Governor signed into law Act No. 106 of 2017, which reformed the Commonwealth Retirement Systems, so that their active participants would deposit their individual contributions in a new Defined Contribution Plan that will be managed by a private entity. Act No. 106 of 2017 creates the legal framework so that the Commonwealth can guarantee payment to pensioners through the Pay-Go system.

ERS Voluntary Transition Program – As a result of the fiscal crisis and the hurricanes impact which exacerbated such crisis, AAFAF on behalf of the Puerto Rico Government circulated an Administrative Order (OA-2017-5) on November 7, 2017, which created an "ERS Voluntary Transition Program" intended to create an alternate program for eligible employees under the ERS. On April 18, 2018 a second Administrative Order (OA-2018-5; amended on June 29, 2018 as OA-2018-9) was circulated extending the program to a second phase, and on October 23, 2018, a new Administrative Order (OA-2018-13; amended on November 15, 2018 as OA-2018-14) further extended the program to a third phase. Employees had until November 30, 2018 and December 15, 2018, respectively to enroll in the programs. Eligible employees who availed from the program and voluntarily resigned to their position received economic incentives consisting of 6-month salary as well as a medical plan incentive and payout of unused vacation leaves up to 60 days, according to Act 26-2017. During the first phase of the program, a total of approximately 107 employees applied and 58 were approved and voluntarily resigned by June 30, 2018.

No employees were retired on the Second Phase. For the third phase of the ERS Voluntary Transition Program, 92 eligible and approved employees 41 and 51 employees resigned effective November 30, 2018 and December 31, 2018, respectively.

(22) Subsequent events – (continued)

Government Development Bank (GDB) – Debt Restructuring Act -

GDB entered into a Restructuring Support Agreement, and Title VI Process under PROMESA, providing for a transaction resulting in the wind-down of GDB's operations. The GDB Title VI Plan provides for certain GDB creditors (primarily holders of GDB public bonds and deposit claims held by certain municipalities and certain municipal and non-public entities) to exchange their claims against GDB at a 45% discount for new bonds. On August 24, 2017, the Governor signed into law Act No. 109 – "GDB Debt Restructuring Act", which provides for the determination of liabilities between any government entity and GDB, by automatically applying the outstanding balance of any deposit of such entity against the outstanding balance of any loan of such entity with GDB, in a manner consistent with the Qualifying Modification - as described in Title VI of PROMESA.

On November 29, 2018, GDB completed the restructuring of certain of its indebtedness pursuant to a Qualifying Modification under Title VI of PROMESA. Under the Qualifying Modification, the credit facility of the Authority with GDB was offset on a dollar-for-dollar basis by deposits held at GDB, reducing the debt balance to $58 million.

Other Events

On June 25, 2019, the Oversight Board approved its latest own 6-year fiscal plan for the Authority (the "PRASA Fiscal Plan") pursuant to PROMESA and the requirements imposed by the Oversight Board. The PRASA Fiscal Plan includes a series of new initiatives, including, among other things: (i) rate increases; (ii) P3 projects for commercial services; (iii) increases in government account collections; (iv) reductions in physical water losses; and (v) new federal funding commencing in fiscal year 2020.

Required Supplementary Information

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

Schedule of the Authority's Proportionate Share of the Net Pension Liability
June 30, 2017

(In thousands)

For the fiscal year ended June 30,	Authority's proportion of the net pension liability	Authority's proportionate share of the net pension liability	Authority's covered - employee payroll	Authority's proportionate share of the net pension liability as percentage of covered-employee payroll	ERS plan's fiduciary net position	ERS Plan's fiduciary net position as a percentage of the total pension liability
2017	4.18031%	$ 1,575,926	$ 141,200	1116.09%	$ (1,265,884)	-3.47%
2016	4.46859%	$ 1,489,715	$ 135,965	1095.66%	$ (668,272)	-2.05%
2015	4.18154%	$ 1,260,268	$ 148,131	850.78%	$ 80,666	0.27%

Notes

This schedule will be expanded to show 10 years, once information becomes available in the future.

Schedule of Pension Contributions
June 30, 2017

(In thousands)

For the fiscal year ended June 30,	Contractually required contribution	Contributions in relation to contractually determined contributions	Contribution deficiency (excess)	Covered-employee payroll	Contributions as a percentage of covered-employee payroll
2017	$ 76,280	$ 76,280	$ -	$ 141,200	54.02%
2016	$ 32,988	$ 32,988	$ -	$ 156,575	21.07%
2015	$ 33,290	$ 33,290	$ -	$ 149,773	22.23%
2014	$ 29,896	$ 29,896	$ -	$ 163,093	18.33%

Notes

This schedule will be expanded to show 10 years, once information becomes available in the future.

In fiscal years 2016 and 2015, the census data collection data is as of beginning-of-year. The total pension liability at end of year was determined by actuarial valuation as of the census data collection date at beginning-of-year and was then projected forward to end-of-year, using roll-forward methods and assuming no liability gains or losses.

Methods and assumptions used for the computation of the net pension liability as of June 30, 2016 (measurement date) follows:

Valuation date	June 30, 2015
Measurement date	June 30, 2016
Actuarial cost method	Entry age normal cost
Asset -valuation method	Market value of assets
Actuarial assumptions:	
Discount rate	2.85%
Inflation	2.50%
Salary increases	3.00% per year. No compensation increases are assumed until July 1, 2021 as a result of Act No. 66 and the current general economy.
Investment rate of return	6.55%
Mortality tables:	

- *Pre-retirement Mortality* – For general employees not covered under Act No. 127, RP-2014 Employee Mortality Rates for males and females adjusted to reflect Mortality Improvement Scale MP-2016 from the 2006 base year, and projected forward using MP-2016 on generational basis. For members covered under Act No. 127, RP-2014 Employee Mortality Rates are assumed with blue collar adjustments for males and females adjusted to reflect Mortality Improvement Scale MP-2016 from the 2006 base year, and projected forward using MP-2016 on generational basis. As generational tables, they reflect mortality improvements both before and after the measurement date. 100% of deaths while in active service are assumed to be occupational only for members covered under Act No. 127.

- *Post-retirement Healthy Mortality* – Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of the ERS Plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 92% of the rates from the UP-1994 Mortality Table for Males and 95% of the rates from the UP-1994 Mortality Table for Females, both projected from 1994 to 2010 using Scale AA. The base rates are projected using Mortality Improvement Scale MP-2016 on a generational basis. As a generational basis, it reflects mortality improvements both before and after the measurement date.

- *Post-retirement Disable Mortality* – Rates which vary by gender are assumed for disable retirees based on a study of the ERS Plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 105% of the rates from the UP-1994 Mortality Table for Males and 115% of the rates from the UP-1994 Mortality Table for Females. The base rates are projected using Mortality Improvement Scale MP-2016 on a generational basis. As a generational table, it reflects Mortality improvements both before and after the measurement date.

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
June 30, 2017

(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
Year Ended June 30, 2017

(In thousands)

Revenues		
Service revenues (cash basis)	$	1,026,012
Other income		1,720
Developers contributions		1,985
Transfer from rate stabilization account		-
Operating revenues (cash basis)		1,029,717
Budgetary reserve fund		-
Total authority revenues		1,029,717
Operating expenses:		
Payroll and payroll related		352,889
Electricity		126,650
Other operating expenses		213,812
Total net operating expenses		693,351
Non cash reserve adjustments		80,694
Adjusted operating expenses		612,657
Total net revenues per MAT	$	417,060
Debt service coverage calculation:		
Operating revenues	$	1,029,717
Senior debt (net of funds available in the Senior Bond Fund of $43.6 million)		230,789
Accumulated coverage ratio (Min 2.5x) - Section 7.01 (i) MAT		***4.46***
Senior subordinated debt		2,721
Accumulated coverage ratio (Min 2.0x) - Section 7.01 (ii) MAT		***4.41***
All bonds and other system indebtedness		233,510
Accumulated coverage ratio (Min 1.5x) - Section 7.01 (iii) MAT		***4.41***
Rate covenants:		
Authority revenues	$	1,029,717
All debt plus current expenses		924,595
Accumulated coverage ratio (Min 1.0x) - Section 7.01 (iv) MAT		***1.11***

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

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

We have audited, in accordance with the auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Puerto Rico Aqueduct and Sewer Authority (the Authority) as of and for the year ended June 30 2017, and the related notes to the financial statements, which collectively comprise the Authority 's basic financial statements and have issued our report thereon dated September 30, 2019.

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the 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.

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.

Kevane Grant Thornton

Compliance and Other Matters

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

Purpose of this Report

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

San Juan, Puerto Rico,
September 30, 2019.

Kevane Grant Thornton LLP

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KEVANE GRANT THORNTON LLP
CERTIFIED PUBLIC ACCOUNTANTS