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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, 2018 and 2017

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

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Kevane Grant Thornton

Kevane Grant Thornton LLP
33 Bolivia Street
Suite 400
San Juan, Puerto Rico 00917-2013

T + 1 787 754 1915

F + 1 787 751 1284

E kgt@pr.gt.com

linkedin.com/company/kevane-grant-thornton
facebook.com/kevanegrantthornton

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 sheets as of June 30, 2018 and 2017, and the related statements of revenues, expenses and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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Opinions

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, 2018 and 2017 and the respective changes in financial position, and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Restatement of Prior Period Financial Statements
As discussed in Note 22 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 22 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 17, the schedule of the Authority's proportionate share of the net pension liability on page 73 and, the schedules of contributions on pages 74 - 75 and the schedule of changes in the Authority's total other postemployment benefits ("OPEB") liability and related ratios on page 76, 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.

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

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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 December 31, 2020, 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
December 31, 2020.

Kevane Grant Thornton LLP

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As management of Puerto Rico Aqueduct and Sewer Authority ("the Authority" or "PRASA"), we offer readers of the Authority's annual financial report our discussion and analysis of the Authority's financial performance during the fiscal years ended on June 30, 2018 and 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.

June 30, 2018 and 2017 Financial Highlights

- 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. 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. Hurricanes Irma and María *(the "Hurricanes')* caused together devastating damage to the island. Both Hurricanes badly damaged the electric power infrastructure, which in turn affected the continuity of water and sewer services to numerous customers throughout the island. The Hurricanes also damaged most of the Authority's infrastructure island wide. The operational and financial impact consisted of (i) lower customer consumption during fiscal year 2018 (despite 90% of the Authority's service being restored by November 2017); (ii) higher rate of uncollectible bills in all rate categories (residential, commercial, industrial and government); (iii) lower revenues from other services and fees (i.e., disconnection/reconnection fees); and (iv) higher expense costs to normalize operations and to address response and recovery needs (i.e., diesel costs for generators operation, security, chemicals**,** overtime**,** generators rental and water distribution contracts). The Authority's infrastructure damage estimate is $769 million, including a projection for potential additional unidentified damages of ancillary facilities, but excluding the unknown impact on buried assets. This estimate, however, only considers repairing and replacing the Authority's Systems (the "Systems") to exactly (or similar to) their condition prior to the hurricanes, thereby excluding the implementation of any resiliency projects to mitigate or reduce future risks related to hurricanes or other natural disasters or enabling the Systems assets to comply with current regulatory standards. The Authority estimates that revenue reduction and incremental expenses incurred and committed as a result of the storms amounted to $293 million and $220 million, respectively.

- The Authority's net position in fiscal year 2018 decreased by $308.4 million or 49.1% when compared to fiscal year 2017 net position of $628.4 million, mostly as a result of the Hurricane's impact on the Authority's financial condition. The decrease in net position is due to an increase in operating expenses by $256.3 million (including depreciation and amortization) and an increase in net non-operating expenses by $1 million, net of an increase in operating revenues by $90.9 million mainly as a result of business interruption insurance proceeds and an increase in capital contributions by $100.5 million, mostly from the Federal Emergency Management Agency ("FEMA") to recover a portion of incremental expenses related to the Hurricanes.

- Operating revenues increased by $53 million to $1,085 million, or 5.1%. During fiscal year 2018, the Authority recognized insurance proceeds for business interruption of $144 million, net of adjuster's broker fee, from the Hurricane Maria revenue loss claim. When comparing the water and sewer service revenue for fiscal year 2018 versus prior year, revenues decreased by $91 million, even after an implemented rate adjustment, mainly as result of the services interruption caused by the Hurricanes.

- Operating expenses, including depreciation and amortization, increased by $256.3 million to $1,250.1 million, or 25.8%. On fiscal year 2018, after the Hurricanes impact, the Authority through an engineer's firm performed an assets and properties assessment, which included site visits to the principal facilities and properties to identify and estimate damages to the Authority system. Based on such analysis the Authority registered an asset impairment of $194.2 million (which is presented net of insurance proceeds of $135 million, net of adjuster's broker fee) following Governmental Accounting Standards Board (GASB) Statement No. 42 (Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries). GASB 42 defines asset impairment as a significant, unexpected decline in the service utility of a capital asset. The impairment was calculated by using the Restoration Cost Approach which derives the amount of impairment from the estimated cost to restore the utility of the capital asset to its original condition.

- The Authority incurred additional expenses as part of the effort to re-establish the water and wastewater service on the island resulting in an increase of $88 million in operating expenses, including an increase of $26.4 million in repairs and maintenance expense, payroll and payroll related expenses by $7.1 million. Also, other operating expenses including security services, electric generators rentals units, diesel for generators and water transport increased by $85.5 million. At the same time, the Hurricanes impact resulted in savings on various operating expenses, such as electricity by $22.1 million, materials and replacement by $6.1 million; professional and consulting services by $3 million; and chemicals by $2.8 million.

- Non-operating expenses increased by $1 million, or 0.4% to a net expense of $247.8 million, including mostly the interest expense for the period.

- Capital contributions increased by $100.5 million to $104.5 million, primarily as a result of an increase of $97.5 million in funds obligated by FEMA to reimburse the Authority a portion of the costs incurred in the system recovery process after the Hurricanes impact.

- Total assets and deferred outflow of resources decreased by $138.1 million to $7,868.5 million or 1.7% when compared to $8,006.6 million in fiscal year 2017. The reduction is related to a decrease in capital assets of $552 million, caused mainly by depreciation and amortization of $272.5 million, the recognition of the assets impairment prior to insurance proceeds of $329 million, asset additions of $52.2 million, and a decrease in deferred outflows of resources of $41.2 million, offset by an increase in current assets of $450.6 million, which includes an increase by $186 million in receivable from insurance companies and an increase in cash and cash equivalent of $147.9 million; and increase in noncurrent restricted cash of $4.5 million.

- Total liabilities and deferred inflow of resources increased by $170.3 million to $7,548.5 million or 2.3%, which reflect an increase in account payables of $70.6 million, an increase in accrued liabilities of $70.3 million, an increase in compensated absences, post-employment and other benefits of $46.5 million, an increase in accrued interest of $52.2 million, and an increase in unearned revenue of $9.6 million; net of a decrease in pension liability of $168.7 million, and a decrease in long term debt of $57.2 million.

June 30, 2017 and 2016 Financial Highlights

- On fiscal year 2017, the Authority implemented 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 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.

- Operating expenses, including depreciation and amortization, increased by $6 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 years ended June 30, 2018 and 2017, which include Balance Sheets, Statements of Revenues, Expenses and Changes in Net Position, Statements of Cash Flows and the notes to financial statements.

Financial Analysis of the Authority

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

Analysis of Financial Results

The following table provides a summary of the Authority's net position as of June 30, 2018 and 2017 (in thousands):

	June 30, 2018	June 30, 2017	Change
Current and restricted assets	$ 1,094,454	$ 639,324	$ 455,130
Capital assets, net	6,446,540	6,998,570	(552,030)
Deferred outflows of resources	327,511	368,710	(41,199)
Total assets and deferred outflows of resources	7,868,505	8,006,604	(138,099)
Long-term debt outstanding	4,987,101	5,044,321	(57,220)
Other liabilities	2,377,680	2,295,968	81,712
Deferred inflows of resources	183,739	37,956	145,783
Total liabilities and deferred inflows of resources	7,548,520	7,378,245	170,275
Net position:			
Investment in capital assets, net	1,702,037	2,195,602	(493,565)
Restricted	122,818	79,606	43,212
Unrestricted deficit	(1,504,870)	(1,646,845)	141,975
Total net position	$ 319,985	$ 628,363	$ (308,378)

Net Position

June 30, 2018 and 2017

The Authority's net position for fiscal year ended June 30, 2018 was approximately $320 million. This is a decrease of $308.4 million, or 49.1%, from the net position as of June 30, 2017 of $ 628.4 million.

Total assets and deferred outflows decreased by $138.1 million, or 1.7%, during the fiscal year ended June 30, 2018, primordially due to the recognition of $329.2 million on impairment loss on capital assets in connection with the impact of hurricanes Irma and Maria. Insurance proceeds amounting to $135 million, net of adjuster's broker fee, were recovered from this impairment.

Current and restricted assets increased by $455.1 million, principally due to an increase of $147.9 million in cash and cash equivalents due to the receipt of $93 million from insurance companies proceeds, an increase of $39.9 million in current restricted cash and cash equivalents, an increase of $186 million in accounts receivable from insurance companies, an increase of $39.9 million in accounts receivable net, and an increase of $26.3 million in accounts receivable from federal agencies.

For the fiscal year 2018, restricted cash, unrestricted cash, cash equivalents and other deposits increased by $192.4 million compared with fiscal year ended June 30, 2017. The increase is primary due to the $93 million received from insurance proceeds for business interruption and $70.6 million received from FEMA, an increase of $51.6 million in government accounts collections, and $38.4 million deposited into the operational reserve fund account, which is held by the Authority's trustee agent. In addition, during fiscal year 2018, the Authority deposited $77.4 million in the capital improvement fund account to finance the capital improvement program.

Capital assets decreased by $552 million, or 8% to $6,446.5 million, primary related to depreciation and amortization of $272.5 million and $3.8 million in retirements, additions for the period of $52.2 million and the recognition of an impairment loss of $329.2 million in capital assets being depreciated, as result of the damages caused by the impact of the Hurricanes. For the fiscal year 2018, the Authority recognized a receivable from insurance companies of $186 million.

Deferred outflow of resources decreased by $41.2 million, mainly as a result of the actuarial valuation on the GASB 68 by $36.2 million, a decrease of $4.6 million for the amortization of losses resulting from debt refunding, and a decrease in deferred outflows of resources from GASB 75 by $0.4 million.

Total liabilities and deferred inflows of resources increased by $170.3 million to $7,548.5 million, or 2.3% when compared with fiscal year 2017 total liabilities and deferred inflows of resources of $7,378.2 million. Total current liabilities increased by $260 million, driven by an increase of $70.6 million in accounts payables as a result of the Hurricanes impact in operational costs and in the Authority's liquidity during that period, an increase of $70.3 million in accrued liabilities, an increase of $52.2 million in accrued interest, increase in current portion of pension liability of $39.7 million and an increase of $9.6 million in unearned revenue and increase in the current portion of long-term debt of $10.7 million.

Total non-current liabilities and deferred inflows of resources decreased by $89 million, which is mainly driven by a decrease in non-current pension liability of $208.3 million, partially offset by an increase in deferred inflows of resources form GASB 68 of $146.2 million as results of the actuarial valuation performed by the Employee Retirement System, an increase in postemployment and other benefits liability of $46.5 million, due to the recognition of early termination benefits liability for $48.2 million for employees qualifying for the Pre-Retirement Program created by Act No. 211 of 2015 (repealed on August 23, 2017 by Act No. 106). In addition, the noncurrent portion on long term debt decreased by $69 million, principally due to the principal payment of $54.2 million on outstanding bonds.

Net Position

June 30, 2017 and 2016

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 months 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 decreased by $39.7 million, driven by a decrease of $51.7 million in the current portion of long-term debt (which reflects a reclassification of $97.4 million to noncurrent liabilities to conform with 2018 financial statement presentation) , decrease of $75.9 million in accounts payable as part of the initiative to reduce CIP contractors' obligations due, and a decrease of $12.4 million in accrued liabilities; net of an increase of $53 million in pension liability, and an increase of $50.9 million in the accrued interest.

Total non-current liabilities increased by $1,562.1 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.

Capital Assets

Capital assets as of June 30, 2018 and 2017 were as follows (in thousands):

	June 30,		
	2018	2017	Change
Capital assets being depreciated	$ 10,662,414	$ 10,935,871	$ (273,457)
Accumulated depreciation and amortization	(4,614,248)	(4,345,624)	(268,624)
	6,048,166	6,590,247	(542,081)
Land and other nondepreciable assets	74,956	74,913	43
Construction in progress	323,418	333,410	(9,992)
Capital assets, net	$ 6,446,540	$ 6,998,570	$ (552,030)

During fiscal year 2018, as a result of the impact of hurricanes Irma and Maria in its assets, the Authority, in compliance with GASB No. 42 "Accounting and Financial Reporting for Impairment of Capital Assets for Insurance Recoveries", performed a capital assets and facilities assessment, and recognized an impairment loss on capital assets of $329.2 million. The decrease of $552 million in capital assets includes a reduction of $273.6 million due to such impairment partially off-set by the additions of the year, an increase by $272.5 million in depreciation and amortization, and a reduction of $10 million in work in progress. Additions during fiscal year 2018 amounted to $52.2 million and are broken down as follows:

- $10.4 million in the Authority's capital improvement program
- $41.7 million in renewal and replacement projects.

The Authority has $323.4 million in construction in progress as of June 30, 2018. As of June 30, 2017, capital improvements program was halted and some projects were prioritized in order to comply with regulatory agencies and other projects were rescheduled for the following years.

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

	June 30,		
	2017	2016	Change
		As previously reported	
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 being depreciated includes (i) net additions of $87.2 million, including additions of transfers from work in progress, (ii) reduction of $273.5 million in depreciation and amortization and (iii) $75.9 million in reduction of work in progress mostly as a result of transfers to fixed assets net from $47 million in capital investment during fiscal year 2018 by $47 million broken down as follows:

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

The Authority had $333.4 million in construction in progress as of June 30, 2017. As of June 30, 2017, capital improvements program was halted 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, 2018 and 2017 was as follows (in thousands):

	June 30,		
	2018	**2017**	**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	9,550	25,240	(15,690)
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	351,400	386,380	(34,980)
2012 Series A Term Bonds	1,381,995	1,381,995	-
2012 Series B Serial Bonds	123,430	123,430	-
2012 Series B Term Bonds	107,115	107,115	-
Rural Development Serial Bonds	389,096	392,646	(3,550)
Plus premium on bonds refunding	24,596	25,196	(600)
Less: bond discounts	(15,435)	(15,647)	212
Total bonds	$ 4,341,276	$ 4,395,884	$ (54,608)

(Continued)

	June 30, 2018	June 30, 2017	Change
Bonds payable	$ 4,341,276	$ 4,395,884	$ (54,608)
Notes payable:			
Water Pollution Control and Drinking Water Treatment Revolving Funds Loans	580,275	581,276	(1,001)
Notes with commercial banks	-	1,610	(1,610)
Notes with GDB	65,550	65,550	-
Total notes payable	645,825	648,436	(2,611)
Long-term debt outstanding	4,987,101	5,044,320	(57,219)
Other long term liabilities:			
Pension liabilty	1,407,286	1,575,926	(168,640)
Accrued compensated absences	40,560	43,300	(2,740)
Net OPEB and other obligation	75,524	74,549	975
Early retirement obligation	48,243	-	48,243
Customer deposits	89,601	88,371	1,230
Total other liabilities	1,661,214	1,782,146	(120,932)
Total – long-term obligations	6,648,315	6,826,466	(178,151)
Current portion	190,255	132,802	57,453
Long-term obligations, less current portion	$ 6,458,060	$ 6,693,664	$ (235,604)

The Authority's long-term debt decreased by $57.2 million, or 1% from $5,044.3 million as of June 30, 2017, to $4,987.1 million as of June 30, 2018.

Bonds Payable

Bonds outstanding as of June 30, 2018 decreased by $54.6 million, mainly as a result of the payments of principal on 2012 Series B of $35 million and on 2008 Series A Revenue Bonds of $15.7 million and the payment of $3.5 million in principal on Rural Development ("RD") Bonds during fiscal year 2018, under the terms of a forbearance agreement, extended in several occasions until July 2019. During fiscal year 2018, the Authority did not issue additional bond debt.

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

The agreement was approved by the Financial Oversight and Management Board for Puerto Rico (the "Oversight Board") pursuant to Section 207 of PROMESA and consolidates and restructures all RD Bonds into two loans 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 ("MAT").

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 MAT. As of June 30, 2018, the Fleet Term Loan was paid 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, 2018, the Authority's loans outstanding under these programs amounted to approximately $581.3 million, which were considered Commonwealth Guaranteed Indebtedness under the MAT.

On June 30, 2016, the Authority executed a Forbearance Agreement with the Department of Health ("DOH"), the Environmental Quality Board ("EQB") and the Puerto Rico Department of Natural and Environmental Resources as its successor ('PRDNER") and the Puerto Rico Infrastructure Financing Authority ("PRIFA") related to the State Revolving Fund ("SRF") programs. 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.

On July 26, 2019, the Authority and the Puerto Rico Fiscal Agency and Financial Advisory Authority ("AAFAF", by its Spanish acronym) 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 agreement was approved by 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.

On February 29, 2012, the Authority entered into a line of credit agreement with the Government Development Bank of Puerto Rico ("GDB"). This agreement provided an available maximum amount of $150 million for the purpose of assisting with the Authority's cash flow needs during the transition period after amending and restating the MAT 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.

The Loan Agreement was subsequently transferred to the GDB Debt Recovery Authority, a statutory public trust and governmental instrumentality created pursuant to Act 109-2017, as amended, ("GDB-DRA") upon consummation of the GDB Qualifying Modification (the "Qualifying Modification") under Title VI of PROMESA on November 29, 2018. At the time of the transfer to the GDB-DRA, the outstanding principal amount under the Loan Agreement was $57.5 million, plus accrued, and unpaid interest. On November 10, 2020, the Authority, AAFAF, GDB-DRA, and the servicer and collateral monitor for GDB-DRA reached an agreement in principle, contingent on Oversight Board approval, to resolve and settle in full all Authority's obligations under the Loan Agreement for a one-time Authority payment in the amount of $20.5 million (the "Settlement Agreement"). On November 20, 2020, the Oversight Board approved the settlement, and that same day the Authority made the $20.5 million payment in full. Pursuant to the terms of the Settlement Agreement, the Loan Agreement was terminated and the Authority has no further obligation under it.

Pension liability as of June 30, 2018 decreased by $168.6, or 11% to $1,407.3 million compare to $1,575.9 million in June 30, 2017, the change is the results of the most recent actuarial valuation report on GASB 68 performed by the Employee Retirement System ("ERS").

Detailed information regarding long-term debt activity is included in Notes 11 through 13 to the financial statements.

Summary of Revenues, Expenses, and Changes in Net Position

The following table provides a summary of the Authority's changes in net position for the years ended June 30, 2018 and June 30, 2017 (in thousands):

	June 30, 2018	June 30, 2017	Change
Operating revenue:			
Revenues from water and sewer services, net	$ 941,007	$ 1,032,003	$ (90,996)
Insurance proceeds for business interruption	143,998	-	143,998
Total operating revenues	1,085,005	1,032,003	53,002
Operating expenses:			
Payroll and payroll related	360,000	352,889	7,111
Electricity	104,510	126,650	(22,140)
Repairs and maintenance of capital assets	60,810	34,433	26,377
Chemicals	29,188	32,023	(2,835)
Professional and consulting services	28,703	31,715	(3,012)
Materials and replacements	12,497	18,565	(6,068)
Insurance	10,672	7,890	2,782
Service contract – Superaqueduct	4,118	3,852	266
Other operating expenses	170,853	85,334	85,519
Operating expenses (excluding depreciation and amortization)	781,351	693,351	88,000
Depreciation and amortization	272,513	285,228	(12,715)
Impairment loss on capital assets	194,197	-	194,197
Cost of assets disposed	2,019	15,218	(13,199)
Total operating expenses	1,250,080	993,797	256,283
Operating (loss) income	(165,075)	38,206	(112,285)
Nonoperating expenses, net	(247,807)	(246,802)	(1,005)
Loss before capital contributions	(412,882)	(208,596)	(113,290)
Capital contributions	104,504	4,016	100,488
Change in net position	(308,378)	(204,580)	(103,798)
Net position at beginning of year, as restated	628,363	832,943	(204,580)
Net position at end of year	$ 319,985	$ 628,363	$ (308,378)

Net position decreased by $308.4 million or 49.1%, from $628.4 million in 2017 to $320 million in fiscal year 2018.

Major fluctuations that resulted in a decrease in net position of $308.4 million when compared to 2017 operational results are broken down as follows (in thousands):

Increase in operating revenues	$	53,002
Increase in operating expenses		(256,283)
Increase in nonoperating expenses, net		(1,005)
Increase in capital contributions		100,488
Decrease in net position		(204,580)
Net change	$	(308,378)

Operating revenues increased by $53 million or 5.1%. During fiscal year 2018, the Authority recognized insurance proceeds for business interruption of $144 million, net of adjuster's broker fee, from the Hurricane Maria revenue loss claim. When comparing the water and sewer service revenue for fiscal year 2018 versus prior year, revenues decreased by $91 million, even after an implemented rate adjustment, mainly as result of the services interruption caused by the Hurricanes.

Operating expenses increased by $256.3 million or 25.8% primarily due to the net effect of the following:

- Increase of $194.2 million in impairment loss on capital assets.
- Increase of $85.5 million in other operating expense.
- Increase of $26.4 million in repairs and maintenance of capital assets expenses.
- Increase of $7.1 million in payroll and payroll-related expenses
- Decrease of $22.1 million in electricity expense.
- Decrease of $13.2 million in cost of assets disposition.
- Decrease of $12.7 million in depreciation and amortization expense.
- Decrease of $6.1 million in materials and replacements.
- Decrease of $3 million in professional and consulting expenses.
- Decrease of $2.8 million in chemicals expense.

Non-operating expenses increased by $1 million or 0.4% when compared to fiscal year 2017. The increase is the result of a reduction in other income of $2.6 million, and a decrease of interest expense, the amortization of bond premium and discount, and deferred refunding losses of $0.9 million, netted by an increase in interest income of $0.6 million.

Capital contributions increased by $100.5 million primarily as a result of an increase of $97.5 million in funds obligated by FEMA to reimburse the Authority a portion of the costs incurred in the system recovery process after the Hurricanes impact.

Puerto Rico Oversight, Management, and Economic Stability Act

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.

Next Year's Budget and Credits Ratings

On June 15, 2020, the Authority submitted its budget version for fiscal year 2021 to the Oversight Board as requested by PROMESA. On June 30, 2020 the Oversight Board certified its version of the fiscal year 2021 budget for the Authority which is available at https://oversightboard.pr.gov. The certified budget for fiscal year 2021 includes $349 million for the Authority's Capital Improvement Program.

The Authority's Senior Revenue Bonds credit ratings, as of the date of the issuance of this financial statement are "Ca" by Moody's Investor Services and "CCC" by Fitch Ratings. In August 2018, Standard and Poor's withdrew its credit ratings for the Authority's bonds.

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 or (787) 620-3791.

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

Balance Sheets
June 30, 2018 and 2017

(In thousands)

Assets

	2018	2017
Current assets:		
Cash and cash equivalents	$ 233,626	$ 85,718
Accounts receivable, net	239,734	199,875
Receivables from insurance companies	186,000	-
Receivables from federal agencies	26,563	279
Materials and supplies inventory, net	29,421	27,842
Prepayments and other current assets	13,695	4,652
Restricted cash for debt service	216,451	176,472
Total current assets	945,490	494,838
Restricted assets--		
Restricted cash and cash equivalents (noncurrent)	148,964	144,486
Capital assets:		
Capital assets being depreciated	10,662,414	10,935,871
Accumulated depreciation and amortization	(4,614,248)	(4,345,624)
	6,048,166	6,590,247
Land and other nondepreciable assets	74,956	74,913
Construction in progress	323,418	333,410
Total capital assets, net	6,446,540	6,998,570
Deferred outflows of resources:		
Deferred loss resulting from debt refunding	18,349	23,027
Deferred outflows of resources of GASB 68	302,705	338,868
Deferred outflows of resources of GASB 75	6,457	6,815
Total deferred outflows of resources	327,511	368,710
Total assets and deferred outflows of resources	$ 7,868,505	$ 8,006,604

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

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

Balance Sheets
June 30, 2018 and 2017

(In thousands)

Liabilities and Net Position

	2018	2017
Current liabilities:		
Bonds payable	$ 58,000	$ 54,608
Notes payable	10,000	2,611
Pension liability	92,674	52,970
Accounts payable	250,867	180,287
Accrued liabilities	197,528	127,258
Accrued interest	238,380	186,151
Unearned revenue	29,691	20,123
Customers' deposits	7,771	7,820
Compensated absences, postemployment and other benefits	21,810	14,793
Total current liabilities	906,721	646,621
Noncurrent liabilities:		
Bonds payable	4,283,276	4,341,276
Notes payable	635,825	645,825
Pension liability	1,314,612	1,522,956
Customers' deposits	81,830	80,551
Compensated absences, postemployment and other benefits	142,517	103,056
Total noncurrent liabilities	6,458,060	6,693,664
Deferred inflows of resources:		
Deferred inflows of resources GASB 68	176,354	30,162
Deferred inflows of resources GASB 75	7,385	7,794
Total deferred inflows of resources	183,739	37,956
Total liabilities and deferred inflows of resources	7,548,520	7,378,241
Net position:		
Net investment in capital assets	1,702,037	2,195,602
Restricted for environmental compliance, capital activity and other	122,818	79,606
Unrestricted deficit	(1,504,870)	(1,646,845)
Total net position	319,985	628,363
Total liabilities and net position	$ 7,868,505	$ 8,006,604

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

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

Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2018 and 2017

(In thousands)

	2018	2017
Operating revenues:		
Water	$ 652,532	$ 705,448
Sewer	353,217	359,923
Insurance proceeds for business interruption	143,998	-
Bad debt expense	(64,742)	(33,368)
Total net operating revenues	1,085,005	1,032,003
Operating expenses:		
Payroll and payroll related	360,000	352,889
Electricity	104,510	126,650
Repairs and maintenance of capital assets	60,810	34,433
Professional and consulting services	28,703	31,715
Chemicals	29,188	32,023
Materials and replacements	12,497	18,565
Insurance	10,672	7,890
Service contract – Superaqueduct	4,118	3,852
Other operating expenses	170,853	85,334
Operating expenses (excluding depreciation and amortization)	781,351	693,351
Depreciation and amortization	272,513	285,228
Impairment loss on capital assets	194,197	-
Cost of assets disposed	2,019	15,218
Total operating expenses	1,250,080	993,797
Operating (loss) income	(165,075)	38,206
Nonoperating revenues (expenses):		
Interest expense, net of amortization of debt issuance cost, bond premium and discount, and deferred refunding loss	(252,875)	(253,792)
Interest income	2,958.00	2,329
Other income, net	2,110	4,661
Total non-operating expenses, net	(247,807)	(246,802)
Loss before capital contributions	(412,882)	(208,596)
Capital contributions:		
Federal grants and other contributions	104,504	3,894
Other Commonwealth contributions	-	122
Total capital contributions	104,504	4,016
Change in net position	(308,378)	(204,580)
Net position at beginning of year	628,363	832,943
Net position at end of year	$ 319,985	$ 628,363

The accompanying notes are an integral part of these statements.

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

Statements of Cash Flows
Years Ended June 30, 2018 and 2017

(In thousands)

	2018	2017
Cash flows from operating activities:		
Cash received from customers	$ 913,980	$ 1,028,662
Cash received from insurance companies	93,000	-
Cash paid to suppliers	(402,219)	(426,967)
Cash paid to employees	(212,594)	(280,826)
Net cash provided by operating activities	392,167	320,869
Cash flows from noncapital financing activities--		
Net cash from other income	2,110	4,661
Cash flows from capital and related financing activities:		
Additions to utility plant and other capital assets	(54,142)	(29,571)
Proceeds from capital contributions	102,469	6,873
Proceeds from issuance of notes payable	-	1,517
Payments of bonds and notes	(56,832)	(52,966)
Interest paid on bonds, notes and lines of credit	(196,365)	(198,834)
Net cash used in capital and related financing activities	(204,870)	(272,981)
Cash flows from investing activities --		
Interest received on investments	2,958	2,329
Net change in cash and cash equivalents	192,365	54,878
Cash and cash equivalents, beginning of year	406,676	351,798
Cash and cash equivalents, end of year	$ 599,041	$ 406,676
For purposes of the statements of cash flows, cash and cash equivalents include:		
Unrestricted	$ 233,626	$ 85,718
Restricted	365,415	320,958
	$ 599,041	$ 406,676

The accompanying notes are an integral part of these statements.

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

Statements of Cash Flows
Years Ended June 30, 2018 and 2017

(In thousands)

	2018	2017
Reconciliation of operating (loss) income to net cash provided by operating activities:		
Operating (loss) income	$ (165,075)	$ 38,206
Adjustments to reconcile operating (loss) income to net cash provided by operating activities:		
Depreciation and amortization	272,513	285,228
Impairment loss on capital assets	329,199	-
Cost of assets disposed	2,019	15,219
Bad debt expense	64,742	33,368
Change in assets and liabilities:		
Accounts receivable	(102,566)	(38,612)
Receivables from insurance companies	(186,000)	-
Receivables from federal agencies	(26,284)	2,406
Materials and supplies inventory	(1,578)	(42)
Prepayments and other current assets	(9,043)	(306)
Accounts payable	73,021	(84,571)
Unearned revenue	9,568	(76)
Accrued compensated absences, postemployment and other benefits	46,433	917
Accrued liabilities	(22,400)	(2,615)
Customers’ deposits	1,229	1,979
Pension liability	106,389	69,768
Total adjustments	557,242	282,663
Net cash provided by operating activities	$ 392,167	$ 320,869

The accompanying notes are an integral part of these statements.

(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, 2018 and 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 years ended June 30, 2018 and 2017 PRASA Holdings, LLC did not have operational activities. However, it has total assets and net position of $0.5 and $0.6 million as of June 30, 2018 and 2017, respectively.

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.

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 maintained some construction fund accounts related to past bond issuances invested. As of June 30, 2018 and 2017, the account balances amounted to approximately $0.9 million. The accounts were 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 discussed in more detail in the subsequent event section below, in November 2018, GDB ceased operations, and as part of the Qualifying Modification in the Authority's deposits held at GDB were extinguished and the available balances were applied against the outstanding balance under the loan agreement.

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

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

Receivables

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

Materials and Supplies Inventory

Materials and supplies inventory 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, 2018 and 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 sheets.

Capital Assets

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

Utility plant and other capital assets are carried at historical cost or estimated historical cost, which includes capitalized labor, materials, administrative costs, and interest on debt financed construction. 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 halt its construction in progress, as a result the Authority did not recognize capitalized interest for the years ended June 30, 2018 and 2017. As of the date the financial statements were available to be issued, the Authority has re-activated the capital improvement program.

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

Depreciation and amortization expense 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

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 performed an assessment of impairment on capital assets as of June 30, 2018 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.

After the damages caused by hurricanes Irma and Maria, the Authority evaluated its capital assets as required by GASB 42 and an asset impairment of $329 million was recognized for the year ended June 30, 2018. Insurance proceeds amounting to $135 million, net of adjuster's broker fee, were recovered from this impairment.

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 sheets report 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 sheets 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.

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

<u>Deferred outflows</u>

- Unamortized deferred loss from debt refunding. See Note 12.
- 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 14.
- Difference between actual and expected experience related to other postemployment benefits obligation. See Note 15.

<u>Deferred inflows</u>

- Difference between actual and expected experience and changes in assumptions of the net pension liability. See Note 14.
- Difference between projected and actual investment earnings on pension plan investments. See Note 14.
- Changes in assumptions about future economic and demographic factors related to other postemployment benefits obligation. See Note 15.

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.

Termination Benefits

The Authority accounts for termination benefits in accordance with GASB Statement No. 47, Accounting for Termination Benefits. Pursuant to the provisions of GASB Statement No. 47, in financial statements prepared on the accrual basis of accounting, employers should recognize a liability and expense for voluntary termination benefits (for example, early retirement incentives) when the offer is accepted and the amount can be estimated. A liability and expense for involuntary termination benefits (for example, severance benefits) should be recognized in the financial statements when (i) a plan of termination has been approved by those with the authority to commit the government to the plan, (ii) the plan has been communicated to the employees, and (iii) the amount can be estimated.

Postemployment Health Benefits

The Authority provides certain healthcare benefits for retired employees. Substantially all 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. On 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 15.

The total cost of healthcare benefits paid to retired employees amounted to approximately $3 million and $2.9 million for fiscal years 2018 and 2017, respectively.

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" (GASB 68), as* detailed in Note 14.

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, GASB 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, a pay as you go pension mechanism was implemented, therefore, the 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", will become effective for the reporting period ended June 30, 2019.

Net Position

The Net Position is the difference between an entity's assets plus deferred outflows of resources and its liabilities plus deferred inflows of resources.

Net position is reported in three categories:

- ***Net Investment in Capital Assets*** – Includes 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*** – Reflect constraints on the use of net assets that are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation. As of June 30, 2018 and 2017 the Authority had no assets restricted by enabling legislation.

- ***Unrestricted Net Position*** – Consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net position could be designated to indicate that management 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.

Effects of New Pronouncements

The following GASB statements were adopted in fiscal year 2018:

GASB Statement No. 73 ("GASB 73") establishes requirements for defined benefit pension plans and defined contribution plans that are not within the scope of GASB 68. GASB 73 extends the approach to accounting and financial reporting established in GASB 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 68, should not be considered pension plan assets. It also requires that information similar to that required by GASB 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 effective during fiscal year 2019 due to the implementation of the pay-as-you-go system by the ERS with the enactment of Act 106 of 2017.

GASB Statement No. 81, requires that a government that receives resources pursuant to an irrevocable split interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. GASB Statement No. 81 also provides expanded guidance for circumstances in which the government holds the assets. The adoption of this statement had no impact on the Authority's financial statements.

GASB Statement No. 85 addresses practice issues that were identified during implementation and application of certain GASB Statements. The Statement covers a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefit). The adoption of this statement had no impact on the Authority's financial statements.

GASB Statement No. 86 establishes standards of accounting and financial reporting requirements, for in substance defeasance of debt transactions in which cash and other monetary assets acquired with only existing resources—that is, resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of future repayment of outstanding debt. The adoption of this statement had no 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
82	Pension Issues – an Amendment of GASB Statements No. 67, No. 68 and No. 73	2019
84	Fiduciary Activities	2020
87	Leases	2021
88	Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements	2019
89	Accounting for Interest Cost Incurred Before the End of a Construction Period	2021

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
92	Omnibus 2020	2021
93	Replacement in Interbank Offered Rates	2021
94	Public-Private and Public-Public Partnerships and Availability Payment Arrangements	2023
96	Subscription-Based Information Technology Arrangements	2023
97	Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans	2022

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

Commonwealth Appropriations

The Authority receives appropriations from the Commonwealth, which are classified as operating revenue, non-operating revenue or capital contributions as specified in Joint Resolutions approved by the Puerto Rico Legislature. Commonwealth appropriations to pay for operating expenses are classified as operating revenues. Commonwealth appropriations to pay for debt service are classified as non-operating revenues and appropriations for capital projects are classified as capital contributions. During fiscal years 2018 and 2017, the Authority did not receive commonwealth appropriations.

Capital Contributions

The Authority receives contributions from Developers, the Commonwealth Governmental Agencies, and Federal Lenders, such as USDA and EPA, and are classified as capital contributions to be invested in infrastructure projects. In addition, the Authority, also receives contribution from the Federal Emergency Management Agency (“FEMA”) for recovery and resiliency, when a natural disaster occurs and its declared state of emergency by the President of the United States of America.

Reclassifications

Certain amounts in the 2017 financial statements have been reclassified to conform with 2018 financial statements presentation. See Note 11.

(2) Deposits

As of June 30, 2018, and 2017, the carrying amount of deposits with financial institutions of the Authority consisted of the following (in thousands):

	June 30,							
	2018				2017			
	Carrying amount	Impairment loss	Net Carrying amount	Bank balance	Carrying amount	Impairment loss	Net Carrying amount	Bank balance
Unrestricted deposits in commercial banks in Puerto Rico	$ 233,626	$ –	$ 233,626	$ 235,003	$ 85,718	$ –	$ 85,718	$ 84,948
Restricted deposits in commercial banks in Puerto Rico	360,766	–	360,766	360,766	316,322	–	$ 316,322	316,322
Restricted deposits in GDB	14,444	(9,795)	4,649	14,444	14,431	(9,795)	4,636	14,431
Total	$ 608,836	$ (9,795)	$ 599,041	$ 610,213	$ 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.

(3) 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. As result of GDB's cease of operations, the Authority recognized an impairment over deposits held at GDB. GDB was a component unit of the Commonwealth.

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

	June 30,	
	2018	2017
Uninsured and uncollateralized:		
GDB	$ 14,444	$ 14,431
Less: Impairment loss [1]	(9,795)	(9,795)
Total	$ 4,649	$ 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 years ended June 30, 2018 and 2017. The balance of the deposits which was not impaired of $4.6 million as of June 30, 2016, consist of federal grants received under the USDA Rural Development Program to finance construction projects required by the federal program. The Qualifying Modification provided that all federal deposit claims were not impaired by the restructuring.

Pursuant to the terms of the Qualifying Modification, the Commonwealth is in the process of restoring all funds from federal programs held at GDB including $6.3 million related to USDA Rural Development Program. The Authority received such funds from the Commonwealth during fiscal year 2020. In November 2020, USDA Rural Development, requested the Authority to remit $5.3 million of such funds, since there are no further outstanding invoices related to projects for which the funds were assigned to. The remaining funds deposited at GDB by $8 million were reduced from the balance owed by the Authority to GDB under a term loan, as further discussed in Note 13.

(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, 2018 and 2017 consisted of the following (in thousands):

	June 30, 2018	June 30, 2017
Water and sewer services:		
Residential, industrial, and commercial	$ 768,423	$ 675,221
Government agencies and municipalities	134,871	125,531
	903,294	800,752
Other receivables:		
Government agencies and municipalities (1)	7,146	7,146
Private entities	32,420	32,396
	39,566	39,542
	942,860	840,294
Less allowance for uncollectible accounts	(703,126)	(640,419)
Total	$ 239,734	$ 199,875

(1) Other receivables from government agencies and other municipalities as of June 30, 2018 and 2017 includes $3.7 million of receivables of commonwealth appropriations, which consisted of prepaid interest by the Authority on the PFC 2011 Series B Bonds to be reimbursed by the Commonwealth. This receivables from Commonwealth are fully reserved.

(5) Other Receivables

Receivables from Insurance Companies

Following GASB No. 42 Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance companies, the Authority recognized a receivable from insurance companies of $186 million as of June 30, 2018. Such balance reflects the amount to be received from the insurance companies under the property insurance policy coverage for the business interruption and asset damages caused by hurricane Maria. As of the date of the issuance of this financial statement, receivables from insurance companies were fully collected.

Receivables from Federal Agencies

Receivables from federal agencies of approximately $26.5 million and $0.3 million as of June 30, 2018 and 2017, respectively, consisted primarily of amounts to be received from the Federal Emergency Management Agency (“FEMA”) of the U.S. Department of Homeland Security (“USDHS”) as reimbursement for expenses incurred by the Authority for disaster recovery activities. During the fiscal year ended June 30, 2018, Receivable from Federal Agencies increased by $26.2 million due to the declaration of state of emergency made by the President of the United State of America, for the territory of Puerto Rico after the extreme damages caused by hurricanes Irma and Maria in Puerto Rico.

(6) Materials and Supplies Inventory

Material and supplies inventory was approximately $29.4 million and $27.8 million as of June 30, 2018 and 2017, respectively and consisted of materials and supplies 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, 2018 were as follows (in thousands):

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated:				
Land	$ 64,358	$ 7	$ -	$ 64,365
Easement	10,555	36	-	10,591
Construction in progress	333,410	52,135	(62,127)	323,418
Total capital assets not being depreciated	408,323	52,178	(62,127)	398,374
Capital assets being depreciated:				
Infrastructure (water and sewer facilities)	9,659,757	69,762	(211,073)	9,518,446
Wells, tanks and meters	772,765	12,791	(117,414)	668,142
Buildings and improvements	111,069	10,114	(38,275)	82,908
Equipment, furniture, fixtures and vehicles	392,280	19,040	(18,402)	392,918
Total capital assets being depreciated	10,935,871	111,707	(385,164)	10,662,414
Less: accumulated depreciation and amortization:				
Infrastructure (water and sewer facilities)	(3,708,270)	(225,017)	3,889	(3,929,398)
Wells, tanks and meters	(272,598)	(26,376)	-	(298,974)
Buildings and improvements	(42,641)	(1,652)	-	(44,293)
Equipment, furniture, fixtures and vehicles	(322,115)	(19,468)	-	(341,583)
Total accumulated depreciation and amortization	(4,345,624)	(272,513)	3,889	(4,614,248)
Total capital assets being depreciated, net	6,590,247	(160,806)	(381,275)	6,048,166
Total capital assets, net	$ 6,998,570	$ (108,628)	$ (443,402)	$ 6,446,540

On September 6, 2017, Puerto Rico was affected by Category 5 Hurricane Irma and on September 20, 2017, Hurricane María, an extremely destructive category 4 hurricane, made landfall in Puerto Rico. Hurricanes Irma and María (the “Hurricanes’) caused together devastating damage to the island. Both Hurricanes badly damaged the electric power infrastructure, which in turn affected the continuity of water and sewer services to numerous customers throughout the island. The Hurricanes also damaged most of the Authority’s infrastructure island wide. The Authority’s infrastructure damage estimate is $769 million, including a projection for potential additional unidentified damages of ancillary facilities, but excluding the unknown impact on buried assets. This estimate, however, only considers repairing and replacing the Systems to exactly (or similar to) their condition prior to the hurricanes, thereby excluding the implementation of any resiliency projects to mitigate or reduce future risks related to hurricanes or other natural disasters or enabling the Systems assets to comply with current regulatory standards. As a result of the damages caused by Hurricanes, the Authority recorded an impairment loss on capital assets of $194 million, net of insurance proceeds of $135 million (net of adjuster's broker fee) for the year ended June 30, 2018.

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. It also includes funds designed by the Authority for specific projects such as water sustainability and others projects. Construction funds are deposited in accounts held by the Trustee.

Capital Activity Funds –Capital activity funds represent amounts deposited as required by the annual budget into the Capital Improvement Fund held by the Trustee as well as funds deposited to comply with agreements requiring construction of infrastructure projects, including, 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 – Including amounts deposited for the payment of principal and interest on bonds and notes. They also include deposits required by the Master Agreement of Trust (“MAT”) to be maintained in the Debt Service Reserve accounts.

Disaster Recovery Funds – Include funds received from FEMA or other federal agency or insurance proceeds to be invested in infrastructure projects for the system recovery after disaster emergencies, such as hurricanes, tropical storms, earthquakes, and others.

Operating Reserve Fund – Including deposits to comply with the Operating Reserve Fund requirement required by the MAT.

The Authority reclassified to current restricted cash and cash equivalent $216.5 million and $176.5 million as of June 30, 2018 and 2017, respectively, used for debt service payments obligations.

Restricted assets by category as of June 30, 2018 and 2017 consisted of the following (in thousands):

	June 30,	
	2018	2017
Construction funds	$ 53,569	$ 55,769
Capital activity funds	81,418	42,125
Debt service funds	240,223	232,859
	375,210	330,753
Less: Impairment loss [1]	(9,795)	(9,795)
Total	$ 365,415	$ 320,958

Note:

1 The impairment loss was recognized during fiscal year 2016

(9) Accrued Liabilities

Accrued liabilities as of June 30, 2018 and 2017 consisted of the following (in thousands):

	June 30,	
	2018	**2017**
Payroll and related accruals	$ 109,392	$ 40,413
Legal, labor related and environmental contingencies	72,478	70,815
Contract retentions	15,658	16,030
Total	$ 197,528	$ 127,258

(10) Voluntary Termination Benefits Payable

On December 8, 2015, the Commonwealth enacted Act No. 211 to establish a program to eligible employees, as defined, of the Commonwealth of Puerto Rico voluntarily retire of their employment in an incentivized program until they comply with the requirements to retire.

Act 211 early retirement benefits to eligible employees, as defined, consist of a compensation equivalent to 60% of each employee salary, the liquidation of vacations and sick leave accrued balances, considering the top limit established by Act. No 66 of 2014. In addition, employees will maintain health plan coverage and employer contribution for a maximum term of two years.

On August 23, 2017, the Commonwealth enacted Act No. 106 that repealed Act. No. 211, however, articles 7.1 (a), (b), (c) and (d) of Act No. 106 guarantee all the rights and obligations created under Act No. 211.

At June 30, 2018, unpaid long term benefits granted in Act No. 211 were discounted at interest rate of 2.40%.

The impact of the Act No.211 for the Authority as of June 30, 2018 is approximately $48.2 million.

(11) Long-Term Debt

Long-term debt activity for the year ended June 30, 2018 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	-	56,247
2008 Series A Revenue Bonds	1,276,340	-	(15,690)	1,260,650	16,650	1,244,000
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	-	(34,980)	1,733,395	-	1,733,395
2012 Series B Revenue Bonds	230,545	-	-	230,545	36,705	193,840
Rural Development Serial Bonds	392,646	-	(3,550)	389,096	4,236	384,860
Sub total bonds	4,386,335	-	(54,220)	4,332,115	57,591	4,274,524
Add: bond premium	25,196	-	(600)	24,596	633	23,963
Less: bond discount	(15,647)	-	212	(15,435)	(224)	(15,211)
Total bonds	4,395,884	-	(54,608)	4,341,276	58,000	4,283,276
Notes payable:						
Water Pollution Control and Safe Drinking Water Treatment Revolving Funds Loans	581,276	-	(1,001)	580,275	10,000	570,275
Notes with commercial banks	1,610	-	(1,610)	-	-	-
Notes with GDB	65,550	-	-	65,550	-	65,550
Total notes	648,436	-	(2,611)	645,825	10,000	635,825
Other long term liabilities:						
Net pension liabilty	1,575,926	-	(168,640)	1,407,286	92,674	1,314,612
Accrued compensated absences	43,300	9,643	(12,383)	40,560	10,069	30,491
Net OPEB and other obligation	74,548	52,168	(2,949)	123,767	11,741	112,026
Customers' deposits	88,372	7,912	(6,683)	89,601	7,771	81,830
Total other liabilities	1,782,146	69,723	(190,655)	1,661,214	122,255	1,538,959
Total – long-term obligations	$ 6,826,466	$ 69,723	$ (247,874)	$ 6,648,315	$ 190,255	$ 6,458,060

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 (1)	Due Thereafter
Bonds payable:						
2011 Series A PFC Commonwealth Appropriation Bonds	$ 90,099	$ -	$ -	$ 90,099	$ -	$ 90,099
2011 Series B PFC Commonwealth Appropriation Bonds	102,183	-	-	102,183	-	102,183
2011 Series B PFC Commonwealth Appropriation Bonds (Superaqueduct)	162,700	-	-	162,700	-	162,700
2012 Series A PFC Commonwealth Appropriation Bonds	56,247	-	-	56,247	–	56,247
2008 Series A Revenue Bonds	1,291,280	-	(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	3,550	389,096
Sub total bonds	4,436,505	-	(50,170)	4,386,335	54,220	4,332,115
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	54,608	4,341,276
Notes payable:						
Water Pollution Control and Safe Drinking Water Treatment Revolving Funds Loans	580,012	1,518	(254)	581,276	1,001	580,275
Notes with commercial banks	4,153	-	(2,543)	1,610	1,610	-
Notes with GDB	65,550	-	-	65,550	-	65,550
Total notes	649,715	1,518	(2,797)	648,436	2,611	645,825
Net pension liabilty	1,496,377	112,537	(32,988)	1,575,926	52,970	1,522,956
Net OPEB obligation	40,535	36,887	(2,874)	74,548	3,996	70,552
Accrued compensated absences	43,434	9,430	(9,564)	43,300	10,797	32,503
Customers' deposits	86,393	10,297	(8,318)	88,372	7,820	80,552
Total other liabilities	1,666,739	169,151	(53,744)	1,782,146	75,583	1,706,563
Total – long-term obligations	$ 6,762,877	$ 170,669	$ (107,080)	$ 6,826,466	$ 132,802	$ 6,693,664

(1) $97.4 million, presented on prior year financial statements as current portion, were reclassified to noncurrent to conform with 2018 financial statements presentation.

(12) Bonds Payable

Bonds payable as of June 30, 2018 and 2017, consisted of the following (in thousands):

	June 30	
	2018	**2017**
PFC Commonwealth Appropriation Bonds:		
Series 2011:		
Series A, 6.50%, due in semiannual interest payments through August 1, 2028 and annual principal installments from August 1, 2027 to 2028	$ 90,099	$ 90,099
Series B, 5.50% - 6.00% due in semiannual interest payments through August 1, 2031 and annual principal installments from August 1, 2024 to 2031	102,183	102,183
Series B - Superaqueduct, 5.50% - 6.00% due in semiannual interest payments through August 1, 2031 and annual principal installments from August 1, 2024 to 2031	162,700	162,700
Series 2012:		
Series A, 3.10% - 5.35%, due in monthly interest payments through August 1, 2031 and annual principal installments from August 1, 2015 to 2031	56,247	56,247
Revenue Refunding Bonds:		
Series 2008:		
Series A and B, Term Bonds, 5.80% – 6.10%, due in montly interest payments through July 1, 2034 and annual principal payments from July 1, 2021 to 2034	284,755	284,755
Revenue bonds:		
Series 2008:		
Series A, Serial Bonds, 5.00%, due in semiannual interest payments through July 1, 2025 and annual principal payments from July 1, 2012 to July 1, 2025	9,550	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	155,975

	June 30	
	2018	**2017**
Series A, Term Bonds, 5.00% - 6.00%, due in semiannual interest payments through July 1, 2027 and annual principal payments from July 1, 2026 to 2047	1,095,125	1,095,125
Series B, Serial Bonds, 6.15% due in monthly interest interest payments through July 1, 2038 and one principal payment on July 1, 2038	22,445	22,445
Series 2012:		
Series A, Serial Bonds, 4.00% - 5.55%, due in semiannual interest payments through July 1, 2030 and annual principal payments from July 1, 2015 to July 1, 2030	351,400	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	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	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	107,115
Rural development serial bonds:		
Serial Bonds, 2.00% - 5.00%, due semiannually through July 1, 2055	389,096	392,646
Subtotal	4,332,115	4,386,335
Bond premium	24,596	25,196
Bond discount	(15,435)	(15,647)
Total	$ 4,341,276	$ 4,395,884

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 2018 nor 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, 2018 and 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.

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, 2018, and 2017, the Authority's share for the 2011 Series A, 2011 Series B, 2011 Series B Superaqueduct and 2012 Series A Refunding Bonds is approximately $90.1 million, $102.2 million, $162.7 million and $56.2 million, respectively.

Due to the non-appropriations of funds for the payments of the Notes in the Commonwealth's annual budget for fiscal year 2018, none of the payments on the Notes, or any corresponding payments on the PFC Bonds, that have come due and payable in fiscal year 2018 have been paid. As publicly disclosed by GDB and PFC following the approval of the Commonwealth's annual budget for fiscal year 2018, 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, 2018 and 2017, the outstanding balance for the 2008 Revenue Bonds Series A was $1,260.7 million and $1,276.3 million, respectively, which included approximately $28 million of accreted value.

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

The 2008 Series A and B Revenue Bonds are considered senior debt. As of June 30, 2018 and 2017, the outstanding balance for the 2008 Revenue Bonds Series B was $22.4 million.

2008 Series A and B Revenue Refunding Bonds

On March 18, 2008, the Authority issued approximately $284.8 million of Series A and B Revenue Refunding Bonds, (the 2008 Revenue Refunding Bonds), guaranteed by the Commonwealth to refund the Authority's outstanding Revenue Refunding Bonds, 1995 Series (guaranteed by the Commonwealth) in the amount of approximately $262.8 million. The 2008 Revenue Refunding Bonds bear interest at rates ranging from 5.80% to 6.10% per annum with maturity dates ranging from July 1, 2021 to July 1, 2034. The 2008 Series A and B Revenue Refunding Bonds net proceeds of approximately $279.5 million (after payment of approximately $5.3 million in underwriters' discount, insurance, and other issuance costs) and other funds made available from sinking funds and investment accounts from the refunded bonds, were deposited in an irrevocable trust with an escrow agent to pay all future principal and interest payments of the 1995 Series Bonds to their respective dates of redemption or maturity. As a result, the 1995 Series Bonds are considered to be defeased and the liability for those bonds has been removed from the Authority's balance 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, 2018, and 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 million of term bonds bearing interest at rates ranging from 5% to 6% per annum with maturity dates ranging from July 1, 2033 to July 1, 2047.

The 2012 Series B Revenue Bonds of approximately $295.2 million was issued to: (1) provide funds to repay a bond anticipation note issued by the Authority in the aggregate principal amount of $241 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 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 16.

The 2012 Revenue Bonds are issued as Senior Debt, pursuant to the terms of the MAT. As of June 30, 2018 and 2017, the outstanding balance for 2012 Series A and B was $1,963.9 million and $1,998.9 million, respectively.

Rural Development Serial Bonds

The 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, 2018, 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, 2018 and 2017 was $389.1 million and $392.6 million, respectively.

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 following the priorities defined in the Master Agreement of Trust. Therefore, as of June 30, 2018 and 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.

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 $27.8 million.

On July 26, 2019, the Authority and the Puerto Rico Fiscal Agency and Financial Advisory Authority ("AAFAF", by its Spanish acronym) 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 MAT, not guaranteed by the Commonwealth.

Debt Service Payments

Future principal and interest payments on all bonds payable outstanding as of June 30, 2018 are as follows (in thousands):

Fiscal Year	Principal	Interest	Total
2019	$ 57,591	$ 207,545	$ 265,136
2020	65,889	221,088	286,977
2021	67,915	216,986	284,901
2022	80,095	213,164	293,258
2023	86,278	208,824	295,102
2024-2028	603,498	965,976	1,569,474
2029-2033	912,749	835,881	1,748,631
2034-2038	754,874	528,789	1,283,663
2039-2043	901,877	313,551	1,215,428
2044-2048	653,594	103,546	757,139
2049-2053	71,223	13,514	84,737
2054-2058	78,670	6,068	84,737
2059-2063	11,740	252	11,992
Total	4,345,993	$ 3,835,183	$ 8,181,176
Plus: unamortized premium	24,596		
Less: unamortized discount	(15,435)		
Bonds payable, net	$ 4,355,154		

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 restructured new debt agreement, which for Rural Development includes $13.9 million in accrued interest.

(13) Notes Payable

Notes payable as of June 30, 2018 and 2017, consisted of the following (in thousands):

	2018	2017
Puerto Rico Water Pollution Control Revolving Fund	$ 391,553	$ 392,553
Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund	188,722	188,722
Notes with commercial banks	-	1,611
Note with GDB	65,550	65,550
	$ 645,825	$ 648,436

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 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, 2018 and 2017, the Authority had an outstanding balance of approximately $580.3 million and $581.3 million, respectively, under these loan agreements.

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

On June 30, 2016, the Authority executed a Forbearance Agreement (the “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 the Authority'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.

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. The outstanding balance of the Fleet Term Loan was $1.6 million as of June 30, 2017 and was paid in full during fiscal year 2018.

Note with GDB

On February 29, 2012, the Authority entered into a line of credit agreement with GDB. This agreement provided an available maximum amount of $150 million for the purpose of assisting with the Authority's cash flow needs during the transition period after amending and restating the MAT 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.

The Loan Agreement was subsequently transferred to the GDB Debt Recovery Authority, a statutory public trust and governmental instrumentality created pursuant to Act 109-2017, as amended, ("GDB-DRA") upon consummation of the GDB Qualifying Modification (the "Qualifying Modification") under Title VI of PROMESA on November 29, 2018. At the time of the transfer to the GDB-DRA, the outstanding principal amount under the Loan Agreement was $57.5 million, plus accrued, and unpaid interest. On November 10, 2020, the Authority, AAFAF, GDB-DRA, and the servicer and collateral monitor for GDB-DRA reached an agreement in principle, contingent on Oversight Board approval, to resolve and settle in full all Authority's obligations under the Loan Agreement for a one-time Authority payment in the amount of $20.5 million (the "Settlement Agreement"). On November 20, 2020, the Oversight Board approved the settlement, and that same day the Authority made the $20.5 million payment in full. Pursuant to the terms of the Settlement Agreement, the Loan Agreement was terminated and the Authority has no further obligation under it.

The combined future aggregate amount of debt service for these notes as of June 30, 2018 was as follows (in thousands):

	Principal	Interest	Total
2019	$ 10,000	$ -	$ 10,000
2020	76,383	12,109	88,492
2021	10,000	-	10,000
2022	10,000	-	10,000
2023	10,000	-	10,000
2024-2028	50,000	-	50,000
2029-2033	101,386	18,240	119,626
2034-2038	119,482	17,551	137,033
2039-2043	125,592	11,440	137,032
2044-2048	132,015	5,018	137,033
2049-2053	27,202	204	27,406
Total	$ 672,060	$ 64,562	$ 736,622

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 restructured debt agreement, which for SRF includes $26.2 million in new loans granted as of the restructuring date.

(14) 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.

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").

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. 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, effective on July 1, 2013.

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.

The ERS was severely underfunded, its ratio (fiduciary net position as a % of total pension liability) as of June 30, 2017 was negative 6.57% and the net pension liability was approximately $34,218 billion.

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

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 July 1, 2017 the new “pay as you go” (PayGo) mechanism for all the Commonwealth Retirements Systems. On July 1, 2017, employer’s contributions, contributions ordered by special laws and Additional Uniform Contributions were all eliminated.

On August 23, 2017, the Governor signed into law Act No. 106-2017, known as the “Act to Guarantee the Payments to our Pensioners and Establish a New Plan of Defined Contributions for Publics Employees”. As of July 1, 2017, the effective date of Act 106-2017, established the “Pay as You Go” (PayGo) mechanism for the payments of pension benefits by the Commonwealth and reformed the ERS in order that their active participants would deposit their individual contributions in a new defined contributions plan, similar to a 401(K) plan. The new plan would be managed by a private entity. The Act 106-2017 covered employers should 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.

Act No. 106-2017 established the employee contributions for the ERS from 8.50% up to 20% of covered payroll.

Pay Go contributions charged to the Authority during the year ended June 30, 2018 amounted to $92.6 million.

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.

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

The Authority’s net pension liability decreased from $1,575 million as of June 30, 2017 to $1,407 million as of June 30, 2018. The reduction of $168 million on the net pension liability was determined by an actuarial valuation as of June 30, 2017. The Authority’s proportion of the net pension liability was 4.11269% at measurement date of June 30, 2017 (4.18031% for June 30, 2016). 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 reflects 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, other special law contributions, and Act 32 Additional Uniform Contribution.

As of June 30, 2018 and 2017, the Authority recognized pension expense of approximately $106.4 million and $126.6 million, respectively. As of June 30, 2018, the Authority reported deferred outflows of resources and deferred inflows of resources related to pension from the following sources (expressed in thousands):

Deferred outflows of resources	Beginning of year balance	Additions	Deductions	End of year balance
Difference between actual and expected experience	$ 1,288	$ -	$ 337	$ 951
Changes in assumptions	240,377	-	56,407	183,970
Changes in proportion	44,232	-	19,122	25,110
Employer contributions subsequent to the measurement	52,970	92,674	52,970	92,674
	$ 338,867	$ 92,674	$ 128,836	$ 302,705

Deferred inflows of resources	Beginning of year balance	Additions	Deductions	End of year balance
Difference between actual and expected experience	$ 21,635	$ 3,271	$ -	$ 24,906
Changes in assumptions	-	143,228	-	143,228
Net difference between projected and actual investment earnings on pension plan investments	8,527	-	307	8,220
	$ 30,162	$ 146,499	$ 307	$ 176,354

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

The $92.6 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, 2019. 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
2019	$ 13,634
2020	15,592
2021	16,094
2022	(6,404)
2023	(30,348)
	$ 8,568

Actuarial methods and assumptions

The total pension liability as of June 30, 2017 (measurement date) was determined by an actuarial valuation as of July 1, 2016 that was rolled forward to June 30, 2017 and assuming no gains or losses.

The following is a description of the actuarial methods and assumptions used by the ERS for the computation of the net pension liability as of June 30, 2017 (measurement date).

Valuation date	July 1, 2016
Measurement date	June 30, 2017
Actuarial cost method	Entry age normal cost
Actuarial assumptions:	
Discount rate	3.58%
Inflation	Not applicable
Salary increase	3% per year. No compensation increases are assumed until July 21, 2021 as a result of Act No. 66 and the current general economy.
Invetsment rate of return	6.55%
Mortality	(see below)

The mortality tables used by the ERS in the June 30, 2017 actuarial valuation were as follows:

- *Pre-retirement Mortality* – For the Authority employees, RP-2014 Employee Mortality Rates for males and females adjusted to reflect Mortality Improvement Scale MP-2017 from the 2006 base year and projected forward using MP-2017 on generational basis. As generational tables, they reflect mortality improvements both before and after the measurement date.

- *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-2017 on a generational basis. As a generational basis, it reflects mortality improvements both before and after the measurement date.

- *Post-retirement Disabled 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-2017 on a generational basis. As a generational table, it reflects mortality improvements both before and after the measurement date.

(Most other demographic assumptions used in the June 30, 2017 valuation were based on the results of a 2009 actuarial experience study using data as of June 30, 2003, June 30, 2005 and June 30, 2007.

Discount Rate

The ERS system is in a deficit position. 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 3.58% as of June 30, 2017.

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, 2017, calculated using the discount rate of 3.58%, 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 (2.58%) or 1 percent-point higher (4.58%) than the current rate (in thousands):

	1% Decrease (2.58%)	Current Discount Rate (3.58%)	1% Increase (4.58%)
Net pension liability	$ 1,595,801	$ 1,407,286	$ 1,255,509

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.

(15) 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 of a fixed maximum monthly payment (annuity) to cover medical expenses. Based on the Plan's features and functionality, and for the purpose of the actuarial valuation, it has been identified as a single-employer defined benefit healthcare plan. Participants groups covered are employees under 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 or after 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.

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.

During 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. 75, 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.

At June 30, 2017, the date of the most recent actuarial valuation, membership in the OPEB Program consisted of the following:

Retired participants and beneficiaries receiving payments	2,141
Active participants	4,491
Total	6,632

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, 2018 and 2017 was approximately $3 million and $2.9 million, respectively. There is no contribution requirement for plan members.

Annual OPEB costs and Net OPEB liability

As permitted by GASB No. 75, the Authority's total OPEB liability as of June 30, 2017 of $75,525 was measured at June 30, 2017 by actuarial valuation as of that date. In fiscal year 2018, an expected OPEB liability was determined as of June 30, 2018 using standard roll forward techniques. The roll forward calculation begins with the actual OPEB liability as of the prior measurement date, June 30, 2017, adds the annual normal cost and interest at the discount rate for the previous year, and subtracts benefit payments for the year.

The following table illustrates changes in the total OPEB liability for the year ended June 30, 2018 and 2017 (in thousands):

	2018	2017
OPEB liability		
Balance at beginning of year	$ 74,548	$ 74,476
Changes for the year:		
Service cost	1,843	1,843
Interest	2,134	2,134
Difference between expected and actual experience	-	7,173
Changes in assumptions or other inputs	-	(8,204)
Benefit payments	(3,001)	(2,874)
Net changes	976	72
Balance at end of year	$ 75,524	$ 74,548

The following table illustrates the OPEB costs components for the years ended June 30, 2018 and 2017 (in thousands):

	2018	2017
OPEB expense:		
Service cost	$ 1,842	$ 1,842
Interest cost	2,134	2,134
Amortization change (gain)/loss:		
Liability loss	358	358
Assumption change	(409)	(409)
Total expense	$ 3,925	$ 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 years ended June 30, 2018 and 2017 (in thousands):

	2018		2017	
	Deferred outflows of resources	Deferred inflows of resources	Deferred outflows of resources	Deferred inflows of resources
Difference between actual and expected experience	$ 6,457	$ -	$ 6,815	$ -
Net difference between expected and actual earnings on OPEB plan investment	-	-	-	-
Assumption changes	-	7,385	-	7,794
Total	$ 6,457	$ 7,385	$ 6,815	$ 7,794

The following table illustrates the list of amortizations for the OPEB deferred outflows of resources and deferred inflows of resources under GASB No. 75 for the year ended June 30, 2018 (in thousands):

		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	$ 6,457	$ 358
6/30/2016	Assumptions	20.03	19.03	(8,204)	(7,385)	(410)
	Total charges				$ (928)	$ (52)

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

Year Ending June 30,	Amount
2019	$ (52)
2020	(52)
2021	(52)
2022	(52)
2023	(52)
2024 and thereafter	(668)
	$ (928)

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).

Actuarial Assumptions

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

Economic Assumptions

Discount Rate

The discount rate considered for years ended June 30, 2018 and 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 years ended June 30, 2018 and 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.

Demographic Assumptions

Turnover

For the years ended June 30, 2018 and 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.

Disability Table

The Hunter disability table was used for the valuation.

(16) 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 and deposits required by the MAT.

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

As of June 30, 2018, the Authority rate covenant on all obligations was 0.92, as a result of lower revenues and increased costs experienced by the impact in the Authority system of the 2017 hurricanes.

In accordance with the requirements of Section 7.01 of the MAT, the Authority expects to submit the rate covenant calculation to the consulting engineers as soon as the fiscal year 2018 audited financial statements are available. The Authority expects the consulting engineer will issue a report stating the rate covenant results for fiscal year 2018 were affected by the extraordinary impacts of the 2017 Hurricanes and that for fiscal year 2019, taking into account the rate adjustment implemented by the Authority in fiscal year 2019, the Authority is expected to comply with the rate covenant without any additional measure or action to be taken by the Authority’s management.

(17) Capital Contributions

Capital contributions for the fiscal year ended June 30, 2018 and 2017 were as follows (in thousands):

	2018	2017
Developer contributions	$ 3,394	$ 4,138
Contributions from governmental agencies and municipalities	2,736	664
Other contributions from Commonwealth	-	122
Other contributions	894	1,571
	7,024	6,495
Less return of federal grants:		
USDA Rural Development Program	-	(2,101)
Federal Emergency Management Agency	97,480	(378)
	$ 104,504	$ 4,016

(18) Related Party Transactions

Operating revenues for services provided to the Commonwealth and its component units amounted to approximately $125.6 million and $152.4 million during the years ended June 30, 2018 and 2017, respectively. The Authority's government account receivable for water and sewer services for fiscal year 2018 was $134.9 million, and for fiscal year 2017 was $125.5 million, of which, the Authority recognized as uncollectible reserve $104.1 million and $80.5 million for fiscal years 2018 and 2017, respectively. Further, operating expenses during the fiscal years ended June 30, 2018 and 2017 were approximately $104.5 million and $126.7 million, respectively, of charges from Puerto Rico Electric Power Authority (PREPA), a component unit of the Commonwealth.

As of June 30, 2018, and 2017, the Authority had approximately $7.1 million of receivables, from the Commonwealth and its component units, which are fully reserved. Such receivable is reported as accounts receivable net in the accompanying balance sheets.

The Authority had approximately $19.5 million and $3.6 million of excess of collections over billings from the Commonwealth, recorded as unearned revenue in the accompanying balance sheet as of June 30, 2018 and 2017, respectively. During fiscal year 2018, the Authority, the Department of Treasury joined efforts to reconcile central government accounts balances due in order to collect non-disputed outstanding balances.

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, 2018 and 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. On March 23, 2018, GDB ceased its operations and wound down in an orderly manner under Title VI of PROMESA. For more information please refer to the Note 13.

(19) Labor Union Contracts

The collective bargaining agreement with the UIA union was signed effective January 1, 2012 until December 31, 2015 and covered approximately 2,960 and 3,155 blue-collar and clerical employees, as of June 30, 2018 and 2017, respectively.

The collective bargaining agreement with the HIEPAAA union, which covered approximately 117 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 3-2017. Economic clauses and non-economic clauses with economic impact are suspended during the Act 3-2017 applicability.

(20) Agreement for Operation and Management of the Water and Sewer System

The Authority developed the Superaqueduct, as part of the infrastructure of the water intakes and the interconnections tanks in the distribution system, along the PR North Coast route, from Arecibo to Bayamón. 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 2019, the contract was extended for additional three months until December 2019. On January 1, 2020 the contract was renewed until December 2020. The costs incurred under the contract is reported under the caption of *Service Contract – Superaqueduct,* for fiscal year 2018 and 2017 such cost was $4.1 million and $3.9 million, respectively. All other operational costs associated with the operation of the Superaqueduct system are captioned in their respective expense category and are presented in the Authority's statements of revenues, expenses, and changes in net position as part of the financial statements.

(21) Commitments and Contingencies

Environmental Matters

Facilities and operations of the Authority's water and sewer 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

During the calendar year ended December 2016, the Authority accrued approximately $0.56 million for penalties for noncompliance with the remedial measures of the Agreement, corresponding to the Progress Reports 31 to 35. On July 7, 2017, $0.56 million 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.

As part of the Agreement, the Authority paid stipulated penalties during fiscal years 2018 and 2017 of $0.21 million and $0.34 million, respectively. Stipulated penalties were paid by the Authority for failing to comply with remedial measures deadlines and parameters exceedances. The Authority deposited $0.13 million for fiscal year 2018 and $0.24 million for fiscal year 2017 in an escrow account for parameters exceedances. The escrow account is to be used for compliance projects with the approval of the DOH.

The long-term remedial measures are divided in three terms: The Term 1 measures that were to be completed by December 31, 2011, the Term 2 measures that were to be completed by December 31, 2016, and the Term 3 measures are to be completed by December 31, 2021. All long-term remedial measures under Term 1 have been completed. The Term 2 measures have a total of 18 projects of which 14 have been completed.

DOH jointly requested the overseeing court to convert these remaining measures to the Term 3 category, which motion was granted by the court. The Term 3 measures have a total of 13 projects, seven of which have been completed. With respect to the remaining six remedial measures, the Authority and the DOH filed an additional joint motion requesting time extensions for four of these and the elimination of the remaining two, which motion was also granted by the court.

The time frame for the completion of the remaining Term 3 long-term measures remains December 31, 2021, but the Authority has asked to start negotiations with the DOH to amend the 2006 Drinking Water Settlement Agreement to include: (i) an update of the Authority's facilities; (ii) the elimination of certain projects and/or requirements included in the 2006 Drinking Water Settlement Agreement because such projects and/or requirements have already been completed and certified as such; (iii) the acceptance and the implementation of the prioritization system and the Base List as was accepted under the 2015 EPA Consent Decree; and (iv) the inclusion of scheduled mandatory projects under the base list in the 2015 EPA Consent Decree. However, these negotiations were not completed as of the date of these financial statements.

Before Hurricanes Irma and Maria in September 2017, the Authority had been in substantial compliance with the capital improvement project deadlines of the 2006 Drinking Water Settlement Agreement. After these Hurricanes, the Authority submitted a notification to DOH invoking the force majeure provisions of the 2006 Drinking Water Act Settlement Agreement and indicating the possibility of some delays in projects and program due dates

As of the date of the issuance of the financial statements, as mentioned above, the Authority has substantially complied with the capital improvement project deadlines under the 2006 Drinking Water Settlement Agreement. The Authority anticipates, however, that it may have difficulties meeting future deadlines unless the DOH approves the prioritization system under that Settlement Agreement.

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.

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 fiscal years 2018 and 2017, the Authority paid a total of $0.1 million and $0.74 million, respectively, in stipulated penalties under the Consent Decree. 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 was as follows for the period commencing on April 1, 2017 and ending on April 1, 2018:

Real and Personal Property

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.
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 occurance	Included in $150 million property coverage

The renewal of the real and personal property insurance policy starting on April 1, 2018 includes the same policy coverages and limits, except for the increased in deductibles to $100 million per each and every occurrence.

Liability

Coverage	Deductibles	Policy Limits
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	$100 thousand per occurrence	$5.0 million
Excess EPLI	$ 0	Additional $5.0 million

Owner Controlled Insurance Program

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 years 2018 and 2017.

Operating Leases

Certain commercial offices and warehouse facilities of the Authority are leased under operating lease agreements. During the fiscal years ended June 30, 2018 and 2017, the Authority incurred approximately $3.7 million and $3.8 million, respectively, in rent expense.

Future minimum non-cancelable lease payments on existing operating leases as of June 30, 2018, which have an initial term of one year or more, were as follows (in thousands):

Year Ending June 30,	Amount
2019	$ 2,728
2020	2,230
2021	2,002
2022	1,775
2023	1,516
2024-2028	2,351
2029-2033	1,601
	$ 14,203

Litigation

The Authority is a defendant in various lawsuits arising in the normal course of its business, including employment, contract, construction, and miscellaneous environmental claims. In the opinion of the Authority and its General Counsel, the ultimate disposition of such existing proceedings is either covered by insurance or will not have a material adverse effect on the financial position or operations of the Authority. However, management, based on discussion and opinions from legal counsels, has accrued a liability to cover litigation claims and contingencies that are $72.4 million and $70.8 million as of June 30, 2018 and 2017, respectively. See Note 9.

(22) 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 Authority’s beginning of year net position at beginning of year is as follows (in thousands):

				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
2016 - 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)
2016 - As restated	$ (1,517,717)	$ 322,012	$ (25,840)	$ 2,442,040	$ 5,364	$ (1,614,461)	$ 832,943

(23) Subsequent events

Subsequent events were evaluated through December 31, 2020, the date the financial statements were available to be issued, to determine if such events should be recognized or disclosed in the fiscal year 2018 financial statements.

USDA and SRF Debt Modification

On July 26, 2019, the Authority and AAFAF consummated definitive agreements (the "Agreements") restructuring the Authority'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.

Capital Improvement Program Reactivation

The Government's fiscal situation has had a major impact on the Authority, precluding its access to the capital markets to obtain financing for the Authority's CIP projects. In fiscal year 2016, the Authority was forced to suspend the execution of all CIP projects and important renewal work, such as replacing inefficient meters and failed/leaking pipelines was deferred.

Starting in fiscal year 2019, the Authority re-activated all regulatory-driven CIP projects and re-started its deposits into the Capital Improvement Fund. In addition, the Authority regained access to low interest federal loans during fiscal year 2020 as a result of the restructuring of a substantial portion of the Commonwealth Guaranteed Indebtedness as Senior Indebtedness.

2019-2020 Seismic Activity

On January 7, 2020, Puerto Rico was struck by a 6.4 magnitude earthquake causing significant damage to infrastructure in the southwestern portion of the island, an island-wide power outage and water shortages. In order to safeguard the health and public safety of its citizens, the Governor issued executive orders EO 2020-01 and EO 2020-02 declaring a state of emergency, activating an emergency purchasing protocol allowing emergency management agencies to acquire the necessary supplies and essential services to provide a timely and effective response and activating the National Guard to provide support during the emergency. In addition, the Oversight Board authorized through January 31, 2020 the utilization of Emergency Reserve funds from fiscal years 2019 and 2020, as needed by the Government of Puerto Rico, without the Board's prior approval of reapportionments. President Trump also approved an emergency declaration allowing direct federal assistance for emergency measures to protect lives, property and public health after the series of earthquakes.

Puerto Rico continues to experience numerous aftershocks that are not expected to stop any time soon. According to a January 29, 2020 report published by the United States Geological Survey, Puerto Rico is at risk of many potentially catastrophic earthquakes in the near term, a prediction borne out on May 2, 2020, when a 5.4 magnitude earthquake struck Puerto Rico's southwestern coast

The Authority estimates that its Systems in the affected area incurred damages of approximately $6.7 million, much of which is expected to be covered by insurance or be eligible for federal funding to offset the cost to the Authority of repairs.

COVID-19

On March 11, 2020, the World Health Organization declared the Coronavirus disease caused by a novel coronavirus ("COVID-19") a global pandemic. As a result of the health threat and to contain the COVID-19 spread across the island, the Governor issued executive order EO 2020-020, on March 12, 2020, declaring a state of emergency in Puerto Rico to concentrate all efforts and implement necessary measures to safeguard the health, well-being and public safety of the residents of Puerto Rico. The executive order authorizes the Secretary of the Department of Transportation and the Executive Director of the Office of Management and Budget of Puerto Rico to set up a special budget, from any available funds, including the Emergency Fund, to cover all necessary costs for the containment of the virus throughout the island and sharing information with the municipalities. The Governor has issued several extensions on the March order with various modifications to Puerto Rico's social distancing measures. The public emergency remains in effect as of the date of the issuance of these financial statements. On April 9, 2020, Act 39-2020 became effective, which has prevented the Authority from disconnecting residential customer's water services due to non-payment during the public emergency and for two months after it is ended.

The COVID-19 pandemic, associated mitigation policies, and the resulting economic impact have presented certain challenges for the Authority, including but not limited to reductions in collections, increase in operational expenses, shortage of supplies and interruption to contracted services, workforce issues and delayed in implementation of CIP. The Authority management has taken operational initiatives to support its liquidity, including promoting alternative payment options to improve collections, drawing down on previously collected insurance proceeds, and temporarily suspending deposits to its Capital Improvement Fund during the second half of fiscal year 2020.

The Authority also took steps to address operational challenges, including, maintaining on-site employees at minimum required levels in order to ensure an adequate and uninterrupted service while minimizing exposure, providing personal protective equipment to all employees required to report on-site, promoting remote work for administrative and support personnel, significantly expanding the number of virtual tasks performed, and increasing virtual communication among the Authority's personnel.

Force Majeure clause invoking

As a result of increased seismic activity in Puerto Rico in late 2019 and early 2020, as well as the recent COVID-19 pandemic, the Authority again invoked the Consent Decree and DOH Agreement force majeure clause. Although compliance with the capital improvement and program requirements was not affected, the Authority requested and obtained from both local and federal regulatory agencies extensions to deadlines for certain documentation and reporting requirements including Discharge Monitoring Reports (DMRs) and progress reports. As a result of structural damages at several facilities resulting from the recent seismic activities, the Authority has had to implement alternate liquid sludge disposal methods for sludge produced by affected wastewater treatment facilities, including landfill disposal.

2020 Drought

In 2020, PRASA faced a new dry season where 50% of the Island went under moderate to severe drought conditions. A water rationing plan was implemented affecting around 140,000 clients served by the Carraízo system from July 2 to July 27, 2020. Additionally, around 23,000 clients served by the water treatment plants of Canóvanas, El Yunque, Jaguar and Guzmán Arriba were also under water rationing as a result of water levels at the water intakes at the rivers serving the plants. To minimize the impact of the drought and water rationing on its service, the Authority has started taking measures to manage pressures in the system, reduce water production and activate wells to protect and extend water sources availability since December 2019, based on the reservoir levels and its trends. Such actions helped the Authority to reduce the impact to the service, which combined with system interconnections allowed PRASA to avoid more drastic water rationing measures.

Fiscal Plan

On June 29, 2020, 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 others, rate increases, a Public Private Partnership project for improving commercial services, increases in government account collections, reductions in physical water losses, and new federal funding. For more detail on PRASA’s financial projections and measures under implementation or to be implemented as required by the Oversight Board please refer to PRASA Fiscal Plan published in the Oversight Board webpage.

Rate Adjustments

PRASA’s current rate structure was adopted through the public hearing process of Act 21 and approved by the Governing Board pursuant to Resolution No. 2794 on July 3, 2013 and as amended by Resolution No. 2825 dated December 18, 2013. PRASA’s rate structure, set by its Governing Board, provides for an annual rate adjustment of up to 4.5% and not more than 25% through the application of an “Annual Adjustment Coefficient”.

In 2017, the Oversight Board required the Authority to implement moderate, but consistent multi-year rate adjustments to ensure its costs are fully covered by service revenues. On August 1, 2017 the Authority’s Governing Board approved, within the Annual Adjustment Coefficient parameters and authorization of the rate setting process of 2013, a moderate rate adjustment schedule for five years between fiscal year 2018 and fiscal year 2022 through Resolution 3042, as included below (date of implementation and (corresponding fiscal year):

Type of Client	Jan 1, 2018 (2018)	July 1, 2018 (2019)	July 1, 2019 (2020)	July 1, 2020 (2021)	July 1, 2021 (2022)
Residential	2.5%	2.5%	2.5%	2.5%	2.5%
Commercial	2.8%	2.8%	2.8%	2.8%	2.8%
Industrial	3.5%	3.5%	3.5%	3.5%	3.5%
Government	4.5%	4.5%	4.5%	4.5%	4.5%

The four scheduled rate adjustments for fiscal years 2018 through 2021 have been implemented as planned. The next scheduled rate adjustment is expected to be implemented on July 1, 2021.

Voluntary Early Retirement Programs

In recent years, the Government of Puerto Rico has implemented several early retirement programs for government workers, including employees of the Authority. Most recently an early retirement incentive was passed by the Legislature of Puerto Rico on August 3, 2020 (Act 80-2020). Under this program, that became effective in August 2020, retiring employees' pension calculation is based on 50% of the average annual salary during the last three years, and they are entitled to receive $100 per month for their health plan cost until the age of 62 and the payment of the dollar value of their accrued sick leave and vacation leave. Positions that become vacant as a result of this retirement program will not be re-staffed unless approved by Puerto Rico's Office of Management and Budget or through transfer of other current public employees. The Authority has 1,131 eligible employees under Act 80-2020. An informal Authority survey indicated a total of 729 employees are willing to participate under the program. The Oversight Board has stated that Act 80-2020 is not consistent with the Government of Puerto Rico's fiscal plan, and its passage has not been approved by the Oversight Board.

2020 Clean Water State Revolving Funds Loan

After the July 2019 successful debt restructuring of PRASA's outstanding loans under the Puerto Rico State Revolving Fund Program (the "SRF Program"), with the agreement of and in collaboration with the Environmental Protection Agency, PRASA regained access to funds from the SRF Program. On August 18, 2020, PRASA entered into a loan agreement with the Puerto Rico Department of Natural Resources and Puerto Rico Infrastructure Financing Authority for loans totaling up to $163 million to allow for funding of 28 wastewater capital improvement projects.

The executed loan agreement provides for a 30-year amortization after completion of the relevant projects, with a 1% interest rate. The loans were designated as Senior Indebtedness under PRASA's Master Trust Agreement.

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.

PRASA Note with GDB (refer to Note 13 for more details) was subsequently transferred to the GDB Debt Recovery Authority, a statutory public trust and governmental instrumentality created pursuant to Act 109-2017, as amended ("GDB–DRA") upon consummation of the GDB Qualifying Modification under Title VI of PROMESA on November 29, 2018 (the "GDB-DRA Loan Agreement"). The Authority's obligation under the GDB-DRA Loan Agreement was subordinate in all respects to its outstanding Trust Agreement obligations. At the time of the transfer to GDB-DRA, the outstanding principal amount under the GDB-DRA Loan Agreement was $57.5 million, plus accrued and unpaid interest. On November 10, 2020, the Authority, AAFAF, GDB-DRA and the collateral monitor for GDB-DRA reached an agreement in principle, contingent on Oversight Board approval, to resolve and settle in full all Authority obligations under the GDB-DRA Loan Agreement by a one-time Authority payment in the amount of $20.5 million. On November 20, 2020, the Oversight Board approved the settlement, the Authority made that payment in full, the GDB-DRA Loan Agreement was terminated, and the Authority has no further obligation under it.

Disaster Recovery Funds

After receiving $100 million during fiscal year 2018 of the property policy coverage, during fiscal year 2019 the Authority received the remaining balance of $200 million. From the total insurance proceeds of $300 million, $145 million were assigned for asset damage or capital improvement programs and $155 million were classified as business income loss. The insurance claim related to Hurricane Irma is still open. Also, under FEMA Accelerated Award Strategy (FAAST) applicable for all of the permanent work eligible under the FEMA declared disaster 4339DR-PR (Hurricane María), obligation of funds is expected to occur during calendar year 2021.

Debt Refunding

On December 17, 2020, the Authority issued its 2020 Series A and Series B Revenue Refunding Bonds (the "2020 Senior Bonds") in the amount of $1,351.3 million and $18.8 million, respectively, for the purpose of refunding a portion of the outstanding bonds of the Authority. The proceeds of the 2020 Senior Bonds were used to (i) refinance a portion of the currently outstanding 2008 Revenue Bonds, Series A, and Series B (Senior Lien) issued under the Trust Agreement, excluding the non-callable convertible capital appreciation bonds with a current balance of $87.2 million, (ii) refinance all of the Authority's currently outstanding Revenue Refunding Bonds, 2008 Series A and 2008 Series B, each guaranteed by the Commonwealth of Puerto Rico, and (iii) pay costs of issuance of the 2020 Senior Bonds. The par amount of the refunded bonds amounts to $1,427.6 million.

The 2020 Senior Bonds bear coupons at rates ranging from 4% to 5% per annum with yields at the time of issuance ranging from 2.50% to 4.50% with maturity dates ranging from July 1, 2021 to July 1, 2047. The proceeds of the 2020 Senior Bonds totaling $1,471.1 million, including $101 million in premium, were used to (i) pay for $10.4 million in underwriters' discount and other costs of issuance and (ii) deposit $1,460.7 million in an irrevocable trust with an escrow agent to pay the outstanding principal and accrued interest for the refunded bonds on the applicable redemption date. As a result, the refunded bonds are considered to be defeased.

The defeasance of the refunded bonds resulted in a reduction in the Authority's total debt service payments over the next 27 years of approximately $348.2 million and resulted in an economic gain (difference between the present values of the old and new debt service payments) of approximately $213.3 million.

The 2020 Senior Bonds are senior debt. Each purchaser of 2020 Senior Bonds consented by its purchase and execution of an investor letter to the terms and execution by the Trustee of a Second Amended and Restated Trust Agreement. The Second Amended and Restated Trust Agreement will be executed and become effective upon the receipt of the written consent of (1) the holders of all outstanding Bonds of each lien priority under the Trust Agreement and, (2) the Federal Lenders; and provide among other changes, to convert the security on the Authority's revenue from a gross revenue pledge to a net revenue pledge.

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, 2018 and 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
2018	4.11269%	$ 1,407,286	$ 128,722	1093.28%	$ (2,108,853)	-6.57%
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.

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

Schedule of Pension Contributions
June 30, 2018 and 2017

(In thousands)

For the fiscal year ended June 30,		Contractually required contribution		Contribution in relation to contractually determined contributions		Contribution deficiency (excess)		Covered-employee payroll	Contributions as a percentage of covered-employee payroll
2018	$	52,970	$	52,970	$	-	$	128,722	41.15%
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%

<u>Notes</u>

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	3.58%
Inflation	Not Applicable
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 the Authority employees, RP-2014 Employee Mortality Rates for males and females adjusted to reflect Mortality Improvement Scale MP-2017 from the 2006 base year and projected forward using MP-2017 on generational basis. As generational tables, they reflect mortality improvements both before and after the measurement date.

- *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-2017 on a generational basis. As a generational basis, it reflects mortality improvements both before and after the measurement date.

- *Post-retirement Disabled 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-2017 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, 2018 and 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, 2017	$ -	$ 74,549	$ 74,549	0%	$ 128,331	58%
June 30, 2016	$ -	$ 76,226	$ 76,226	0%	$ 143,209	53%
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
June 30, 2018 and 2017

(In thousands)

	2018	2017
Revenues		
Service revenues (cash basis)	$ 899,957	$ 1,026,012
Other income	1,121	1,720
Developers contributions	1,604	1,985
Insurance proceeds from business interruption	50,000	-
Operating revenues (cash basis)	952,682	1,029,717
Budgetary reserve fund	-	-
Total authority revenues	952,682	1,029,717
Operating expenses:		
Payroll and payroll related	360,000	352,889
Electricity	104,510	126,650
Other operating expenses	316,841	213,812
Total net operating expenses	781,351	693,351
FEMA Appropiations	70,747	-
Subsidies (netted from revenues)	4,757	4,585
Non cash reserve adjustments	53,258	80,694
Adjusted operating expenses	652,589	608,072
Deposits to Operating Reserve Fund	38,412	36,000
Deposits to Capital Improvement Fund	87,727	83,120
Total net revenues per MAT	$ 526,450	$ 488,952
Debt service coverage calculation:		
Operating revenues	$ 952,682	$ 1,029,717
Senior debt (net of funds available in the Senior Bond Fund of $43.6 million)	230,788	230,789
Accumulated coverage ratio (Min 2.5x) - Section 7.01 (i) MAT	*4.13*	*4.46*
Senior subordinated debt	1,387	2,721
Accumulated coverage ratio (Min 2.0x) - Section 7.01 (ii) MAT	*4.10*	*4.41*
All bonds and other system indebtedness	254,201	254,576
Accumulated coverage ratio (Min 1.5x) - Section 7.01 (iii) MAT	*3.75*	*4.41*
Rate covenants:		
Authority revenues	$ 952,682	$ 1,029,717
All obligations debt service, current expenses and required deposits by MAT	1,032,929	981,768
Accumulated coverage ratio (Min 1.0x) - Section 7.01 (iv) MAT	*0.92*	*1.05*

Debt Coverage Calculations

The all obligations coverage ratio is calculated as required by section 7.01 of the MAT, by comparing Authority revenues with total obligations. Total Obligations includes required debt service deposits, current expenses, and other deposits required by the MAT such as, the operating reserve fund and the capital improvement fund.

For the rate covenant calculation the total debt service does not include debt service payable on the Commonwealth Supported Obligations as no debt service was due and payable by the Authority with respect to the outstanding Commonwealth Supported Obligation as such debt service is contingent on the Commonwealth of Puerto Rico appropriation of funds to pay such debt service. In the absence of such appropriations, there is no debt service due and payable on the Commonwealth Supported Obligations. Related to Rural Development and State Revolving Funds Programs, considered Commonwealth Guaranteed Indebtedness the debt service requirement was included in accordance with the terms of Forbearance Agreements related to such programs in place starting on July 2016 through July 2020. Therefore, only the debt service required under such Forbearance Agreements was included for rate covenant calculation purposes.

As of June 30, 2018, the Authority rate covenant on all obligations was 0.92, as a result of lower revenues and increased costs experienced by the impact in the Authority system of the 2017 hurricanes.

In accordance with the requirements of Section 7.01 of the MAT, the Authority expects to submit the rate covenant calculation to the consulting engineers as soon as the fiscal year 2018 audited financial statements are available. The Authority expects the consulting engineer will issue a report stating the rate covenant results for fiscal year 2018 were affected by the extraordinary impacts of the 2017 Hurricanes and that for fiscal year 2019, taking into account the rate adjustment implemented by the Authority in fiscal year 2019, the Authority is expected to comply with the rate covenant without any additional measure or action to be taken by the Authority's management.

Kevane Grant Thornton

Kevane Grant Thornton LLP
33 Bolivia Street
Suite 400
San Juan, Puerto Rico 00917-2013

T + 1 787 754 1915

F + 1 787 751 1284

E kgt@pr.gt.com
linkedin.com/company/kevane-grant-thornton
facebook.com/kevanegrantthornton

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 years ended June 30 2018 and 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 December 31, 2020.

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.

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Compliance and Other Matters

As part of obtaining reasonable assurance about the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement`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,
December 31, 2020.

Kevane Grant Thornton LLP

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